of China National Offshore Oil Corporation Ltd (CNOOC),[3] which is 70% owned by the Chinese government, to buy Unocal in the United States of America (USA) in 2005[4] caused political uproar in the USA and raised the alarm for many other countries that are China's trading partners. China Steel bought Midwest in Australia and held five seats on Midwest's board of directors in September 2008.[5] In 2009, China Minmentals' investment in Oz Minerals in Australia was finalized.[6] China Hunan Valin's investment in Fortescue is proceeding. Chinalco's failure to acquire a further shareholding in the dually listed Australian – United Kingdom company Rio Tino in early 2009 raised concern and anxiety among China's Western business partners and their various governments.

The large scale of China's capital injection and aggressive investments in countries that are rich in natural resources has raised increasing and deep concerns among these countries' governments, their business communities, and the public. While it is very important for the PRC to improve its corporate governance law and practice, it is equally important for the PRC's business-partner countries, such as Australia, to understand corporate governance issues within Chinese companies, especially state-owned companies. Only after having acquired substantial knowledge and understanding of corporate governance in the PRC can foreign governments and their business communities, such as those in Australia, deal effectively and efficiently with the Sino-Australian relationship. Unfortunately, up until now, limited comprehensive research on corporate governance in China has been done from a comparative perspective. This book aims to fill this vacuum.

The concept of corporate governance did not come into use in the PRC until the mid-1990s.[7] The lack of understanding of corporate governance in the first decade of the twenty-first century by the senior management of listed Chinese companies was confirmed by some senior executives of these companies.[8] China's great economic achievements do not compare well with the poor corporate governance practices of many Chinese companies. If we take corporate disclosure as

3. 'Unocal Shareholders Approve Chevron Takeover', *All Business: A D&B Company*, <www.allbusiness.com/retail-trade/food-stores/4486656-1.html>, 2 Oct. 2009.
4. Unocal was the ninth-largest oil company in the world at the time. CNOOC withdrew its bid in early August 2005 for 'unprecedented political opposition' after a flurry of legislation was introduced in both Houses of Congress of the United States aiming to derail the deal, *ibid.*
5. 'China Steel Finalises Buying Midwest by Mid September', <www.caijing.com.cn/2008-09-11/110011795.html>, 13 Jul. 2009.
6. ABC, 'Minmetals Launches Oz Minerals Takeover Bid', <www.abc.net.au/lateline/business/items/200902/s2493057.htm>, September 2009.
7. Tu, Guangshao & Zhu Congjiu (eds), *Corporate Governance: International Experience and China Practice* (Beijing: People's Press, 2001), 1.
8. The author and her colleagues' interviews of an Australian Research Council-funded Discovery Project on Corporate Governance of China's Top 100 Listed Companies, which finished at the end of 2005. Also, Mary Ma's unpublished speech at the Ninth Annual Conference of the Asia Corporate Governance Association entitled Asia Business Dialogue on Corporate Governance, which was held in Beijing from 11–12 Nov. 2009. Ma is the Managing Director of TPG (Hong Kong) and a non-executive director and former Chief Finance Officer of Lenovo Ltd, which bought the PC business from IBM. She acknowledged that even in 2007, when she was the CFO of Lenovo, she did not know much about corporate governance.

an example, since the establishment of the Shanghai and Shenzhen Stock Exchanges in 1990, there have been numerous false disclosure scandals.[9] The most recent of these was made public only days before China's grand 60th anniversary celebrations. According to an announcement made by the pivotal regulatory institution for corporate governance in the PRC, the China Securities Regulatory Commission (hereinafter CSRC) on 23 September 2009, Wuliangye Corporation Group, one of China's best-known and largest brewery companies, had been involved in breaching disclosure laws and regulatory rules. One of the breaches was the falsification of business profits of Yuan Renmibi (CNY) 8.251 billion, which was claimed to have been made by one of Wuliangye's subsidiary companies; these profits were disclosed in the 2007 annual report of Wuliangye Corporation Group. According to the CSRC, the real profits for that year were CNY 7.251 billion.[10] A huge discrepancy of CNY 1 billion appeared in the annual report, and this made investors doubt the explanation of the 'recording error' that had been given by Wuliangye Corporation Group.[11] The strong economic achievement of many Chinese SOEs and their relatively poor corporate governance have also made it important to look more closely at this area by researching China's corporate governance theory and practice. The corporate disclosure regime, as one of the fundamental systems of corporate governance, plays a critical role in this regard, and it has therefore been selected as the core area of attention of this book.

1.2. AN OVERVIEW OF CORPORATE DISCLOSURE AND CORPORATE GOVERNANCE IN CHINA

1.2.1. The Concept of Corporate Governance Used in China

Like its economic achievements, the PRC has also made significant progress in law reform since 1978. The Chairman of the National People's Congress of the PRC, Wu Bangguo, proudly declared on 8 March 2009 that the socialist legal system with Chinese characteristics was 'basically formed'. According to him, by January 2009, China had made 231 Laws, more than 600 Administrative Regulations, more than 7,000 Local Regulations, and more than 600 Autonomous Regional regulations.[12]

Among China's numerous laws, regulations, and rules, those with a direct impact on corporate governance were mainly made during the last decade, as corporate governance is a relatively new term, only recently introduced into China. Around the world, there is no universally accepted concept of corporate

9. More disclosure cases will be discussed in Ch. 6.
10. <http://finance.people.com.cn/GB/10144385.html>, 30 Sep. 2009.
11. *Wuliangye Announcing Recording Error Leading to the Extra RMB 10 Billion in Profits*, <http://finance.people.com.cn/GB/10144385.html>, 30 Sep. 2009.
12. <http://society.people.com.cn/GB/8217/165799/165802/9975961.html>, 3 Oct. 2009. China's legal system is discussed in Ch. 3.

had made major achievements in building a modern enterprise system in its SOEs.[57]

The Sixteenth CPC National Congress was held in Beijing from 8–14 November 2002. The then Party Chief, Jiang Zeming, presented a Report entitled 'Building a Comprehensively Affluent Society and Opening a New Situation of a Socialism with Chinese Characteristics'.[58] According to this Report, the foundations of China's socialist market economic system had been laid, the reform of SOEs had been moving steadily, and China's living standards had reached an affluent status. This Report also set a target to build a comprehensive affluent society. To achieve this target, a number of measures were to be implemented. One of them was to authorize the central government and local governments to represent the state's shareholdings in SOEs at the central and local levels so as to deepen the reform of state assets management.[59] The CPC also required the separation of governments from SOEs and the separation of ownership from management.

The Third Plenary Session of the Sixteenth CPC National Congress was held in Beijing from 11–14 October 2003.[60] It passed the CPC Central Committee Resolution Dealing with Several Issues with Regards to Improving the Socialist Market Economic System. In this Resolution, it was pointed out that China should encourage multiple forms of ownership and construct a shareholding system as the main form of public ownership; that China should establish and improve its state assets management and supervision; that China should deepen reform of SOEs and improve its corporate governance structure; and that non-public enterprises should be given equal treatment in the areas of investment, taxation, use of land, and foreign trade.[61] The Resolution also set out the measures for improving corporate governance.[62] These were to clarify the rights and responsibilities of the shareholders' congress (or meeting), the board of directors, the supervisory board, and the managers; the CPC was to support the shareholders' congress, the board of directors, the supervisory board, and the managers of an enterprise, and to participate in the major decision-making of the enterprise; and the CPC was to focus on the role of managing its cadres who served as officers of the enterprise.[63]

The Sixth Plenary Session of the Sixteenth CPC National Congress was held in Beijing from 8–11 October 2006. This Congress passed the Resolution on Several

57. *The Announcement of the Fifth Plenary Session of the Fifteenth CPC National Congress*, <http://cpc.people.com.cn/GB/64162/64168/64568/65404/4429268.html>, 3 Oct. 2009.
58. <http://cpc.people.com.cn/GB/64162/64168/64569/65444/4429125.html>, 3 Oct. 2009.
59. *Ibid.*, Report entitled *Building a Comprehensive Affluent Society and Opening a New Situation of a Socialism with Chinese Characteristics*, s. 3(4).
60. <http://cpc.people.com.cn/GB/64162/64168/64569/65411/4429167.html>, 3 Oct. 2009.
61. *Ibid.*
62. Section 2(8), <http://cpc.people.com.cn/GB/64162/64168/64569/65411/4429165.html>, 3 Oct. 2009.
63. *Ibid.*

Major Issues Regarding Building a Socialist Harmonious Society.[64] It was also emphasized that opening up and reform were the only road to the development of a socialist market with Chinese characteristics and to achieving the goal of a renaissance of the great Chinese people.[65]

The Seventeenth CPC National Congress was held in Beijing from 15–21 October 2007. In his Report, the new Party Chief, Hu Jintao, pointed out that, to develop the economy, China must implement a number of measures, including preserving multiple forms of ownership; equally protecting all kinds of property rights; deepening the shareholding system reform of SOEs; adopting fair and just capital-raising requirements so as to encourage the development of individual, private, and medium and small enterprises; and building and improving the credit system in the whole society.[66]

While the Chinese government under the leadership of the CPC has been constantly reviewing its policies and plans for economic reform and enterprise reform, the theory and practice of corporate governance in Western countries have gradually had a greater impact on China in a bottom-up approach.

The Research Centre of the SSE is the one of the earliest institutions that pioneered systematic research on corporate governance theory and practice in China. Since 1997, the Centre has set up corporate governance research projects, and has attended and participated in the Asian Corporate Governance Roundtable.[67] One of the empirical studies that it did was conducting a survey of all the companies listed on the Shanghai Stock Exchange. Based on this research, the SSE released the first Directive Document on corporate governance in China – Shanghai Stock Exchange Guidelines for Corporate Governance of Listed Companies – in October 2000.

This Directive Document has seven parts, with fifty-three articles. The seven parts are entitled 'Objectives and Principles'; 'Shareholders and Annual General Meeting'; 'Directors and the Board of Directors'; 'Supervisors and the Board of Supervisors'; 'Managers'; 'Remuneration Policies'; and 'Disclosure'. The content of this Document shows that the SSE had undertaken research on all the major issues of corporate governance in a broad sense of the term. Since then, the SSE has been focused on corporate governance research and practices. Since 2003, the SSE has been publishing its Annual Corporate Governance Report, which includes the research results of its Research Centre. Sometimes, the SSE publishes interim research reports on corporate governance issues. The continuing research of the SSE has apparently guided and is still driving corporate governance lawmaking in China.

64. *The Announcement of the Sixth Plenary Session of the Sixteenth CPC National Congress*, <http://cpc.people.com.cn/GB/64162/64168/64569/72347/4912748.html>, 3 Oct. 2009.
65. *Ibid.*
66. Hu, Jintao's Report at the Seventeenth CPC National Congress, <http://cpc.people.com.cn/GB/64093/67507/6429847.html>, 3 Oct. 2009.
67. Zhu, Congjiu, Preface to the SSE *China Corporate Governance Report 2003* (Shanghai: Fudan University Press, 2003), 3.

Western countries is an important means for most companies to raise capital from the public, and the government is not usually involved in such fund raising by companies. From the establishment of the London Stock Exchange in 1773 until the market crash of the late 1920s, Western securities markets developed largely free of government intervention; this reflected the laissez-faire environment that existed up until that time.[6] In comparison, the formation and development of the PRC's securities market were affected by government policies from an early stage of its emergence. Strong governmental interference in the PRC's securities market is fundamentally different from the situation that is found in Western securities markets, which largely emerged and developed in a free-market context.

The PRC's securities market is often described as an emerging and transitional market[7] with unique features that are substantially different from those of mature and complex securities markets, such as those in the USA, the UK, and Australia. The PRC's securities market emerged soon after the commencement of economic reforms in the late 1970s. This signalled that the Chinese government realized that the planned economy had to be changed. However, some four decades of experience with a planned economy had already had a deep influence on the development of the Chinese economy. The state continued to embrace the planned economy when the securities market started to emerge in the early 1980s.[8] The government did not constitutionally adopt a market economy until 1993,[9] but even then, the PRC distinguished its economy from that of most Western countries by labelling it as 'a socialist market economy'.[10] During the 1980s, the PRC's economy experienced a transition from a planned economy to a planned commodity economy.[11] The PRC's economy is still in a transitional stage of development, now moving from a planned commodity economy to the so-called socialist market economy. The PRC's securities market is still experiencing many changes as a result of this ongoing transition.

The development of the PRC's securities markets has followed a pattern that is very different from that of most Western securities markets. The two securities

6. Hong, Weili, *Securities Regulation: Theory and Practice* (in Chinese) (Shanghai: Shanghai University of Finance and Economics, 2000), 104–105.
7. Hong, Weili, *Preface* in *Securities Regulation: Theory and Practice*; Zhou, Daojiong, *Promote the Standardisation and Development of China's Securities Market by Attaining Perfection of Securities Legislation: Opening Remarks for the International Symposium on the Securities Law Bill* (Beijing: Law Press, 1997), 3; the China Securities Regulatory Commission, *China Capital Markets Development Report* (in Chinese) (Beijing: China Finance Press, 2009), 3.
8. Article 15 of the PRC Constitution of 1982 provides that, 'The state practises a planned economy on the basis of socialist public ownership'.
9. Article 15, the PRC Constitution of 1993.
10. Under this economic system, public ownership is still the dominant part of the whole economy.
11. The Twelfth National Congress of the Chinese Communist Party (hereinafter the CCP) held its Third Plenary Meeting in Beijing in 1984. This Meeting passed the Resolution of the Central Committee of the Chinese Communist Party on Economic Reform. This Resolution points out that the socialist economy of China is a planned commodity economy based on public ownership. See fn. 35 of vol. 3 of *Select Article Collections of Deng Xiaoping* (in Chinese) (Beijing: People's Press, 1993).

exchanges of the PRC were first established by local governments with the approval of the central government.[12] They began to move from the control of their local governments to the direct control of the central government, when the State Securities Commission and its operational arm, the CSRC, both were established at the end of 1992.[13] The enactment of the PRC's first Securities Law in 1998 set the regulatory role of the CSRC.[14] Under this Law, the articles of association of each stock exchange have to be approved by the CSRC;[15] the general manager of each stock exchange is also appointed by the CSRC.[16] In addition, each stock exchange adopted the same Listing Rules that were approved by the CSRC,[17] and more than 90% of listed PRC companies are former SOEs.[18] However, the supremacy of the CSRC's securities market regulatory role was not finalized until August 1997. This will be discussed in detail in Chapter 4. In 2005, the PRC made substantial amendments to the Securities Law, which, however, maintained the CSRC's control of the two stock exchanges.[19] These led to the unique features that are evident in the PRC securities market. To understand this market, it is necessary to review these unique features and to identify the common features that are shared with the markets in other countries.

The PRC's economic reform was one of the results of its open-door policy. The formation of its securities market has, however, been greatly influenced by ideas drawn from securities markets in other countries. With more and more knowledge of the practices of Western countries, the PRC learned a great deal from major Western countries and regions. However, it faced a major problem in choosing an appropriate model that would be used to establish a regulatory framework for its own market. As the USA was viewed as having the most developed economy, the American model was always treated as the ideal model by the Chinese.[20] Moreover, the American experience has always been studied and adopted first because the senior staff of the CSRC, from an early stage, had been

12. The Shanghai Stock Exchange was established by the Shanghai municipal government with the approval of the Central Committee of the CCP; see Li, Zhangzhe, *Finally Successful: The Report on the Chinese Securities Market Development*, 129; The Shenzhen Stock Exchange was established by the Shenzhen municipal government with the approval of the central government; see Li, Zhangzhe, *Finally Successful: The Report on the Chinese Securities Market Development*, 177.
13. C. Walter & F.J.T. Howie, *Privatizing China: The Stock Markets and Their Role in Corporate Reform* (Singapore: John Wiley & Sons (Asia) Pte Ltd, 2003), 59.
14. Article 7.
15. Article 96.
16. Article 100.
17. Before 1997, each stock exchange had its own listing rules. From 1997 to 2000, both the Shanghai and the Shenzhen Stock Exchanges had similar listing rules, in which there were only two Articles that were different. Since 2001, both stock exchanges have adopted standard listing rules, which were approved by the CSRC.
18. Tu, Guangshao & Zhu Congjiu (eds), *Corporate Governance: International Experience and Chinese Practice* (in Chinese) (Beijing: People's Press, 2001), 103.
19. Articles 103, 107, and 118.
20. Zhou, Yousu (ed.), *General Theories on Securities Law* (in Chinese) (Chengdu: Sichuan People's Press, 1999), 12.

Chinese law; examining the procedures of law and rule making in the PRC makes it easier to effectively trace the path of PRC disclosure rules, which are discussed in Chapter 4. Examining the poor record of the enforcement of law helps lead to an understanding of why there have been so many cases involving the violation of disclosure laws and why cases of breach of disclosure laws constantly occur in the PRC's securities market.

Chapter 4 examines the various types of participants involved in PRC securities regulation. By reviewing their roles and functions in the securities market, this chapter seeks to identify the difficulties in maintaining consistency among disclosure rules made by different governmental departments. The structure and functions of the CSRC, as the most prominent regulator, shows the strong influence of convergence of economic development. This chapter also demonstrates that the strong governmental control in the PRC has created an inflexible market and that the existence of multiple regulatory bodies had caused inefficient market regulation.

Chapter 5 analyses PRC securities regulatory laws and rules. An overview of the securities regulatory regime is provided in this chapter. The discussion of the process of disclosure rule making demonstrates the existence of a stronger influence of convergence than that of divergence. The major problems evident in PRC corporate disclosure practices, which are identified in this chapter, demonstrate that the PRC's corporate disclosure regime does not properly reflect the impact of divergence in its securities market development practice.

Chapter 6 first provides an introduction the development of the Chinese securities market and then discusses some classic disclosure cases that have arisen in this market. This chapter also identifies the driving forces behind the market. The development of the PRC securities market demonstrates stronger divergence than convergence. This chapter makes an assessment of the level of information available in the PRC's securities market. It also identifies problems with the remedies available to investors who suffer losses caused by a breach of disclosure rules and shows the existence of a large gap between disclosure rules and disclosure practices. This chapter concludes that the PRC's securities market is still in a stage of transition because listed companies, securities companies, securities investors, and market regulators are not sufficiently experienced and securities regulatory rules are not sophisticated enough as a result of how the securities market was formed and developed and how the regulatory rules are formed. It warns that the PRC in this transitional period has to be extremely cautious while transplanting corporate disclosure laws from developed and complicated securities markets.

Chapter 7 provides a comparative study of the Australian corporate disclosure regime; this is relevant and important because it allows a better understanding of problems with the PRC's corporate disclosure regulatory regime from a comparative perspective. It examines the history of the Australian securities markets and the development of the corporate disclosure regime in Australia. In particular, it reviews the assumptions underlying the Australian corporate disclosure framework. It traces the process of the establishment of the corporate disclosure framework in Australia and identifies unique features that are not found in the USA

securities market, which has been the most important foreign model in forming the PRC's corporate disclosure framework thus far. By examining the establishment and the continuous improvement of the Australian corporate disclosure regime, this chapter draws the conclusion that the approach by which Australia adopted foreign experiences in disclosure regulation provides a more useful model for the PRC than those that have been relied upon to date.

The final chapter of this book demonstrates that the legal system of a country is closely connected with the country's own culture, history, economy, and politics. When transplanting foreign corporate disclosure experiences into the PRC, it is essential to focus on the country's domestic situation, because the development of the PRC's securities market tends to follow the differentiation hypothesis. The simple copying of foreign experiences is one of the most fundamental reasons why the PRC's corporate disclosure regulation constantly fails. It is suggested that the approach that Australia adopted from foreign experiences provides appropriate lessons for the PRC.

2.5. METHODOLOGY

Because securities disclosure involves both theoretical debates and practices, the following methodology is used in this book. First, through a comparison of the history of securities markets development and the adoption of foreign experiences of Australia and the PRC, this book intends to demonstrate the utility of the convergence theory and the path dependence theory in shaping an appropriate corporate disclosure regime. Through a review of the history of the development of the PRC's securities market, it demonstrates that this history affects the making of disclosure rules in the PRC, thereby providing an understanding of the current approach that has been adopted in regard to PRC securities regulation.

In the process of reviewing the functions of the PRC and Australian corporate disclosure regulatory regimes, face-to-face interviews and telephone interviews were conducted in Beijing, Shanghai, Hong Kong, Sydney, and Melbourne at different times from 1998 to 2008. Different questions were asked of different interviewees, depending on the issues raised at the time and the expertise of the interviewees. Interviewees included legislators of the NPC and its Standing Committee, drafters of the PRC Company Law and Securities Law Bills, rule makers of the State Council, regulatory officials of the CSRC, policy researchers at the Shanghai, Shenzhen, and Hong Kong Stock Exchanges, prominent corporate and securities law academics and practitioners in China, and regulators of the Hong Kong Securities and Futures Commission. Several Australian securities law academics and Australian advisers to the Australian government's corporate law reform were also among these interviewees.

As noted above, to provide a better understanding of the PRC's securities regulatory regime, one chapter of this book discusses Chinese legal history and its legal system. Only after understanding the PRC legal system can one properly understand the regulatory rules of the PRC's securities market and how they work

incorporated into Article 31 of the PRC Constitution in 1982. This article allows the state to establish special administrative regions when necessary.

Following Deng's comments in 1979, a new Constitution was enacted in 1982. A new legislative system was established to speed up China's lawmaking process: firstly, the PRC Constitution of 1982 provides the NPC and the Standing Committee of the NPC with lawmaking power;[46] secondly, it provides the State Council with the power to make administrative regulations and provides the ministries and commissions under the State Council with the power to make departmental administrative rules; and thirdly, it provides the People's Congresses of provinces, minority autonomous regions, and municipalities directly under the control of the central government with the power to make local regulations.

With the enactment of the PRC Constitution of 1982, China formally began a new stage to improve its lawmaking. It is worth pointing out that from 1979 to 1982, the key laws that were enacted focused on the state administration apart from the laws on foreign investments (such as the Joint Venture Laws). The Constitution of 1982 reflected the 'one centre two basic points' of the Third Plenary Meeting of the Eleventh Central Committee of the CPC. From then on, the PRC's legislation included not only lawmaking regarding the state's political structure, but also the enactment of laws regarding the economic system. It was around 1983 when China's securities market started to emerge. Following the development of the securities market, local regulations on securities were first adopted.[47]

From 1982 to 1989, China enacted a number of basic laws to improve its legal system. However, most of them were public laws, and the guidelines for legislation were still Marxism-Leninism and Mao Zedong's thoughts.[48] Few of them were commercial laws, including the General Principles of the Civil Law of 1986, the Customs Law of 1987, the Technology Contract Law of 1987, the Law of Industrial Enterprises Owned by the Whole People of 1988, and the Chinese-Foreign Contractual Joint Venture Law of 1988. However, the pace of legislation slowed down after the crackdown on the 1989 students' movement.

It was after Deng Xiaoping's speech in his famous tour of southern China in early 1992 that China furthered its economic reform, including developing its securities market.[49] It was the CPC that first created the term 'socialist market economy' in the Third Plenary Meeting of the Fourteenth CPC Congress. The CPC declared that:

> The establishment and improvement of a socialist market economic structure must be regulated and protected by a comprehensive legal system. We must pay due attention to the construction of legal system, to ensure the co-ordination of reform and opening up to the outside world with legal construction, and to learn to manage the economy with legal mechanisms. The goals of establishing a legal system are: first, following the principles prescribed in the Constitution, to speed up the economic lawmaking so as to further improve the civil, commercial and criminal laws and to basically build a legal system appropriate for a socialist market economy by the end of this century; second, to reform and improve the judicial system and the administrative law-enforcement mechanism; third, to establish a sound supervisory mechanism of law enforcement and legal service institutions for the deepening and promotion of legal education, so as to enhance legal consciousness throughout the whole society.[50]

46. The PRC Constitution of 1982, Arts 62 and 67.
47. This first piece of law on securities may be the Interim Rules on Securities Issue by the People's Bank of China in 1983.
48. The Constitution of 1982, Preamble.
49. See above Li, Zhangzhe, 191.

This policy of the CPC was later incorporated into the Amendments to the Constitution in March 1993. The establishment of a socialist market economy and a legal system serving such an economy was an ideological breakthrough in China. Under the leadership of Deng Xiaoping, the Chinese government had become very pragmatic.[51] The focus of the country moved to economic development. With the PRC in need of this development, the legislative task moved to another focus – the construction of a legal system serving its socialist market economy.

The NPC set economic legislation as the most important work for itself and its Standing Committee at the First Plenary Session of the Eighth NPC in March 1993. The then Chairman of the NPC, Qiao Shi, said that, 'This Standing Committee shall set the economic legislation as the first task to fulfil, and shall enact a number of laws on the socialist market economy'.[52] From then on, the main task of the legislature was to enact a set of commercial laws that suited the development of economic reform. The Company Law of 1993 was one such law. It included many basic provisions on fundraising, which laid the foundation for further regulation of the Chinese securities market. This Law was a product of the mixture of the experiences of common law countries such as the USA, the UK, and Hong Kong, and civil law countries such as Japan, Germany, and Taiwan.[53] Following the Company Law of 1993, a number of commercial laws were enacted: the revised Economic Contract Law, the Arbitration Law, the Consumer Protection Law, the Law of Negotiable Instruments, the Maritime Law, the Foreign Trade Law, the Advertisement Law, etc. Meanwhile, the drafting of the Securities Law had also begun. The legislative plan for 1992 to 1997 was to enact 125 laws, of which fifty-four were related to the 'socialist market economy'.[54] The lawmaking during this period demonstrated that the development of the Chinese legal system had been driven by the deepening of China's economic reform. The fact that many articles in the Laws are inadequate by today's standards is a reflection of the process of gradual development.

50. *The Resolution of the Central Committee of the CPC Concerning the Establishment of a Socialist Market Economy 1993*, para. 44.
51. Chen. Jianfu, *Chinese Law*, 43.
52. Qiao, Shi, *The Work Report of the First Plenary Session of the Eighth NPC*, 1993.
53. The legislators either toured these countries and regions or studied with law professors specialized in the laws of these countries and regions.
54. Author's copy of the NPC Legislative Plan 1992–1997.

the power to make local administrative rules. The People's Congresses and executive governments of SEZs have the power to make SEZ regulations and SEZ rules.

3.5. LAWMAKING PROCESSES IN THE PRC

Because there are different forms of law in the PRC, the lawmaking processes are very complex. This part provides a brief introduction to the lawmaking processes by following the hierarchy of the authority of different forms of law.

3.5.1. LAWMAKING PROCESS OF THE NPC

Lawmaking procedures of the NPC are governed by the Constitution of 1982, the Law on Lawmaking of 2000, the Rules of Working Procedures for the NPC of 1989, and the Organic Law of the NPC of 1982. Among these, the Law on Lawmaking was based on the other three pieces of legislation and contains more-detailed procedures. Currently, the enactment of a piece of legislation by the NPC usually has to go through five stages: the proposal and presentation of a bill, the examination of the bill, the revision of the bill, the passage of the bill, and the publication of the enacted law.[137] It should be noted that a proposed bill may be examined more than once.

The processes of lawmaking of the NPC are relatively formal and detailed because there are four national laws that govern this matter. As pointed out previously, the NPC only conducts one meeting each year, and therefore it only passes Constitutional amendments and basic laws. As discussed above, the function of lawmaking is mainly performed by the NPC's Standing Committee.

Under the Law on Lawmaking, the proposal of a bill may be made in two ways. First, it may be made by state institutions, including the Presidium of the NPC, the Standing Committee of the NPC, the State Council, the Supreme People's Court, the Supreme People's Procuratorate, and the Committees of the NPC.[138] Second, it may be made by a delegation of the NPC[139] or by thirty delegates of the NPC.[140] In practice, most proposals of bills are initiated by the Standing Committee of the NPC or the State Council.[141] The proposed bills from the State Council are usually drafted by its relevant ministries or commissions.[142]

137. The PRC Law on Lawmaking of 2000, Art. 2 of Ch. 2.
138. *Ibid.*, Art. 12.
139. The delegates from the same province form a delegation.
140. The PRC Law on Lawmaking of 2000, Art. 13. These thirty deputies do not have to be from the same delegation.
141. According to the author's experience while working for the LAC, the Standing Committee of the NPC mainly initiated basic law bills, while the State Council usually initiated departmental law bills. However, there is no clarification about the power to initiate a bill.
142. For example, the bill of the Lawyers Law was introduced by the Ministry of Justice.

Once the proposal of a bill is made, a decision on whether the proposed bill will be presented to the NPC will be decided by the Presidium of the NPC.[143] Once a proposed bill is presented to the NPC, it will be examined by all the delegates of the NPC[144] and then by the relevant special committee of the NPC.[145] Before the examination, either the person responsible for the proposal of the bill or the Standing Committee of the NPC must make a legislative explanation to the NPC.[146]

If the bill is accepted after examination by the delegations and the relevant special committee, the Law Committee of the NPC will conduct a final examination and then revise the bill according to the comments of the delegations and the relevant special committee of the NPC. It will then submit an examination report to the Presidium of the NPC.[147] If the proposed bill is not accepted by either the delegation from a province or the relevant special committee of the NPC, it will not be presented to the NPC.

The final draft of the bill will be presented to the General Assembly of the delegates of the NPC for a vote. If a simple majority votes for the bill, it will be enacted.[148] After enactment, the bill will be signed by the President of the PRC and become a law.[149] The law will be published in the major national newspapers and the *Gazette* of the NPC.

One point that needs to be made here is that, although the delegates and the relevant committee(s) of the NPC have the power to examine a bill, the drafting of the bill and the revision of the bill according to the comments and suggestions of the examining bodies are the responsibilities of a working body of the Standing Committee of the NPC,[150] the Legislative Affairs Commission (hereinafter the LAC). The LAC consists of about 100 lawyers. Its working procedures are clarified by legislation; however, through the legislative practices over the last two and a half decades, the LAC has developed very detailed working procedures.

The first responsibility of the LAC is the drafting of bills. Once a proposed bill is accepted by the NPC, its Standing Committee will name a drafting group to draft a trial bill. The members of the drafting group include legal experts in the relevant area,[151] the representatives from the relevant ministries and commission of the State Council, and the representatives from the relevant special committee of the NPC.

Once the trial bill is finalized, it will be sent to the LAC, which then will conduct research and investigation for the drafting of the bill. These are the most important procedures of the LAC. First, it will organize many seminars that will be attended by members of the relevant ministries and commissions of the State

143. The PRC Law on Lawmaking of 2000, Arts 12 and 13.
144. *Ibid.*, Art. 16.
145. *Ibid.*, Art. 17.
146. *Ibid.*, Art. 14.
147. *Ibid.*, Art. 18.
148. *Ibid.*, Art. 22.
149. *Ibid.*
150. *Ibid.*, Arts 34–36.
151. Chen, Jianfu, *Chinese Law,* 120.

temporary solution to meet practical needs. Both Administrative Regulations contain several articles on share issuing. They can be seen as the first national rules on share issuing. From then on, the central regulation of the securities market started. The first step of the State Council was to set up the State Council Securities Commission (SCSC) and the CSRC in October 1992.[234] Soon after the establishment of these two commissions, the State Council issued the Circular on Further Strengthening Micro-management of the Securities Market. Under this Administrative Regulation, the State Council clarified the division of the administrative powers among its ministries and commissions. The departments involved in the regulation and supervision of the securities market and their powers will be discussed in detail in the following chapters.

While the SCSC and the CSRC were the national government departments to regulate the securities market and make administrative rules on securities regulation, the other ministries and commissions could also supervise the securities market and make relevant administrative decrees with their respective jurisdiction.[235] There were more than ten ministries and commissions that were involved in the regulation of the securities market. Most of the laws regulating the securities market were very detailed departmental administrative rules. They were released either by the ministry or commission in charge of the relevant issue or by the ministries and commissions in charge jointly. For example, the SCSC and the State Commission of Restructuring the Economic System (hereinafter SCERS) jointly released the Prerequisite Provisions in the Articles of Association of Companies Seeking Listing Overseas in August 1994.

The Company Law of 1993 has one chapter that includes thirty articles on share issuing and transfer, as well as on listed companies. However, most of these articles are general principles. To implement these principles, the Securities Law was needed. Another reason to enact the Securities Law of 1998 was that the articles about the securities in the Company Law only covered the issuing and transfer of shares. There were no provisions on the regulation of the market as a whole. The articles in the Company Law of 1993 were far from meeting the needs of the development of the securities market. Thus, the Securities Law of 1998 (which was first drafted in 1992) was once again put on the agenda of the NPC Standing Committee.

The Securities Law of 1998 was the first law that was drafted by a drafting group organized by a special committee of the NPC. The drafting group was set up in mid-1992 at the suggestion of the then Chairman of the NPC, Wan Li.[236] The members of the drafting group included experts from Beijing University, China University of Politics and Law, The University of International Business and Trade, and the members of the Finance and Economics Committee of the NPC, as well as experts in the securities industry.

234. *Ibid.*, 205.
235. *Ibid.*, 326.
236. The NPC Drafting Group of the Securities Law, *Annotation of the PRC Securities Law* (Beijing: China Financial Press, 1999), Preface.

The first draft was finished in August 1993 and was submitted to the Third Session of the Eighth NPC Standing Committee for its first examination. In December, the revised draft was submitted to the Fifth Session of the Eighth NPC Standing Committee for a second examination. In June 1994, the Eighth Session of the Eighth NPC Standing Committee examined the revised draft for the third time. After that, the legislative process stopped because of the occurring of a number of securities and futures cases.[237]

Beginning in October 1998, the Fifth Plenary Session of the Ninth NPC Standing Committee again examined the draft Securities Law that was submitted by the LAC. This draft was different from the 1993 draft in many aspects. There were many reasons for these differences: first, the LAC drafters were more focused on the domestic situation; second, they lacked a good understanding of the regulation of securities markets in Western countries; third, the leaders of the drafters were very conservative CPC members and they did not like the 1993 draft, which was mainly written by scholars who had been educated in the USA and had several years of work experience on Wall Street. Although the draft provided by the LAC was very disappointing to the hard line reformists, it was basically accepted by the members of the NPC Standing Committee, who had little knowledge of securities. The NPC Standing Committee and the NPC special committees had conducted further study and investigation at home and abroad. These committees draw upon the experiences from the USA, Hong Kong, Japan, and Australia.[238] The then Chairman of the NPC, Li Peng, specifically flew to Shenzhen to investigate the main issues raised by the members of the NPC Standing Committee.[239] In December 1998, the Sixth Session of the Ninth NPC Standing Committee examined the draft for the fifth time and passed it on 29 December 1998.

Before the Securities Law of 1998 was enacted, the PRC securities market had moved to a new stage. The combination of regulation by both the central government and local governments caused many inconsistence in policies and practice. The central government decided to unify regulation of the securities market. The State Council minimized the ministries' and commissions' involvement in the securities market by dissolving the State Council's Securities Commission and delegating the highest rule-making power to the CSRC.[240] From then on, the CSRC released a large number of administrative decrees to regulate the securities market. From its establishment in October 1992 until the end of 1999, the CSRC passed about 200 departmental administrative rules. Many of them are about disclosure, which is a major problem in the securities market. Because there was no law or regulation on the procedure for the making of departmental administrative rules,

237. Song Yanni & Shuqiang Liu, *Textbook on China's Company Law*, 58.
238. Law professors, lawyers, and securities regulators from these countries were invited to China to introduce their home countries' experience.
239. Song Yanni & Shuqiang Liu, *Textbook on China's Company Law*, 59.
240. In March 1998, the State Council Securities Commission was dissolved. The CSRC was given the regulative powers over the securities market that used to be enjoyed by the State Securities Commission. In July, the CSRC took over the Securities Regulative Offices from the local governments with the release of a circular by the General Office of the State Council.

the regulation of the local governments and the PBOC, other departments of the State Council were also involved in securities regulation within their respective areas. For instance, the SCRES issued administrative rules on implementing the shareholding system, the State Tax Bureau issued rules on stamp duties and other taxes on share issue and trading, the Ministry of Finance and the former State Planning and Development Commission decided on the T-bonds' issue scale, and the Ministry of Finance was in charge of the setting of Accounting Standards. This multi-department regulation caused a number of problems, including share trading in the black market, market manipulation, and insider trading.[55]

4.2.2. Trying to Centralize Securities Regulation

To solve the problems of inconsistency among all kinds of administrative rules, the State Council formed the Share Markets Working Meeting, which consisted of the PBOC, the State Planning Commission, the Ministry of Finance, the State Foreign Exchange Authority, and the State Tax Bureau.[56] This Meeting undertook the day-to-day regulation of the securities market on behalf of the State Council.[57] In June 1992, this Meeting was dissolved and the State Council's Securities Regulatory Working Meeting was set up. Its working body was the securities regulatory office within the PBOC.[58] However, the Securities Regulatory Working Meeting did not become a real national securities regulatory body.

While the two stock exchanges, in Shanghai and Shenzhen, were becoming national share trading sites, the differences between the administrative rules released by different local governments caused inconsistencies in practice between the different markets. These inconsistencies led to unfair competition between the markets. It became necessary to set up a national regulatory body and release a set of national securities regulations.

To improve the regulation of the securities market and ensure its stability, the State Council decided to set up a national body to regulate the securities market. This national body, the SCSC, was established in October 1992. It was the national authority responsible for exercising centralized market regulation.[59] Its working body, the CSRC, was also established at the same time with the responsibility of conducting market supervision in accordance with the law. Under the State Council's Circular Concerning Further Strengthening Macro-Management of Securities Markets, released on 17 December 1992, the PRC's securities regulatory structure consisted of the SCSC and the CSRC, other government bodies, and the Securities Industry Association.

55. Ye, Lin, *China's Securities Law* (in Chinese) (Beijing: China Audit Press, 1999), 110.
56. Li, Zhangzhe, *Finally Successful: Report of the Development of China's Securities Market*, 93.
57. Zheng, Zhenlong (ed.), *A Concise History of Chinese Securities Development*, 325.
58. Ye, Lin, *China's Securities Law*, 110.
59. Zheng, Zhenlong (ed.), *A Concise History of Chinese Securities Development*, 325.

4.2.3. The Functions of the SCSC and the CSRC

It is worth pointing out that both the SCSC and the CSRC were not established by the NPC in a usual way by which a governmental ministry or commission in the PRC is established. A ministry or a commission is usually set up by a proposal of the State Council and then approval by the NPC. However, the SCSC and the CSRC were both established by an administrative regulation issued by the General Office of the State Council on 12 October 1992. This was because the SCSC was set up as a macro-management and coordination body, while the CSRC was established as a working body for the SCSC.[60] However, neither of them had been given enough authority and resources to fulfil their functions properly. The establishment of two commissions demonstrated that the central government either had not realized the importance of the regulation of the securities market or had not decided how to regulate the securities market rationally.

The SCSC was a quasi-ministry of the State Council. It was chaired by the former Deputy Premier and later by a former Premier Minister, Zhu Rongji. It made policies guiding the development of the securities market and consisted of representatives from relevant government departments, including the People's Bank of China, the State Planning Commission,[61] the State Commission for Restructuring the Economic System,[62] the State Council Economic and Trade Commission, the Ministry of Finance and the Ministry of Foreign Trade and Economic Co-operation, the Ministry of Supervision, the State Administration of Industry and Commerce, the State Administration for Tax, the State Bureau for State-Owned Assets, the State Administration for Foreign Exchange, the Supreme People's Court, and the Supreme People's Procuratorate.[63]

The functions and powers of the SCSC and the CSRC were formally announced by the State Council in its Circular on Further Strengthening the Macro-Management of the Securities Market on 17 December 1992. Under this Administrative Regulation, the SCSC was the department in charge of national macro-management. It had the following functions and powers:

(i) to organize the drafting of the securities law and regulations;
(ii) to investigate and make policies and administrative directives on the securities market;
(iii) to plan the development of the securities market and make relevant suggestions;

60. *Ibid.*
61. In the restructure of the State Council in March 1999, it was renamed as the State Development Planning Commission. In March 2003, it was merged with the Ministry of State Economics and Trade Commission and the successor of the SCRES – the Office for Restructuring Economic System as the State Development and Reform Commission.
62. In the restructure of the State Council in March 1999, it was changed into the Office for Restructuring the Economic System. In March 2003, it was merged into the newly established State Development and Reform Commission.
63. Li, Zhangzhe, *Finally Successful: Report of the Development of China's Securities Market*, 93.

February 2001 to August 2003. Prior to her appointment at the CSRC, she was a deputy chairperson of the Hong Kong Securities and Futures Commission for some years. Since her appointment at the CSRC in February 2001, she constantly worked to bring the corporate governance ideas and experiences of Hong Kong into mainland China.[104] The adoption of independent directors in Chinese listed companies is one of her endeavours. A former deputy executive chairman, Gao Xiqing was educated at a top American law school and has been a law professor for a long time. He brought in many American lawyers, legal academics, and securities practitioners to introduce American securities regulatory theory and practices. The CSRC also provides all kinds of training courses for its staff and participants in the securities market. The CSRC has staff members with relatively good professional skills. This has laid a significant foundation for the improvement of securities market regulation.

Although there are several major defects in the regulatory regime of the PRC, its securities market regulation has achieved great success. Through more than fifteen years of practice, the CSRC has accumulated substantial experience in securities regulation and rule making and has become a nationally recognized regulatory body. With the work of the CSRC, the PRC securities market has been moving towards maturity, although it still has a long way to go.

4.3. THE REGULATORS OF THE CHINESE SECURITIES MARKET: OTHER DEPARTMENTS UNDER THE STATE COUNCIL

The growth of securities regulatory bodies came after the re-emergence of share issuing. The national securities regulatory body was established long after the re-emergence of the securities market and the establishment of the two stock exchanges. One might say that it was the re-emergence of the securities market that pushed the emergence of the securities regulatory regime; but it is the continuous development of the securities market that improves this regime.

Before the CSRC was given the status as the sole regulator of the Chinese securities market, there had been a long period of debate over which department was the most appropriate one to be responsible for securities regulation. During that period of time, many other departments of the central government played very important roles in securities regulations within their respective areas. The most powerful body among them was the PBOC.

4.3.1. Regulation by the PBOC

Securities trading markets were first established as regional markets. The Shanghai and the Shenzhen Stock Exchanges were first established as local securities markets. The Shanghai and Shenzhen municipal governments were heavily

104. *Ibid.*, 66.

involved in securities policy making. In the meantime, securities markets were seen as a part of the financial market, which is regulated by the PBOC. Thus, the branches of the PBOC in both Shanghai and Shenzhen first exercised regulatory powers together with local governments in these two securities markets. This is because under the Interim Regulation Concerning Administration of Banks of 1986, the PBOC was clearly given the power to approve the establishment of banks and other financial institutions and to regulate enterprise shares and bonds.[105] For a long time, the PBOC was in charge of the licensing of securities companies and investment funds, as well as the establishment of stock exchanges and securities trading centres. It also issued a number of administrative rules, such as the Circular on Enterprise Shares, Bonds and Other Financial Services Administration, and the Circular on Strict Control of Share Issue and Transfer. The PBOC was gradually moved out of securities regulation following the State Council's decision to make the CSRC the sole regulatory body in August 1997.

In the 1980s, the PBOC was given many powers to regulate securities issuing as a result of the problems with the traditional division of functions among the ministries and commissions under the State Council. The PBOC had been in charge of the administration of all the banks and other financial institutions in China. The Ministry of Finance was and still is in charge of financial and fiscal matters. Nevertheless, securities regulation is different from either banking regulation or financial regulation. When the securities market started re-emerging in the early 1980s, no department had clear power to regulate this area.

On 12 January 1991, the PBOC issued the Circular on Strict Administration of Foreign Securities Investment. Under this Circular, if any foreign investment fund wants to enter into China's domestic securities market, it must obtain approval from the head office of the PBOC; provincial governments or their departments themselves cannot approve such investments.

Because of the problems that resulted from the lack of regulation of the securities market, the PBOC first started regulating share issuing in the 1980s. This regulation was tacitly approved and confirmed by the State Council in its Administrative Regulations passed from 1987 to 1989. Under some provisions of the Interim Regulations on Banks Administration, the Interim Regulations on Administration of Enterprise Bonds, and the Circular on Strengthening Administration of Shares and Bonds, the PBOC was made the major regulatory body of securities matters.

However, this arrangement was not welcomed by many other ministries and commissions of the State Council at that time, such as the State Planning Commission, the Ministry of Finance, the State Commission of Restructuring Economic Reform, etc. Within the PBOC, its departments were also fighting for regulatory power. In early 1992, the PBOC set up its Department of Shares to regulate the shares market, but the 'August 10 Incident'[106] led to a change in the

105. Article 5.

106. On 10 Aug. 1992, many people went to the Shenzhen Stock Exchange to buy newly listed shares. Because of over-speculation of the market, there were riots happening during the

has shown the unique environment surrounding this market and the strong involvement of the government. These unique features of the PRC's securities market caused the PRC to establish a securities regulatory regime with some unique characteristics. This chapter will give an overview of the PRC's securities regulatory scheme by examining its disclosure rules. It will also demonstrate that the development and improvement of the disclosure rules in the PRC have also reflected the influence of both the corporate law theory of path dependency and the theory of convergence.

The regulation of the securities market in the PRC went through the process of 'bottom to up'[2] and then the process of 'top to down'.[3] This regulation began with the local governments. The administrative documents of local governments were the first rules regulating the re-emerging securities market. Later, the ministries and commissions of the State Council came to join the regulatory team. To avoid abuses of the share issuing scheme and prevent fraudulent misconduct, local governments first started releasing regulatory documents on share issuing. As the national securities markets were only operated in Shanghai and Shenzhen, SOEs in each province and region had to compete to be listed on either of these two markets.[4] Sometimes, SOEs had to use all the means they could to be listed on a stock exchange. The ministries and commissions of the central government had to separately or jointly release regulatory rules to punish and prevent misleading, deceptive, and fraudulent conduct in the process of listing. Because of a lack of coordination and cooperation, the rules of all gatekeepers in the securities market had conflicts among themselves. This practice resulted in an inefficient and fraudulent market. It caused the frequent occurrence of fraudulent and deceptive listings in the mid-1990s. Only after a number of serious fraudulent cases occurred did the PRC's central government begin to draw on lessons and experiences from foreign countries, to centralise regulatory power, and to make uniform regulatory rules.

Based on the model of the Securities and Exchange Commission (SEC) of the USA, the CSRC was given more authority to become the sole regulator of securities trading in late 1997.[5] In the primary market, even though the Ministry of Finance, the PBOC, and the State Development and Reform Commission still maintain the power to approve the issuing of state bonds, financial bonds, and enterprise bonds, respectively, the listing of these securities has to be approved by

2. Share issuing was first used by collective enterprises in the countryside to raise capital, then by enterprises in the cities, then by the SOEs of the local governments, and then by the SOEs of the central government. The regulatory rules were first made by the local governing bodies, then by the local governments, then by the central government, and then by the Standing Committee of the NPC.
3. After the central government decided to adopt the shareholding system in SOEs in the early 1990s, it took control of securities issuing by centralizing the power to decide which enterprises could issue securities and to make rules at different levels.
4. Walter, Carol E. & Fraser J.T. Howie, *Privatizing China: the Stock Markets and Their Role in Corporate Reform* (Singapore: John Wiley & Sons (Asia) Pte Ltd, 2003), 90.
5. Zheng, Zhenlong (ed.), *A Concise History of the Chinese Securities Market* (Beijing: Economic Science Press, 2006), 328.

the CSRC. The rules released by the ministries and commissions of the State Council or local governments are focused on the requirements for securities issuing and the liabilities for contravention of these rules. Few of them are concerned about information disclosure. Although the State Council's 1993 Interim Regulations contain principles of securities disclosure, these provisions are too general to be implemented properly. The CSRC started issuing regulatory rules on disclosure soon after its establishment. However, these rules of the CSRC were not treated as administrative rules[6] until the end of 1998. The rules of the CSRC released before then were often ignored by companies and even by other government departments. Even after the CSRC rules were made administrative rules, they still may not be complied with because administrative rules are not enforceable by the courts in the Chinese legal system, as discussed in Chapter 2. The practices in the PRC demonstrated that multi-level rules without coordination did not function well.

To tackle the problems with the multi-party regulatory structure, the PRC government decided to enact a national law regulating the securities market. Consequently, the Securities Law of 1998 came into effect, and via legislation, it made the CSRC the sole regulator of the securities market. However, administrative regulations made by the State Council and administrative rules made by the relevant ministries or commissions of the State Council continue to play a role in securities regulation. The day-to-day supervision and regulation of the securities market has been delegated to the CSRC. Thus, the administrative rules on securities disclosure released by the CSRC constitute the core body of the securities disclosure regime.

During the process of drafting laws, administrative regulations, and administrative rules, the PRC sets the rules, which have 'Chinese characteristics' to deal with the problems in practice. It also draws on lessons from Western countries. When the Chinese securities market re-emerged in the mid-1980s after forty years of non-existence, it was in great need of the experiences of other jurisdictions. Many legal concepts and principles were then borrowed from Western countries. The officials of the CSRC who were educated in the USA naturally intended to adopt the US model in securities regulation, especially because the US securities market was seen as the most developed market in the world. As Hong Kong was seen as the biggest financial centre in Asia and it is culturally, geographically, and economically closer to the PRC than any other jurisdiction, the experience of securities regulation in Hong Kong also became a model that the PRC central government thought would be more appropriate and easier to adopt. The PRC has learned a great deal about Hong Kong securities regulation since 1993, when several SOEs sought listing on the Hong Kong Stock Exchange. Of course, the rule makers also looked at the development of its domestic securities markets. To deal with the problems that occurred in practice, they set some rules with 'Chinese characteristics'. In learning from foreign experiences, China's lawmakers

6. As discussed in Ch. 2, administrative rules are the rules made by an administrative commission or ministry of the State Council. The CSRC was not given administrative status until the passage of the PRC Securities Law of 1998.

Securities Law of 2005, this scheme is very confused one. Another problem is the poor enforcement of law in China.[52] These defects affect investors' confidence in the Chinese securities market.

5.2. MAJOR RULES DEALING WITH DISCLOSURE IN FUNDRAISING

5.2.1. Disclosure in Initial Public Offerings (IPOs)

5.2.1.1. Sources of Rules on IPOs

The establishment of national securities markets in the PRC is modelled on the securities markets of Hong Kong, the USA, and other Western countries. In drafting its first Company Law and Securities Law, the PRC also drew upon lessons and experiences mainly from Hong Kong and the USA, although it also looked briefly at experiences of other Western countries, including Australia. Many legal ideas and concepts were borrowed from Western law.[53] However, the fundamental purposes of company and securities legislation in the PRC are different from those of Western countries. The Company Law of 1993 was enacted when China was at the beginning of establishing its modern enterprise system. It only generally adopts the principles of information disclosure and contains few detailed provisions on disclosure.[54] For a long time, the principles of information disclosure were only contained in the 1993 Interim Regulations. These Regulations not only contain the principles for information disclosure, but also contain many detailed provisions on the publication of the most important document of IPOs – the prospectus. To implement the 1993 Interim Regulations, the CSRC issued the Implementing Rules on Information Disclosure by Public Share Offering Companies in 1993. It lists the contents of information disclosure in more detail. As a day-to-day regulator, the CSRC accumulated more experience from China's securities market and has issued a set of standard rules on content and format for information disclosure since 1997. It also constantly updates these standard rules.

The rules governing IPOs in the PRC can be found in the following sources: the Company Law, the Securities Law; the 1993 Interim Regulations Concerning Administration of Share Issue and Trading; the Implementing Rules Concerning Disclosure, Rule No. 1 on Content and Format of Disclosure – Prospectus, Rule No. 7 of Content and Format of Disclosure – Notice of Share Listing, and Rule No. 9 on Content and Format of Disclosure – Documents for IPO Application.

52. This problem was analysed in Ch. 2.
53. See the CSRC (ed.), *Collection of Essays and Articles from the International Symposium on Securities Law Bill* (Beijing: Law Press, 1997).
54. The PRC Company Law of 1993, Arts 130 and 140.

5.2.1.2. IPOs and Offerings of Other Shares

In mainland China, there are two ways to set up a joint stock company: either by means of sponsorship or by means of a share offer.[55] The former means to incorporate a company by subscription from the sponsors of all the shares to be issued by the company. The latter means to incorporate a company through the sponsors' subscription of a portion of the shares while the rest of the shares are to be offered to the public by a public offer.[56] A joint stock company has been a new form of enterprise after the economic reform began. As most of the enterprises in the PRC are state-owned, the establishment of the modern enterprises system in China involves a large number of SOEs. Under the Company Law of 1993, the transformation from a state-owned enterprise to a joint stock company must be conducted by means of a public offering.[57] Up until now, most of the joint stock companies listed on the Shanghai or the Shenzhen Stock Exchange were still SOEs. Thus, in the PRC, most listed companies were incorporated in the latter way described above.

In the PRC, SOEs had been the subordinates of the government for a long time under the planned economic system. The adoption of the shareholding system in SOEs started later than its adoption in non-state-owned enterprises. The procedures for issuing shares reflect the strong control of the state. With the development of the economic reform, SOEs gradually moved towards a modern enterprise system. As a result, the shareholding system was adopted in SOEs, and it is being improved with the deepening of the PRC's economic reform. The shareholding system was first experimented in collective enterprises and then in SOEs.[58] In 1997, the State Council announced the ban on SOEs from issuing shares by public offering.[59] The experiment of share issuing by public offering in SOEs did not resume until 1989.[60]

At the beginning of the adoption of the shareholding system, there were three forms for share issuing: a public offer, pre-decided share issuing (*ding xiang fa xing*), and an internal offer (*nei bu fa xing*). With public offers, the ordinary public had equal rights to decide whether to accept the offer. The shares bought by the public were called public shares, which could be freely transferred. A pre-decided offer meant that the offer was made to particular entities or government departments. The pre-decided shares included legal entities' shares, which were bought by the legal entities, and state-owned shares, which were bought by the government departments before they were offered to the public.

55. *Ibid.*, Art. 74.
56. *Ibid.*
57. *Ibid.*, Art. 75.
58. The State Council, *Circular on Strengthening the Administration of Shares and Bonds 1987.*
59. *Ibid.*
60. The State Council, *Circular of the Key Points of the Economic System Reform by the State Commission for Economic Restructuring 1989* stated that only a few large and medium-sized enterprises would experiment with share issues by public offer.

5.5.4. What Should Be Disclosed?

To disclose complete information does not mean that an issuer of shares must disclose everything about the issuance. It only requires that an issuer disclose major facts that may have a material effect on the share price.[117]

Such major facts include the following:

(i) major contracts entered into by the company which may have substantial effect on the company assets, debts, interests and/or operation;
(ii) major changes in company operation policy or operation projects;
(iii) the company's major investment or purchase of expensive long term assets;
(iv) the company's major debts;
(v) the company's breach of contract by not paying debts due;
(vi) the company's major losses;
(vii) major damage to the company assets;
(viii) major change in the company's operational environment;
(ix) newly released laws, regulations and rules which may have a material effect on company business;
(x) the change of the chairman of the board of directors, or a change of 30% or more of company directors, or a change of the general manager;
(xi) the increase or decrease of one type of shares held by a shareholder who holds more than 5% of the company's shares;
(xii) major lawsuits involving the company; and
(xiii) liquidation or insolvency of the company.[118]

The above is a very detailed list of the major facts that should be disclosed by a company, However, this does not mean those facts must be disclosed at every disclosure. Under certain circumstances, the duty of disclosure may be waived by the CSRC. If the issuer has strong reasons to believe that disclosure of some material facts to the public may bring damage to the interests of the company, and non-disclosure will not cause a material change of the share price, it may not disclose this information with the agreement of the stock exchange.[119] It is widely accepted that commercial secrets do not need to be disclosed.

Currently, in the PRC, there is only one kind of disclosure document for the initial share issuance – the prospectus. However, in Western countries, other alternative disclosure documents have been accepted.[120] Thus, the PRC's disclosure rules were made for the punishment of securities fraud, and market efficiency is not one of the considerations. Since the first release of Rule No. 1 on Content and Format of Disclosure – Prospectus in 1993, the CSRC has revised this document

117. The 1993 Interim Regulations, Art. 60.
118. *Ibid.*
119. *Ibid.*
120. For example, under Ch. 6D of the Australian Corporations Act of 2001 (Cth), disclosure documents include prospectuses, profile statements, and offer information statements.

several times. The last substantial changes were passed in 2001. These changes contain very detailed provisions on the prospectus. There are about 180 articles in this document. Rule No. 1 not only repeats the criteria of disclosure provided in laws and administrative regulations, but it also lists the information to be included in the prospectus. It requires listed companies to disclose risks, related party transactions, and the corporate governance structures of the companies.

The Securities Law of 1998 authorizes the State Council to make rules concerning the issue and trading of B shares.[121] To date, the State Council has not released new rules to update the regulation concerning B-share issuing. Under this circumstance, B-share issuing still follows the old rules reflected in the State Council's Provisions Concerning Listing of Foreign-Invested Shares by Joint Stock Companies inside China of 1995 and the SCSC's Implementing Rules Concerning Listing of Foreign-Invested Shares by Joint Stock Companies of 1996. With the opening of B shares market to Chinese citizens living inside China since February 2001, there are no longer substantial differences between A shares and B shares, except that these two kinds of shares are traded in different currencies. Consequently, the disclosure rules released after 2001 apply to both A and B shares.

One important aspect of enhanced information disclosure in Western countries is continuous disclosure. Listed companies not only have a duty of information disclosure when they initially issue their shares, but they also have a duty to continuously disclose any material information that may have a material effect on the trading of the companies' shares. The Australian Corporations Act of 2001 has a chapter on the scheme of continuous disclosure.[122] Unlike Australia, US legislation does not use the concept of 'continuous disclosure,' but it has requirements for annual reports, half-yearly reports, and quarterly reports, as well as current reports.[123]

The concept of 'continuous disclosure' had not been formally used in PRC legislation until the Securities Law of 1998 was enacted, even if Article 60 of the 1993 Interim Regulations contain what should be disclosed after the IPO. There are two main reasons for this. One is that at the time of enactment of the Company Law of 1993, information disclosure was not considered by the legislators as one of the key issues; the other is the lack of in-depth theoretical research and understanding of lessons from Western countries in respect to this area. Nevertheless, as the regulator of the Chinese securities market, the CSRC always pays great attention to the continuous disclosure issues. One of its officers pointed out that besides the prospectus and listing announcement, listed companies also bear liability to continuously disclose information affecting the operation of the companies, the rights and interests of the shareholders, and the price of shares.[124]

121. Article 213.
122. Chapter 6CA.
123. See Listing Rules of the NYSE.
124. Nie, Qingping, 'Chinese Securities Market and Its Supervision System', in *Business Law of the People's Republic of China* (Hong Kong: Butterworths, 1997), 90.

B-shares. This policy temporarily stimulated the B-share market. However, on 1 June 2001, the CSRC completely opened its B-share market to domestic investors to crack down on the black foreign currency market, and all Chinese people could trade in the B-shares market. On December 2001, both the Shanghai and the Shenzhen Stock Exchanges adopted new business rules, of which most provisions apply to both A-share and B-share trading.[70]

In conclusion, at this time, there are only three differences between A-share and B-share trading. Firstly, B-shares are still calculated in USD or HKD, while A shares are calculated in CNY. Secondly, B-share trading must be done through designated brokers, while investors may directly trade in A shares. Lastly, A-shares are still not open to foreign investors. The central government has been considering the merger of A-shares and B-shares for some time. The inconvertibility of CNY, however, remains the major hurdle. The changing of the business rules of the two stock exchanges is another step towards the merger between A-shares and B-shares. This merger will happen once CNY becomes completely floating.

6.2.2. Four Types of Shares in Shareholding Companies Converted from SOEs

Shares in the PRC can be classified as state shares, legal entity shares, employee shares, and public individual shares, according to the ownership of shares. These are the four types of shares in state-owned companies. In companies that are established by share issue, there are state shares, legal entity shares, and public individual shares. However, in companies converted from SOEs, there are state shares, legal entity shares, and employee shares, as well as public individual shares.

State-owned shares include state shares and legal entity shares.[71] The concept of state-owned shares came from the adoption of the shareholding system by the government in SOEs starting in 1992. The percentage of state-owned shares in the total number of shares of a state-owned company is completely decided upon by the government. To date, this percentage is still very high. Generally, it is above 40%; in some companies, it may be as high as 80%.[72] As most listed companies in the PRC are converted from SOEs and state-owned shares were not freely transferable, most shares of most listed companies were not transferable until May 2005, when the State Council released the Regulation on Division of State-owned Shareholding. This situation demonstrates that the shareholding structure in PRC listed companies is inappropriate and irrational. The shareholding structure forced the government to be heavily involved in the management of listed companies. With this structure, it was unlikely that a real market economy could be formed in

70. See the CSRC, *Disclosure Requirements of China Securities Market*, 311–352.
71. Li, Zhangzhe, *Finally Successful: The Report of the Development of Chinese Share Market*, 606.
72. Hu, Ruyin and Di Liu, 'Conclusions and Policy Suggestions', in *Corporate Governance: International Experience and China Practice* (in Chinese), ed. Tu, Guangshao & Congjiu Zhu (Beijing: People's Press, 2001), 173.

the PRC. This structure also put the minority shareholders in the PRC in a disadvantageous situation and led to the constant occurrence of infringement upon public shareholders by the controlling shareholders in state-owned companies. As the majority of listed companies are SOEs, the government had to focus on SOEs' ability to raise capital by issuing shares rather than consider the issue that disclosure and transparency were important regulatory tools in ensuring the confidence of investors.

In 1992, SOEs started transforming into shareholding companies.[73] As the senior managerial staff of SOEs were appointed by the government, these people were first responsible to the state. Because modern corporate management was not included in the companies transformed from SOEs until 1992, the senior managerial staff of these companies had not established a sense of loyalty to their companies. They could not be easily removed from their positions once they had been appointed, and consequently, some of them abused their powers for personal interests. For instance, during the process of transformation from SOEs into shareholding companies – except for state-owned shares – company directors and senior managerial staff had the power to divide employee shares and public individual shares. In China, there is a big difference between the internal issuing price and the public issuing price; the issuing price for employee shares is much lower than the price for publicly issued shares. The holders of more employee shares could benefit greatly from selling these shares at the market-trading price. In most cases, directors and senior managerial staff of the state-owned companies received more employee shares than did ordinary employees, which reflects the fact that at the beginning of the establishment of the shareholding system in SOEs, the principle of fairness was not adopted.

A big problem with state-owned shares is that they are not freely transferable. With the distribution of dividends and the allotment of new shares in most companies, the state became the largest shareholder and formed 'a dominant single shareholding' (*yi gu du da*).[74] This means that the state has the dominant holding of shares with voting rights. Currently, state shareholding on the average accounts for at least 65% of the total value of shares.[75] Non-transferability of state-owned shares is a sign that this securities market is not sophisticated.

73. The General Office of the State Council, the State Commission for Restructuring Economic Reform, the State Planning Commission, the Ministry of Finance, and the People's Bank of China jointly released the *Measures Concerning the Experiment of Shareholding System in SOEs* in 1992. See Wang, Yuming & An Jiang, *The Economic Law Perspective of State-owned Enterprises Reform*, 17.
74. *Yi gu du da* has become a special term in China to refer to the state-dominated shareholding structure in most listed Chinese companies. See Xu, Hongtang, 'Corporate Self-Regulation and the Reform of Company Law: Focused on Corporate Governance' in unpublished essays of the 2002 Annual International Symposium on Corporate Law Reform under the Global Economic Competition at the School of Law, Tsinghua University, Beijing, September 2002, vol. 2; Wu, Jinglian, *Reform: Now at a Critical Point* (Beijing: Sanlian Bookshop Press, 2002), 161.
75. Li, Zhangzhe, *Finally Successful: The Report of the Development of Chinese Share Market*, 606.

6.9.2. Information Availability under the Law and in Practice

Under Chinese law, true, accurate, complete, and timely information must be available for investors. Both the Company Law[172] and the Securities Law[173] require the issuer to prepare and publish a prospectus. However, often, the disclosure provisions are not complete. For example, although Article 17 of the Securities Law requires a company to prepare free copies of disclosure documents at a designated place for the investors to read, there are no liabilities provisions dealing with the companies that fail to do so. Article 64 requires disclosure to be made in designated newspapers and other publications.

In addition to these places, disclosure must be made at a company's business address and on the stock exchange where it is listed. In fact, most shareholders do not live in the same city where listed companies are located and do not live in the same city where the stock exchanges are located. As there is no requirement for listed companies to send copies of documents to the investors and no requirement for Internet disclosure, the function of disclosure in the PRC has been greatly diminished. Although Article 19 of the Interim Regulations of 1993 requires an issuer to provide copies of documents to investors and underwriters, and to display a prospectus at its business site, in fact, information is only available in form – not in substance. In addition, the laws and regulations do not contain liabilities provisions on non-compliance with the above-mentioned Articles.

The CSRC's Rule No. 1 on Content and Format of Disclosure by Listed Companies: Prospectus has very detailed provisions on the preparation and availability of prospectuses to investors. For example, it makes clear that all the information that may have a material impact on investors' decision-making must be disclosed.[174] It repeats three principles of disclosure and limits the effective period of prospectuses. However, it does not have an article that relates at all to punishment for violations of this Rule.

As for periodic disclosure, from the national laws to the CSRC's administrative rules, there are requirements for annual reporting, half-yearly reporting, and interim reporting. China did not formally adopt quarterly reporting until 2002. Again, this was borrowed from the US experience. The information disclosed by listed companies is often not precise and out of date. Another problem is that investors do not really get information from these reports. There are two main reasons for this: first, the poor quality and false information in these reports have made most investors lose confidence in them; and second, as most computers are not widely used in China, many investors cannot get information from the Internet but instead find information on the companies they are interested in from the newspapers designated for disclosure. The public library system is also very poor.

172. Article 88.
173. Article 17.
174. Article 3.

Information disclosed by listed companies in designated publications or places is not effective for other reasons as well. First, most Chinese investors are inexperienced. They are prone to the influence of their friends and hearsay but not to the information disclosed on formal documents. Of course, this phenomenon is related to the nature of the Chinese securities market – 'the policy market' – which means that the PRC securities market is dominated by the government's policies.

Second, the liability system dealing with false disclosure is incomplete. There are articles relating to punishment only for false disclosure but not for the non-displaying of securities issuing documents or for not sending prospectuses to investors. The Securities Law and the Company Law of 2005 have provisions for civil liability, criminal liability, and administrative liability imposed for conduct involving false disclosure, fraud, and major misstatements. However, the civil liability provision lacks details and is very hard for implementation in practice. In addition, there is no liability for late disclosure, even though listed companies are required to give timely disclosure. The problems with civil, criminal, and administrative liabilities will be discussed later.

6.9.3. Bodies Involving Enforcement of Securities Regulations

As discussed in previous chapters, the national regulator in charge of the PRC securities market is the CSRC. Several other bodies still have regulatory roles to play in their respective areas. For instance, the Ministry of Finance is in charge of setting accounting standards, issuing accounting licenses, and punishing accounting firms and individual accountants who are involved in misconduct of disclosure. The State Bureau of Industry and Commerce is in charge of registration and de-registration of companies.

The CSRC is the most active body in charge of securities regulation and enforcement by administrative means. On particular issues, it has to cooperate with other bodies. For instance, it has to jointly issue business licenses to securities companies, securities law firms, accounting firms specializing in securities, and their professional staff with the State Bureau of Industry and Commerce.

In addition to the administrative bodies, the courts also play an important role in enforcement of securities regulations by dealing with securities cases. The courts not only handle disputes between issuers and securities investors, disputes between issuers and underwriters, and disputes between underwriters and investors, but also, disputes between issuers and the CSRC. A lawsuit between an issuer and the CSRC is called administrative litigation. The PRC Administrative Litigation Law of 1989 broke the Chinese tradition that 'ordinary people do not sue the officials' *(min bu gao guan)* and represented a step forward in the development of democracy in China. In 2000, the CSRC was sued by Hainan Kaili Company for not approving its listing application. The CSRC became a defendant for the first time and lost the case in 2001. This shows that although the CSRC has been given a broad range of powers, it still has to act within its authority.

'the essential assumptions and fundamental concepts' underlying financial reporting.[134] However, it rejected the proposal of the professional accounting bodies that their standards should enliven the minimum statutory requirements because of the fact that neither they nor users of financial statements in Australia had developed a conceptual framework capable of serving the information needs of the market.[135]

The NCSC also considered the statutory definition that constitutes a 'true and fair view' by reference to (i) the purposes of financial statements and (ii) the persons to be primarily served by those statements – or a wholly new requirement – might give more precise guidance to directors and auditors in discharging their responsibilities'.[136]

It is noteworthy that the financial reporting rules of Australia can be traced back to the UK Companies Act of 1844.[137] However, 'the first recommendations on accounting principles which were published by the Institute of Chartered Accountants in England and Wales in the 1940s were not substantially adopted by the Institute of Chartered Accountants in Australia until 1946'.[138]

7.2.4.10. The Griffiths Report[139] of 1989

Corporate disclosure ensures that participants in the markets can access the market equally. One important aspect of the disclosure regime is to prevent insider trading. Prohibiting insider trading is based on the theories of fairness, fiduciary duty, economic efficiency, and corporate injury.[140] The earliest provisions on insider trading in Australia are in section 124 of the Uniform Companies Act of 1961, which prohibited company officers from using information acquired by their position to gain an advantage for themselves, or to cause detriment to the company.[141] The inquiry of the Rae Report in 1970 included an investigation of the powers of a Commonwealth securities commission to act speedily against manipulation of prices, insider trading, and other improper practices.[142] The first law in Australia specifically prohibiting insider trading was section 75 of the New South Wales Securities Industry Act of 1970.[143] Later on, section 128 of the

134. NCSC, *Financial Reporting Requirements of the Companies Act and Codes (the Green Paper of 1983)* (Canberra: AGPS, 1983), para. 2.7.
135. *Ibid.*, para. 2.9.
136. The Green Paper of 1983, para. 4.4.
137. *Ibid.*, para. 3.4.
138. *Ibid.*
139. The House of Representatives Standing Committee on Legal and Constitutional Affairs Report, *Fair Shares for All: Insider Trading in Australia*, 1989.
140. The Griffiths Report, para. 3.1.2.
141. *Ibid.*, para. 2.1.3.
142. *Ibid.*, para. 2.1.5.
143. *Ibid.*, para. 2.1.6.

Securities Industry legislation regulated insider trading under the cooperative scheme administered by the NCSC.[144]

On 8 February 1989, the then Attorney-General, the Honourable Lionel Bowen, requested that the House of Representatives Standing Committee on Legal and Constitutional Affairs conduct an inquiry into insider trading and other forms of market manipulation. The inquiry committee was chaired by Member of Parliament (MP) Alan Griffiths. It released the Griffiths Report, entitled *Fair Shares for All: Insider Trading in Australia* in October 1989. This inquiry arose as a result of evidence provided by the NCSC in July 1988 in the context of its inquiry into mergers, takeovers, and monopolies.[145] The NCSC indicated that proving insider trading cases under the existing legislation was extraordinarily difficult.[146] Another reason for the establishment of this inquiry was the release of a study into insider trading by Dr R.A. Tomasic and Mr. B.D. Pentony.[147] Tomasic and Pentony concluded in their study that, 'The law against insider trading is practically non-existent'.[148]

It is very import to note that the Griffiths Report reviewed and compared overseas experiences with Australian practices. It analysed the American approach of regulating insider trading and clearly pointed out that this approach did not suit Australia.[149] It also indicated that the Australian approach was closer to that of New Zealand and the UK.[150]

It is also worth mentioning that before conducting its inquiry in 1988, the NCSC retained Philip Anisman, then Professor of Law at Osgoode Hall Law School, York University of Canada, in 1986 to prepare an initial issues paper on insider trading. Although Professor Anisman could not finish his task because he left Australia, the NCSC published his recommendations as *Insider Trading Legislation for Australia: An Outline of the Issues and Alternatives* in 1986 for public debate.[151] From this perspective, Australian insider trading legislation might have been influenced by the Canadian experience as well.

7.2.4.11. The CASAC Report of 1991 and the Lavarch Committee Report of 1991

In 1989, the Commonwealth Parliament enacted the Corporations Act, the Australian Securities Commission Act, and related legislation, all of which were designed to nationally regulate the entire field of companies and securities law. The principal purpose of these acts was to establish a single national regulatory

144. P. Anisman, *Insider Trading Legislation for Australia: An Outline of the Issues and Alternatives* (Canberra: AGPS, 1986), vi.
145. The Griffiths Report of 1989, para. 1.2.1.
146. *Ibid.*
147. *Ibid.*, para. 1.2.2.
148. *Ibid.*, para. 1.2.4.
149. *Ibid.*, paras 2.2.4 and 2.2.5.
150. *Ibid.*, para. 2.2.7.
151. The Rae Report, Preface.