OECD-China Policy Dialogue
on Corporate Governance

Corporate Governance of Listed Companies in China

SELF-ASSESSMENT BY THE CHINA SECURITIES REGULATORY COMMISSION



OECD

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Foreword

This Report looks at the institutional framework of corporate governance in China through the prism of the *OECD Principles of Corporate Governance* and is a product of the ongoing *OECD-China Policy Dialogue on Corporate Governance*. By assessing a broad range of laws, regulations and codes, it provides a valuable reference for understanding how much has been achieved in Chinese corporate governance and the main ambition of future reform efforts. The Report shows that corporate governance has improved significantly since the Chinese stock market was created in 1990, with important achievements in establishing and developing the legal and regulatory framework.

In preparing the Report, the China Securities Regulatory Commission (CSRC) has, together with other relevant agencies and ministries, accomplished a major body of work and taken it through a process of extensive consultation and inter-agency drafting. OECD considers this an important achievement; a tangible sign of China's commitment to excellence and testimony to its readiness to continue the modernization of the country's capital markets and corporate governance practices.

Throughout the drafting process, the OECD Secretariat, as well as national representatives from the OECD Corporate Governance Committee, have been engaged in workshops and policy discussions with their Chinese counterparts. In November 2010, the full Committee had an opportunity to discuss the report in-depth with a Chinese delegation and was impressed with the breadth and depth of the legal and regulatory framework that China has established in the area of corporate governance.

The Committee noted that the corporate governance framework in China is developing and adapting to the country's economic transformation. As market discipline is still evolving, the role played by the formal legal and regulatory framework remains essential for building an efficient and competitive capital market.

Given China's concentrated ownership structure, potential conflicts of interest between majority and minority shareholders remain a core corporate governance issue. It is therefore very useful that the Report looks at the issues of equitable treatment of shareholders and mechanisms to prevent abusive related party transactions. The Report is also helpful in identifying mechanisms for shareholder redress. On a related topic, the Committee pointed to the challenges of coordinating the multiple roles played by state entities – as shareholders, regulators and managers.

In terms of provision of information to the market, the Report demonstrates the importance China attaches to improving disclosure and transparency. This includes the introduction of low-cost dissemination channels and ensuring that Chinese accounting and auditing standards are of high quality and aligned with international standards. The Committee took an interest in China's dual board system, the board of directors and supervisory board. The Report emphasises board composition and duties. In particular,

the discussion highlighted the importance of providing information to investors about the board and senior management selection process.

China – like all other countries around the world – faces the continuous challenge of ensuring that its corporate governance laws and regulations are translated into good corporate practice. Ultimately, the rules and laws on paper must be effectively implemented in order to make a difference. This is a long-term commitment that will benefit from constant attention to the quality of the legal system; the presence of self-regulatory organizations and cooperation with international institutions. For China, priority areas for attention may include: curbing abusive related party transactions, enhancing the quality of boards, improving shareholder protection and curbing market abuse. It may also be useful to devote special attention to the all-important issue of how to improve effective implementation and enforcement.

To conclude, the OECD Corporate Governance Committee considered the discussion of China's self-assessment an important and timely exercise. Members of the OECD Corporate Governance Committee were also pleased to participate when the Report was launched at the OECD Asian Roundtable on Corporate Governance in Shanghai, which was kindly hosted by the CSRC and the Shanghai and Shenzhen Stock Exchanges in December 2010.

Building on this Report, bilateral cooperation between China and the OECD will continue to enhance the understanding of China's corporate governance system and how it impacts on company and investor behaviour. As a consequence, the OECD Corporate Governance Committee looks forward to further strengthening of cooperation and a mutually beneficial dialogue with Chinese authorities in the area of corporate governance.

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Preface

by
SHANG Fulin
Chairman, China Securities Regulatory Commission

This year marks the 20th anniversary of the Chinese capital market. In the past two decades, it has started from scratch and experienced an extraordinary growth with market size increasing from small to big and market coverage from regional to nationwide, playing an important role in the national economic and social development. The development of the capital market has promoted the establishment of a modern enterprise system in China. Listed companies, outstanding representatives of Chinese enterprises, are the corner stone of sound capital market development. The improved governance system and higher governance level of listed companies have consolidated the foundation of the capital market, increased its attractiveness and vitality, given an effective boost to the capital market's role in optimising resource allocation and promoted the healthy and steady development of the Chinese capital market.

Corporate governance in China has been explored and established in the process of state-owned enterprises reform and private enterprises growth. Corporate governance experience and model with Chinese characteristics have come into being in light of the actual situation in China. It has developed under the joint effort of the government and market participants, with the former playing a leading role in the construction and improvement of the corporate governance legal framework. Although China has started the creation of a legal system for corporate governance rather lately, the system has developed fairly quickly and increasingly full-fledged. The China Securities Regulatory Commission (CSRC) has all along identified the improvement of corporate governance as a priority, adopted various strong measures in the areas of independent directorship, information disclosure, interest related party transaction, general shareholders' meeting, merger and acquisition and reorganization and investor protection within the framework of the Company Law and the Securities Law, and issued a series of department rules and normative documents, including Code of Corporate Governance of Listed Companies, Regulations on Information Disclosure of Listed Companies, Guidelines on Articles of Association of Listed Companies, Rules on Shareholders' Meetings of Listed Companies, Guiding Opinions on the Establishment of the System of Independent directors in Listed Companies, Provisions on Strengthening the Protection of the Rights and Interests of Public Shareholders, Regulations on the Takeover of Listed Companies, Regulations on Major Asset Reorganization of Listed Companies, and Regulations on Option Incentives of Listed Companies (Trial) etc. The formulation and implementation of these regulatory provisions and normative documents have greatly promoted the corporate governance reform process and facilitated the improvement of corporate governance level of listed companies. Meanwhile, pushed by the CSRC, a special campaign was launched as of 2005 for listed companies to conduct non-tradable share reform, clear off outstanding

debts from controlling shareholders and improve corporate governance. The campaign has consolidated the market foundation and is of great practical significance to build up market confidence and encourage steady investment growth.

The development of corporate governance practices in China and the constant improvement of the relevant legal system offer useful information for other countries. China also needs to further draw upon mature experiences of other countries and relevant international organizations and objectively evaluate achievements and gaps. For this reason, the CSRC and the Organisation for Economic Co-operation and Development (OECD) reached an agreement to cooperate on a joint corporate governance assessment programme. As an international organization born to deal with challenges of economic globalization, the OECD has all along committed itself to providing a platform for governments to explore, develop and improve economic and social policies. The organization has long-term experience in the field of corporate governance. Its Principles of Corporate Governance provide a set of international standards for corporate governance and have extensive influence in member states as one of the most influential guidance on corporate governance in the world. The cooperation between the CSRC and the OECD is designed to advance dialogue and communication between Chinese corporate governance legal system and internationally accepted rules and therefore of special significance for the exploration into a mode of compatibility between Chinese and foreign corporate governances.

The OECD-China corporate governance joint assessment programme was formally launched in 2009. Upon consulted arrangement between the two sides, the CSRC working group completed a self-assessment report after meticulous discussions and revisions, i.e., the present China Listed Company Corporate Governance Report. The English edition of the report was presented to the OECD, which then provided feedbacks and conducted a discussion about the report at its Corporate Governance Committee meeting. The now finalized report describes the status of corporate governance in China, covering shareholders' rights, equal treatment of shareholders, information disclosure, responsibility and supervision of the board of directors and the supervisory board, stakeholders and corporate social responsibility. It features a detailed comparison between Chinese corporate governance system and practices and the relevant OECD principles.

The creation and development of Chinese corporate governance and other legal systems governing companies have moved from drawing upon experiences of other countries to finding its own corporate governance model. For a long time, China has humbly learned from others on the basis of its national conditions and made active efforts to integrate itself into the world economic system. Looking into the future, China will take an active part in international rule-making. Dialogue and communication between China and the world including cooperation between the CSRC and international institutions will continue and expand comprehensively, which will be very much beneficial for Chinese enterprises to go global and for foreign enterprises to invest in China.

SHANG Fulin
Chairman of China Securities Regulatory Commission

Preface

by
Richard Boucher
Deputy Secretary-General, OECD

For more than twenty years, Chinese authorities have worked hard to build a stronger corporate governance framework as part of accelerated enterprise reform and capital market development. Indeed, since the stock market was established in 1990, the corporate governance framework has been transformed and capital markets have developed dynamically. New institutions have been created and many new laws and regulations have been adopted – and this process continues.

In this Self-Assessment, the Chinese Securities Regulatory Commission (CSRC) presents China's laws and regulations by reference to the OECD Principles of Corporate Governance. The assessment documents how much has been accomplished, and points out the direction for further development. The report was thoroughly discussed by the OECD Corporate Governance Committee which was impressed by the breadth and depth of the legal and regulatory framework that has been developed by the Chinese authorities. All aspects of the Principles are addressed.

The Self-Assessment is an important and timely benchmarking exercise. The OECD is very pleased that it is being launched at the OECD Asian Roundtable on Corporate Governance in Shanghai, hosted by the CSRC and the Shanghai and Shenzhen Stock Exchanges. The Self-Assessment will contribute to better understanding and exchange of experience among all the jurisdictions in the region.

Going forward, China – like many other countries around the world – faces the challenge of ensuring that its laws and regulations are translated into changed corporate practice. This is a key issue for many authorities who seek to sustain capital market and corporate development and has become central to the OECD Committee's work.

This report is a key output of the OECD-China Policy Dialogue on Corporate Governance that began in 2004 and has proven very successful in promoting mutual understanding and supporting China's reform agenda. The OECD looks forward to continuing to deepen our partnership with China in improving corporate governance.



Richard Boucher
Deputy Secretary-General, OECD

Chapter 1

The corporate governance framework in China

1.1 The history and development of corporate governance in China

Corporate governance in China has emerged and developed as China has shifted from a planned economy to a market economy. The establishment and growth of China's capital market and the evolution of Chinese enterprises from government affiliates to modern companies have made it necessary to establish a new corporate governance framework.

Until 1978, most Chinese enterprises were state-owned. A major characteristic of the state-owned enterprise management mechanism was its administration-driven, unified and collective governance. Enterprises were mainly managed by "administrative" means and ranked in accordance with the levels of government concerned and the size and affiliation of the company. Corporate production plans were not decided by the market, but by the government according to a national plan and its sub-plans. Business performance was measured by the number of planned targets that were met, rather than by the market value realised. Political entitlement was the major incentive for managers and employees. Managers had no independence in business activities, nor could they share the fruits of successful business operations, and therefore lacked the drive to improve enterprise management. As managers' autonomy and corresponding administrative ranks were mainly decided by the size and economic resources of their companies, they were inclined to expand the size of the enterprise while paying little attention to its business performance.

Economic reform progressed in China's urban areas after the Third Plenary Session of the 11th Communist Party of China's (CPC) National Congress in 1978. The centrepiece of the reform was the revitalisation of state-owned enterprises (SOEs) to make them more efficient by restructuring the old enterprise system. Spawned by the reform of SOEs, China's attention to corporate governance grew as the SOEs strived to put a modern enterprise system in place. China's corporate governance made steady progress as more and more companies were listed.

China's corporate governance development to date has been a 30-year process that can be divided into four phases.

1.1.1 Phase 1: From 1978 to 1984

The major feature of this phase was decentralisation. In 1979, the State Council promulgated a number of rules and regulations on reforming the enterprises' management

mechanism. These new rules were geared to readjust the relationship between the state and its enterprises, to give SOE managers more freedom in business activities, and to replace the state's direct administrative control over the SOEs with a management model in which direct state control is supplemented by economic incentives. Favourable measures in terms of fixed-asset investment, asset depreciation and working capital management were provided to the SOEs to expand their incentives for better business performance. Pilot programmes to enhance SOEs' business independence were introduced and their successful experiences were summarised and formulated into the SOE Management Responsibility System in 1981, which was set by the state as the goal of SOE management mechanism reform.

1.1.2 Phase 2: From 1984 to 1992

The major feature of this phase was the change in SOEs' profit distribution and the formation of the management responsibility system. Before the reform[1], SOEs' profits were all claimed by the state. After the reform, the profits of large and medium-sized SOEs were taxed, after-tax profits were shared by the state and enterprises, and the "SOE Manager Accountability Mechanism" was put in place. In 1984, the idea that the ownership and management of state-owned enterprises could be separated as appropriate was suggested for the first time. In 1986, the CPC Central Committee, together with the State Council, issued a number of documents, including the *Terms of Reference for Managers of State-owned Industrial Enterprises*, explicitly stipulating that the manager is a company's representative of a legal personality, and a new type of corporate leadership system featuring "overall responsibility of the manager, a supervisory and guarantee role for the company's CPC subcommittee, and democratic management by the employees" was also established.

From 1987 onwards, the transformation of the SOEs' operational mechanism became the priority of SOE reform. According to the principle that ownership and management of companies can be separated, a major reform of SOEs' business operation models was initiated and a contract-based responsibility system[2] was set up. In the transitional period from a planned to a market-based economy, the contract responsibility system played a positive role in guaranteeing the steady growth of government revenue, promoting the separation of enterprise ownership from management, and the separation of government from enterprises, providing SOE employees with greater autonomy and incentives, and making SOE development more sustainable. But experience has shown that the contract responsibility system had embedded weaknesses too, mainly in that it failed to avoid the short-term performance oriented behaviors. The basis of the contracts was often arbitrarily decided and was neither fair nor objective: the contractors shared the gains when the enterprises were profitable but were not personally liable when they incurred losses. The system failed to find a fully satisfactory solution to the challenge of separating the role of the government from enterprises.

In July 1992, the State Council formulated and promulgated the *Regulation on the Transformation of Operational Mechanisms of Industrial Enterprises Owned by the Whole People*, delegating 14 independent powers of operation to SOEs, thereby accelerating the pace at which SOEs moved from a planned economy to a market economy.

1.1.3 Phase 3: From 1993 to 2003

The establishment of a modern enterprise system was at the core of SOE reform during this phase. In 1993, it was made clear that "efforts need to be made to transform the SOE management mechanism and establish a modern enterprise system that suits the needs of a market economy, with clearly defined ownership, rights and responsibilities, and features the separation of government from enterprises and scientific management. Modern enterprises can have many organisational forms based on the composition of capital. Practising the corporate system in SOEs proved to be a useful way to start building a modern enterprise system."

The *Company Law*, which was promulgated in December 1993, provided legal support to the establishment of a modern enterprise system and laid the groundwork for China's corporate governance framework. China made the decision to define its basic economic system as one in which state ownership is the main feature, with the common development of diverse forms of ownership. In line with this definition, efforts were made on two fronts. Firstly, SOE reform and structural adjustment of the national economy were accelerated towards the direction of building a system in which enterprises would become legal entities responsible for their own business operations, profitability, development, self-discipline, and risk portfolio as real market players. Some SOEs were restructured into limited liability companies or limited joint-stock companies. With articles of association drafted, shareholders' meetings, boards of directors, and supervisory boards established, and senior management appointed, a basic framework for a corporate governance structure had taken shape. Secondly, as the non-state sector of the economy was elevated from a previously subordinate position to one of importance on a par with the public sector, the policy and institutional obstacles limiting its rapid development were removed. As a result, the number of non-state firms has continued to grow steadily.

Since the early 1990s, a nationwide capital market with stock exchanges acting as the main agent has gradually developed and the number of listed companies has grown exponentially. Most of the listed companies were restructured SOEs that had gone through shareholding reform. As the state or state-owned companies still held controlling shares of those listed companies, many of the old SOE management styles and mechanisms were maintained. Meanwhile, as the number of listed non-state holding companies grew, so their governance increasingly became an issue. The improvement of the corporate governance of listed companies was a major item on the agenda of China's capital market development at that time.

In 2001, China joined the World Trade Organisation and undertook to adopt the *OECD Principles of Corporate Governance* and improve corporate governance of Chinese listed companies.

The China Securities Regulatory Commission (CSRC) and the National Economic and Trade Commission jointly issued the *Code of Corporate Governance of Listed Companies* in early 2002. This document is based on the OECD Corporate Governance Principles and gives particular consideration to the circumstances and outstanding issues of listed companies in China. It expounds on the basic principles of corporate governance, the means to achieve investor protection, and the basic code of conduct and professional ethics that need to be observed by directors, supervisors, managers and other executives of listed companies.

1.1.4 Phase 4: From 2004 to present

Historical constraints to good governance of listed companies started to be gradually addressed from 2004 onwards. With the help of government regulators, such as those represented by the CSRC, the level of corporate governance among listed companies has been constantly improving. The State Council issued *Opinions on Promoting the Reform, Opening and Steady Growth of Capital Markets* in January 2004, clarifying the strategic importance of capital markets in national economic development and charting the course for resolving some long-standing problems. In April 2005 the CSRC, under the guidance of the State Council, introduced a reform designed to address the issue of non-tradability of certain shares held by a company's shareholders, a residual problem from the period before the companies went public. The smooth progress of this reform successfully solved the problem of dividing interests and prices among the state-owned shares, institutional shares and tradable shares in a company's share structure, and enabled equal rights to the trading of and earnings on shares among all categories of shareholders. All categories of shares are now valued by the market mechanism, which constitutes the basis for common interests among all categories of shareholders.

The *Company Law* and the *Securities Law*, both introduced in 2006, provide the foundation for drawing up and developing a corporate governance framework in China. The revised *Company Law* improved companies' governance structure and mechanisms to protect lawful shareholders' rights and public interests. It highlighted the legal obligations and responsibilities of those in actual control of the company – the directors, senior management and supervisors. It improved companies' financing and financial accounting systems of companies and the systems governing corporate mergers, divisions and liquidation. While ensuring the lawful rights and interests of the creditors are well protected, it facilitated the reorganisation of companies.

The revised *Securities Law* improved the system governing the issuance, trading, registration and settlement of securities and provided for the establishment of multi-tiered capital-market architecture. It improved the supervision of listed companies, made issuance examination more transparent, established the mechanism of introducing a system for recommending/sponsoring listing. It also increased the legal responsibilities and rules on integrity obligations of the controlling shareholders or those actually in control, namely the directors, supervisors and senior management of listed companies. The revised law strengthened investor protection, especially for minority investors, established a securities investor protection fund, and defined the system of civil responsibility to compensate for damages to investors. Following the revision, related agencies made corresponding adjustments to other relevant laws, regulations and criterion documents to ensure that they better reflect market rules.

The state-owned Assets Supervision and Administration Commission of the State Council carried out corporatisation reforms of large central government SOEs and piloted the establishment of boards of directors according to the *Company Law* and in light of the *OECD Guidelines on Corporate Governance of State-Owned Enterprises.*

The issue of fund misappropriation by major shareholders and other related parties was a problem that seriously affected the healthy development of listed companies. To address this issue effectively, the CSRC drafted regulations imposing a strict limitation on fund misappropriation in listed companies by controlling shareholders and other related parties. It conducted pilot programmes on "shares for debt" and co-operated with local governments and other relevant agencies to deal with the difficult problem of debt repayment arrears. At the same time, it focused on the establishment of a long-term

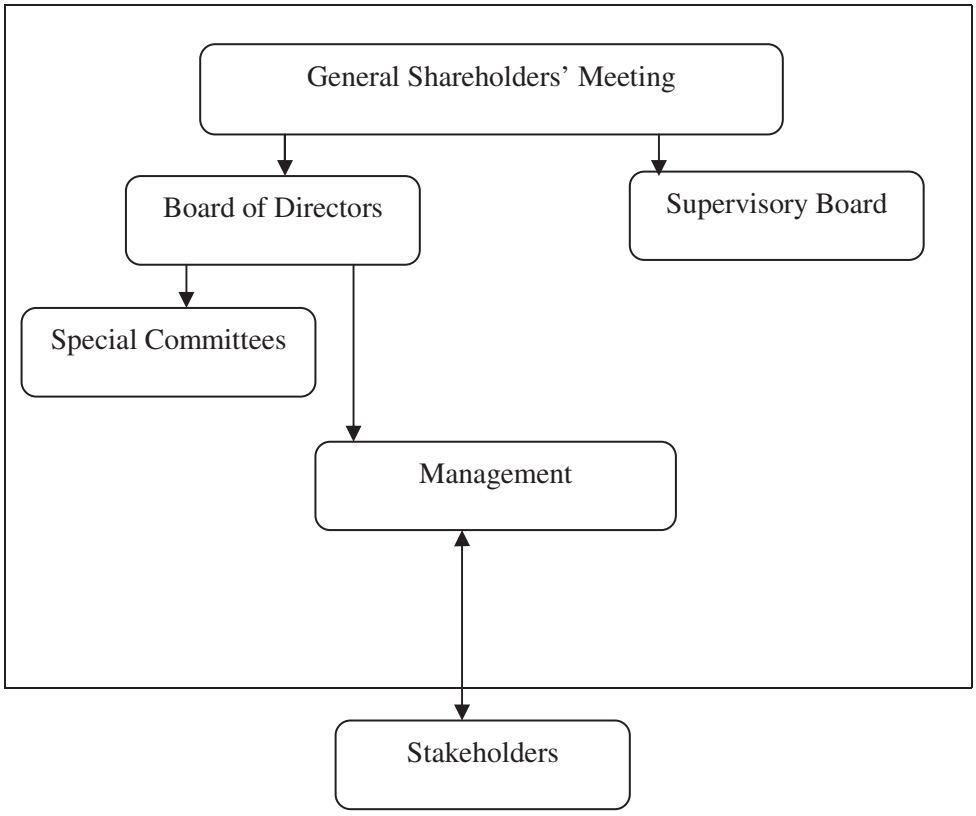
mechanism to forestall new debt repayment arrears while old arrears were being repaid. The *Criminal Law* was amended to inflict greater penalties on major shareholders and actual controllers involved in fund misappropriation of listed companies. This problem was essentially resolved by the end of 2006.

Following the completion of the reform on non-tradable shares and collection of debt repayment arrears, in March 2007 the CSRC launched a three-year campaign to strengthen the governance of listed companies. During the campaign, listed companies looked into existing problems in corporate governance and conducted in-depth, effective rectification of misappropriation of company funds by major shareholders, incomplete separation of funds and personnel between a listed company and its controlling shareholder, irregular operations of listed companies' boards of directors, shareholders' meetings and supervisory boards, and inadequate internal controls.

During this campaign, the listed companies gained greater awareness of standard operations and improved their level of governance, and some listed companies gradually introduced effective corporate governance models adapted to their companies.

1. Listed companies were marked by greater independence and the diversification of directors has started to play an important role in the constant improvement of corporate governance and internal controls.
2. Operations of the board of directors, supervisory board and general shareholders' meeting are more standard and effective. Online voting at general shareholders' meetings has increased and the use of accumulative voting is more extensive. The rules of procedures for board meetings are more standardised and relevant decision-making more scientific. The functions of the board of directors' specialized committees have been further strengthened, with many companies adopting work procedures, detailed responsibilities and clarified procedures for the specialized committees.
3. The system of internal control has been further improved, with many listed companies systematically sorting out and improving their internal controls by drawing up rules and improving them where necessary.
4. The information disclosure systems of listed companies has become more fully fledged and detailed. Meanwhile, companies are more likely to take the initiative to disclose information with more in-depth and extensive coverage. They are also more sensitive and respond faster to substantive information.
5. The management of investor relations has greatly improved. Most listed companies have improved their investor relations management system, appointed full-time staff responsible for investor relations, set up hotlines and designated website modules for investors, and interact and exchange information with investors on an irregular basis. They are also more active in implementing corporate social responsibility.

The chart below shows the current Corporate Governance Framework of Listed Companies in China:



Concerning allocation and balance of company powers, four specific company organs with power and work division are set up to form the organizational structure.

The general shareholders' meeting is the power and decision-making organ of the company and has decision making power concerning major issues. The board of directors is the operational implementation organ of the company, being responsible to the general shareholders' meeting, and has the decision making power concerning management issues under the authority of general shareholders' meeting. The board of directors may, according to the resolution of the general shareholders' meeting, set up special committees, such as strategy committee, auditing committee, nomination committee, remuneration and appraisal committee, etc., The management is responsible to the board of directors, and is in charge of the daily operation and management of the company. The supervisory board is the supervision organ of the company, which supervises whether directors and managers violate laws or articles of association of the company when accomplishing corporate duties, and is entitled to inspect company's finance.

1.2 The legal framework of corporate governance for listed companies in China

China's legal framework for corporate governance comprises four levels: basic laws, administrative regulations, regulatory provisions, and self-disciplinary rules.

The first level comprises some fundamental laws, formulated either by the National People's Congress or its Standing Committee. They include the *Company Law*, the

Securities Law, the *Criminal Law Amendment Act (6)*, the *Law on the State-Owned Assets of Enterprises* and *the Accounting Law*.

The second level includes State Council administrative regulations, notably: Opinions on Promoting the Reform, Opening and Steady Growth of Capital Markets, Circular of the State Council on its Approval of the CSRC's Opinion on Improving the Quality of Listed Companies.

The third level involves departmental provisions formulated by the Ministries, Commissions, the People's Bank of China, the Auditing Administration and other agencies with administrative jurisdiction directly under the State Council. These include: the *Code of Corporate Governance of Listed Companies, Regulations on Information Disclosure of Listed Companies, Guidelines on Articles of Association of Listed Companies, Rules on Shareholders' Meetings of Listed Companies, Guiding Opinions on the Establishment of the System of Independent Directors in Listed Companies, Provisions on Strengthening the Protection of the Rights and Interests of Public Shareholders, Regulations on the Takeover of Listed Companies, Regulations on Major Asset Reorganisation of Listed Companies, Regulations on Option Incentives of Listed Companies (Trial), Regulations on the Registration and Settlement of Securities.*

The fourth level of self-disciplinary rules refers to the *Rules on Listing Stocks* and *Trading Rules* made by the stock exchanges, among others.

When the laws, regulations and rules at various levels are drafted, the legislature or competent administrative departments generally carry out in-depth research and implement the relevant legal procedures strictly to solicit a broad scope of opinions through round-table discussions, argumentation, consultation and comments so that individual citizens and market entities are able to express their views directly or through their representatives, thereby safeguarding their legitimate rights and interests.

Perpetrators of irregularities and violations in corporate governance shall be held accountable for the relevant administrative, civil and criminal responsibilities. The CSRC may deliver administrative sanctions, such as warnings, fines, disqualification and banning the entry into the securities market of the companies and individuals responsible for violations. Those suspected of a criminal offence shall be transferred to the judicial departments to ascertain criminal liability. The company registration department and other competent departments may also punish violating companies, intermediaries and persons responsible by ordering them to return company property, confiscating the illicit gains, imposing a fine, cancelling company registration and revoking a business licence, ordering intermediaries to stop business operations and revoking qualification certificates of those directly responsible. Furthermore, shareholders may also, according to law, file lawsuits against those persons and institutions that have undermined the legitimate rights and interests of the company and its shareholders and claim civil damage. Companies in violation shall undertake the responsibility of civil compensation and pay the fines. When assets are insufficient, civil damage compensation shall be paid out first. Criminal responsibility shall be investigated when a criminal offence is involved.

1.2.1 Basic laws

1.2.1.1 Company Law (2006)

The *Company Law* (2006) is formulated to standardise the organisation and behaviour of companies, to protect the legitimate rights and interests of companies, shareholders and creditors, safeguard socioeconomic order and promote the development of a socialist market economy. It governs the incorporation and organisational structure of limited liability companies, equity transfers of limited liability companies, the incorporation, organisational structure, issuance and transfer of shares of companies limited by shares, the qualifications and obligations of company directors, supervisors and senior executives, corporate bonds, corporate finance and accounting, company mergers, splits, capital increases and reductions, company dissolution and clearance, branches of foreign companies and legal liabilities.

1.2.1.2 Securities Law (2006)

The *Securities Law* (2006) was drawn up to standardise securities issues and transactions, protect the legitimate rights and interests of investors, safeguard socio-economic order and public interests and promote the development of a socialist market economy. It governs securities issues, securities transactions, general provisions, listing of securities, disclosure of information, prohibited transactions, acquisition of a listed company, stock exchanges, securities companies, securities registration and clearance institutions, securities service organisations, securities industry associations, securities regulatory institution and legal liabilities.

1.2.1.3 Criminal Law Amendment Act (6) (2006)

Amendment VI to the Criminal Law (2006) was designed to match the amended *Securities Law* and *Company Law*, to give a more complete definition of legal liabilities in the securities field, improve the laws governing the securities market and promote its healthy development. The Amendment governs the following corporate governance-related offences: disclosure breaches, non-disclosure of major information, breach of trust and damage of listed company's interests, insider trading and leakage of insider information and manipulation of securities or futures market.

1.2.1.4 Law on the State-Owned Assets of Enterprises (2009)

The *Law on the State-Owned Assets of Enterprises*[3] (2009) was promulgated to safeguard the country's basic economic system, to consolidate and develop the state-owned sector, strengthen the protection of state-owned assets, allow the state-owned sector to play a dominant role in the national economy, and promote the development of a socialist market economy. The Law governs the institution that performs the function of investor, enterprises with funds from the state, the selection managers of enterprises funded by the state and the assessment of their performance, significant matters bearing on the rights and interests of the investor of state-owned assets, operational budgets of state-owned assets, supervision of state-owned assets and legal liabilities.

1.2.1.5 Accounting Law (2000)

The *Accounting Law* (2000) was introduced to standardise accounting behaviour, ensure the truthfulness and completeness of accounting materials, strengthen economic administration and financial management, improve economic performance and safeguard the order of the socialist market economy. This law lays out requirements regarding accounting practices, special provisions on companies' accounting practices, accounting supervision, accounting offices, accounting personnel, and legal liability.

1.2.2 Administrative regulations and regulatory documents

1.2.2.1 Regulations on the Administration of Company Registration (2005)

These regulations provide for the confirmation that a company qualifies as a legal personality, standardised company registration and complete and standardised provisions concerning the establishment, alteration and termination of companies in terms of registration, registered items, registration of establishments, changes and cancellations, as well as registration procedures.

1.2.2.2 Opinions on Promoting the Reform, Opening-up and Steady Growth of Capital Markets (2004)

These opinions focus on the need to fully appreciate the importance of capital market development, the guiding ideology and tasks for promoting reform, and the opening-up and steady growth of capital markets. Efforts need to be made to improve relevant policies to promote the steady growth of capital markets. The structure of capital markets needs to be optimised and the range of investment securities expanded. The quality of listed companies needs to be improved and their operation should be standardised. Efforts should be made to promote the standardisation of intermediaries in the capital markets and strengthen their professional skills. The development and integrity of the legal system need to be promoted to raise the level of supervision over capital markets. Emphasis should be put on co-ordinated efforts to fend off and monitor market risks. Past experiences and lessons learned should be reviewed to steadily promote implementation of the opening-up policy.

1.2.2.3 Circular of the State Council on its Approval of the CSRC's Opinion on Improving the Quality of Listed Companies (2005)

This document discusses how improving the quality of listed companies must be viewed as a priority. Corporate governance must be improved to enhance listed companies' business performance and management and raise their level of standardised operations. Efforts need to be made to address both the symptoms and root causes of the quality issues pertaining to listed companies, especially related to outstanding problems. Effective measures must be taken to help listed companies grow and excel. Their supervision and management mechanisms must be improved and regulatory co-ordination must be strengthened. Better leadership and guidance should be provided to create a favourable environment for the healthy development of listed companies.

1.2.3 Regulatory provisions and normative documents

1.2.3.1 Code of Corporate Governance of Listed Companies (2002)

The *Code of Corporate Governance for Listed Companies* (2002) was drawn up in line with the basic principles established by the original *Company Law*, *Securities Law* and other relevant laws and regulations, and has made a positive contribution to promoting listed companies in China to establish and improve a modern enterprise system, standardise their operations and promote the healthy development of the securities market. The *Code* governs shareholders and shareholders' meetings, listed companies and controlling shareholders, directors and board of directors, supervisors and the supervisory board, performance assessment and incentive and disciplinary systems, stakeholders, and information disclosure and transparency. The *Code* comprises the main measurement criteria used to judge whether a listed company has a sound corporate governance structure. The securities regulatory institution has the power to order the listed companies that have major problems in corporate governance to remedy them according to the *Code*. The CSRC is making active preparations to amend the *Code*, along with the amendments to the *Company Law*, *Securities Law* and other relevant laws and regulations, in order to adapt to the changed market environment, enhance the effectiveness of listed-company governance, encourage them to improve quality and promote the healthy development of Chinese capital markets.

1.2.3.2 Regulations on Listed Companies' Information Disclosure (2007)

These regulations set out the requirements and listing particulars for the issuance of an Initial Public Offering (IPO) prospectus, offering circular, periodic reports, ad-hoc reports, information disclosure management, supervision and legal liability.

1.2.3.3 Guidance on Listed Companies' Articles of Association (2006)

This document provides guidance on business purposes and scope, shares, shareholders and shareholders' meetings, boards of directors, managers and other executives, supervisory boards, financial and accounting systems, profit distribution and auditing, public announcements and notices, mergers, divestments, capital increases and reductions, dissolution and liquidation, and revision of the articles of association.

1.2.3.4 Rules on Listed Companies' Shareholders' Meetings (2006)

These rules relate to the convening of shareholders' meetings, their resolutions and related notifications, and supervisory measures.

1.2.3.5 Guiding Opinions on the Establishment of the System of Independent Directors in Listed Companies (2001)

These opinions provide guidance on independent directors, who must truly be independent and have the necessary qualifications to perform their duties. The nomination, election and appointment of independent directors must be conducted

according to the law and relevant regulations. Listed companies must accord the appropriate importance to independent directors and the role they play. Independent directors must have independent opinions on major issues affecting the listed company, which shall provide its independent directors with the required conditions to fulfil their roles.

1.2.3.6 Provisions on Strengthening the Protection of the Rights and Interests of Public Shareholders (2004)

These provisions cover the introduction of a trial public shareholder voting system on major issues pertaining to a company and the enhancement of the independent directors system, giving more importance to the role played by independent directors. They also seek to improve investor relations management and raise the quality of information disclosure by listed companies, including those with active profit distribution plans, and to reinforce the supervision of listed companies and their senior management.

1.2.3.7 Regulations on the Takeover of Listed Companies (2006)

These regulations outline listed companies' requirements in relation to the disclosure of rights and interests, tender offers, block purchases, indirect purchases, exemption applications, financial advisors, ongoing supervision, supervisory measures and legal liability.

1.2.3.8 Regulations on Major Asset Reorganisation of Listed Companies (2008)

These regulations outline listed companies' requirements in relation to the principles and standards, procedures and information management governing major asset reorganisation. They also include special provisions on issuing shares for asset purchase, applications for issuing new shares or company bonds after a major asset reorganisation, supervision management and legal liability.

1.2.3.9 Regulations on Equity Incentives of Listed Companies (Trial) (2005)

These regulations outline listed companies' requirements in relation to general provisions, restricted shares, stock options, implementation procedures and information disclosure, supervision and penalties for breaches of regulations.

1.2.3.10 Regulations on the Registration and Settlement of Securities (2006)

These regulations outline listed companies' requirements regarding institutions in charge of registering and settling securities, managing security accounts, trusteeship and depository of securities, the clearance and delivery of securities and money, risk prevention and handling delivery defaults.

1.2.3.11 Basic Standard for Enterprise Internal Control (2008)

The Basic Standard covers the objectives, principles and elements that enterprises should establish and implement regarding internal controls, internal environments, risk assessment, control activities, information and communication, and internal supervision.

1.2.4 Self-disciplinary rules

1.2.4.1 Rules Governing the Listing of Stocks on the Shanghai Stock Exchange (2008), Rules Governing the Listing of Stocks on the Shenzhen Stock Exchange (2008)

These rules cover: the general principles and provisions on information disclosure, directors, supervisors and senior management, appointed advisers/investment banks, listing of stocks and convertible bonds, periodic reports, general provisions on ad-hoc reports, resolutions of boards of directors, boards of supervisors and shareholders' meetings, transactions requiring disclosure, related-party transactions, other material matters, suspension and restoration of trading, special treatment, suspension, resumption and termination of listing, applications for review, co-ordination between domestic and overseas listings, day-to-day regulation and dealing with breaches of these rules.

1.2.4.2 Trading Rules of the Shanghai Stock Exchange (2006), Trading Rules of the Shenzhen Stock Exchange (2006)

These rules cover: the trading market, securities trading, other trading-related matters, trading information, supervision of trading activities, handling extraordinary circumstances during trading, trading disputes, trading fees, disciplinary sanctions.

1.3 Institutional framework for the corporate governance of listed companies in China

The institutional framework of China's corporate governance is composed of three parts: the CSRC, the agency in charge of securities and futures markets; corporate governance-related government agencies, such as the Ministry of Finance, the state-owned Assets Supervision and Administration Commission, General Administration of Industry and Commerce, China Banking Regulatory Commission (CBRC), and China Insurance Regulatory Commission (CIRC); and stock exchanges and companies registering and settling securities.

1.3.1 CSRC

The CSRC is a public institution directly under the State Council. Pursuant to relevant laws and regulations, and with the mandate of the State Council, it performs a unified regulatory function over China's securities and futures markets to make sure that market order is maintained and capital market operations comply with the law. CSRC is located in Beijing and has 18 functional departments, one inspection division and three centres. It

also has a public offering review committee and a merger and acquisition reorganisation review committee, composed of both CSRC professionals and invited experts from outside. The CSRC formally became a member of IOSCO in 1995, was elected as a member of the Executive Committee, the IOSCO's decision-making body, for the first time in 1998, and has kept that position since then.

In February 2009, CSRC joined the IOSCO Technical Committee, the standard-setting agency in international securities regulation. CSRC also co-operates actively and extensively with securities regulators in other countries and regions.

The CSRC performs the following regulatory functions in the securities markets:

- devises the relevant rules, regulations and measures for the securities markets according to law, and exercises the right to examine, approve and review according to law; regulate the issuance, listing, trading, registration, custody and settlement of securities according to law;
- supervises securities-related businesses of issuers of securities, listed companies, stock exchanges, securities companies, securities registration and settlement institutions, securities investment fund management companies, and securities services organisations;
- formulates qualification standards and codes of conduct for securities professionals and oversees their implementation, oversees and inspects the issuance, listing and trading of securities and information disclosure, provides guidance and supervision over the activities of securities-industry associations according to law, deals with activities in violation of market supervision and management laws and administrative regulations, and performs other duties as provided for by law and administrative regulations. CSRC can enter into co-operation with counterparts in other countries and regions and carry out cross-border supervision.

The CSRC has established 36 securities regulatory bureaus in the provinces, autonomous regions, municipalities directly under the Central Government and cities specifically designated in the state plan. It also has a Shanghai Commissioner's Office and a Shenzhen Commissioner's Office. With regard to the supervision of listed companies, CSRC has established a local supervision responsibility system that features "local supervision, clear responsibilities, individual accountability and mutual co-operation". This system has further clarified the terms of reference and positioning of the local branches of CSRC, and their role as "on-site" supervisors, and made supervision more timely, targeted and effective. Thanks to this system, regulatory resources have been integrated and strengthened and the work of CSRC has been able to advance in greater depth and with greater momentum.

In order to put the local supervision responsibility system into operation, CSRC has accelerated the construction and improvement of the "comprehensive regulatory framework for listed companies", a framework that involves the participation of many departments and local governments, which will make the regulatory work more authoritative and effective. The main group responsible for "the comprehensive regulatory framework for listed companies" is "the task force for standardised operations of listed companies". This inter-agency task force was established in April 2005 under the mandate of the State Council and with the participation of representatives from 12 ministries including the National Development and Reform Commission, Ministry of Public Security, Ministry of Finance, Ministry of Commerce, People's Bank of China,

state-owned Asset Supervision and Administration Commission, General Administration of Customs, State Administration of Taxation, State Administration for Industry and Commerce, China Banking Regulatory Commission, and China Insurance Regulatory Commission. Its goal was to conduct a joint study on the major issues concerning the standardisation of listed companies, co-ordinate the activities of various departments, form regulatory synergy, and jointly promote standard practices among the listed companies. The task force, since its inception, has accomplished a lot in building a comprehensive regulatory system for listed companies, which is now in place. It has gone a long way towards strengthening co-ordination among relevant supervisory authorities, promoting the non-tradable share reform, preventing the misappropriation of funds by majority shareholders of listed companies and promoting the standardisation of listed companies.

The law enforcement structure of the CSRC comprises four aspects. First, the enforcement bureau, whose main responsibilities include: organising, co-ordinating, guiding and supervising the investigation of cases, case filing and review, enforcing administrative punishment, cross-border law enforcement co-operation and anti-money laundering. Second, the enforcement contingent's major responsibilities include: investigating major cases of insider trading, market manipulation and false statements and other important, urgent or sensitive cases affecting a wide range of sectors and areas. Third, local enforcement bureaus and their enforcement officials, whose major responsibilities include investigating cases within their jurisdictions, informal investigations and all sorts of co-operative investigation. Fourth, the administrative disciplinary bureau, which takes care of the trial of all cases.

1.3.2 Government agencies with a role in corporate governance

1.3.2.1 The Ministry of Finance, a department of the State Council and its responsibilities related to corporate governance mainly include:

1. Drafting laws and regulations pertaining to financial and accounting management, devising and executing regulations and rules of financial and accounting management.
2. Drafting distribution policies between the state and enterprises, managing central government budget that is allocated to support enterprises, drafting and organising the implementation of the General Rules of Finance for Enterprises, supervising the financial affairs of enterprises reporting directly to Central Government, managing the returns on state-owned assets, and administration over the asset-appraisal industry.
3. Drafting and supervising the implementation of accounting rules and regulations and the Accounting Standards for Business Enterprises, drafting and supervising the implementation of the general government budget and the accounting system governing administrative institutions and industries, guiding and supervising the work of certified public accountants and accounting firms, guiding and managing social auditing, and examining and approving the establishment of branches of foreign accounting firms in China.

1.3.2.2 The state-owned Assets Supervision and Administration Commission, a special agency reporting directly to the State Council. Its responsibilities related to corporate governance mainly include:

1. Authorised by the State Council, it performs shareholders' responsibilities according to the *Company Law* and other laws and administrative regulations, supervises and manages the state-owned assets of the enterprises under the supervision of the Central Government (excluding financial enterprises), and enhances the management of state-owned assets.
2. It supervises the preservation and enhancement of the value of supervised enterprises' state-owned assets, including through statistics and auditing, introducing a system that establishes targets/objectives and enhances the value of state-owned assets. It also devises assessment criteria, is responsible for the management of wages and remuneration of supervised enterprises, and drafts and implements policies regulating the income distribution of their senior executives.
3. Guides and drives forward the reform and restructuring of state-owned enterprises, advances the establishment of a modern SOE enterprise system, improves corporate governance, and promotes the strategic adjustment of the layout and structure of the national economy.
4. It names directors and supervisors to state-controlled companies and companies with state-owned assets according to the relevant regulations and the respective companies' articles of association.
5. It is responsible for seeing to it that supervised enterprises turn state-owned capital gains over to the state, participates in devising management systems and methods for the state-owned capital operational budget, which it calculates and implements along with the final accounts, in accordance with related regulations.

1.3.3 Stock exchanges and security registration and settlement company

1.3.3.1 Shanghai and Shenzhen Stock Exchanges

The Shanghai Stock Exchange was founded on 26 November 1990 and the Shenzhen Stock Exchange on 1 December 1990. Both are independent legal entities directly governed by CSRC. They provide venues and facilities for centralised securities trading, organise and supervise securities trading and exercise self-regulatory management. Their functions include: providing a marketplace and facilities for securities trading; drawing up business rules; accepting and arranging listings; organising and monitoring securities trading; regulating members and listed companies; and managing and disseminating market information.

1.3.3.2 China Securities Depository and Clearing Corporation Limited

Founded in 2001, the China Securities Depository and Clearing Corporation Limited is a non-profit legal entity directly governed by the CSRC, providing centralised registration, depository and settlement service for securities trading. Its main functions include: establishing and managing securities and settlement accounts; providing a venue for the depository and transfer of securities; registering securities holders' names and

rights; managing securities and financial clearing and settlement; distributing warrants on behalf of issuers; providing securities registration and settlement of business-related queries, information, advisory and training services according to laws.

Notes

1. Before 1983, SOEs turned their profits over to the government. With the progress of the economic reform, the distributional relationship between the government and the SOEs gradually changed to payment of tax by the latter according to the tax category, item and rate specified by the relevant authorities since 1983.
2. The contract-based responsibility system was an operational and management system that established the respective responsibility, rights and interests of the governments and the SOEs in operational contracts according to the principle of separation of ownership and operations, which allowed enterprises to operate independently and shoulder responsibility for their own profits and losses while complying with socialist public ownership.
3. State-owned assets of enterprises (simplified as "state-owned assets") refer to the rights and interests formed by funding in various forms from the state to the enterprises.

Chapter 2

Shareholders' rights

2.1 Introduction to shareholders' rights

A common practice of Chinese company law theorists is to divide the rights of shareholders into "self-benefit rights" and "co-benefit rights" according to the purposes of exercising the relevant right. The self-benefit right can also be called a beneficiary right, referring to the shareholders' right to seek to acquire economic benefits. These are manifested as rights in economic benefits. Co-benefit rights can also be called shareholders' rights to govern or participate in the relevant company's governance, and are manifested as a number of shareholders' rights to participate in the company's decision-making, operations, management, supervision and control.

As far as the *Company Law* is concerned, in China, shareholders' self-benefit rights include the right to request the distribution of a dividend, the right to request the distribution of residual assets, the right to transfer shares and the right to request share purchases. Shareholders' co-benefit rights include the right to vote, the right to shareholders' representative action, the right to request or convene general meetings of shareholders, proposal rights, enquiry rights, the right to revoke or confirm annulment of decisions of the shareholders' meeting, the right to revoke or confirm annulment of decisions of the board of directors, inspection rights and cumulative voting rights.

2.2 China's practices compared with OECD principles

2.2.1 Principle II A. Basic shareholder rights should include the right to: (1) secure methods of ownership registration; (2) convey or transfer shares; (3) obtain relevant and material information on the corporation on a timely and regular basis; (4) participate and vote in general shareholders' meetings; (5) elect and remove members of the board; and (6) share in the profits of the corporation.

2.2.1.1 Principle II. A (1): Secure methods of ownership registration

According to Article 157 of the *Securities Law*, a securities registration and clearing institution performs the functions of custody and transfer of ownership of securities and registration of the names of the security holders. The Law's Articles 160 and 162 also provide that on the basis of the results of securities registration and clearing, the institution shall confirm the fact that particular securities are held by particular holders and provide registered information on the security holders. It shall ensure the truthfulness,

accuracy and completeness of the register of security holders and the records of registration of change in ownership, that it may not forge, alter or destroy such register or records. The securities registration and clearing institution also carefully preserves the original evidence relating to registration, custody and clearing and important original evidence shall be kept for a period of no less than 20 years. In the early 1990s China set up securities depository and clearing institutions in Shenzhen and Shanghai and in 2001 a merged institution was formed, the China Securities Depository and Clearing Corporation Limited (SD&C). CSRC issued the *Measures for the Administration of Securities Registration and Clearing* in April 2006, providing fairly complete regulations on the registration of stock ownership. According to Article 28 of the *Measures for the Administration of Securities Registration and Clearing*, after a security has been the subject of a public offering, the issuer should submit to the securities registration and clearing institution a list of securities owners and other relevant information on the security issued. On this basis, the securities registration and clearing institution shall carry out initial registration of the list of securities owners. The securities issuer shall guarantee that the information provided be lawful, truthful, accurate and complete.

China realised paperless securities for listed companies at a fairly early stage. The SD&C provides sound back-office support for the transfer of shares and follows universal rules, such as the delivery *versus* payment principle and the principle of mutual counterparties to ensure safety in conveying or transferring shares.

2.2.1.2 Principle II. A (2): Conveying or transferring shares

2.2.1.2.1 Freedom to convey or transfer shares

Article 138 of the *Company Law* provides that shareholders can transfer shares in accordance with the law. Article 39 of the *Securities Law* provides that shares that have been lawfully approved for trading shall be traded on Chinese stock exchanges or other stock exchanges approved by the State Council. Article 102 of the *Securities Law* provides that the State Council shall determine the establishment and dissolution of a stock exchange. The stock exchange provides a venue and facilities where securities are collectively traded and organises and supervises securities trading. According to Articles 111 to 113: investors sign agreements with securities companies, entrusting them with buying and selling securities for them. Entrusted by investors, securities companies will file trading declarations based on the rules of security trading, participate in collective trading and undertake clearing and delivery responsibilities according to transaction results. The securities registration and clearing institutions conduct stock clearing and delivery of securities and capital funds with securities companies in accordance with the rules of clearing and delivery, handle the procedures of security registration and transfer ownership for the clients of securities companies. Stock exchanges provide guarantees for the organisation of fair collective trading.

For a shareholder of a listed company, shares may be transferred directly through stock exchanges' automatic bidding system within trading hours and according to stock exchange trading rules. The securities registration and clearing company will, on the day after the transaction, transfer shares to the counterparty and cash to the seller. In addition to the automatic bidding system, for large-volume transactions, the two sides may choose to use the block-trading system, a transfer procedure, which is similar to that of the

automatic bidding system. In addition, shareholders may also convey or transfer shares by agreement between them.

Article 29 of the *Measures for the Administration of Securities Registration and Clearing* provides that for securities listed and traded on stock exchanges, the securities registration and clearing institution shall update the registration of the list of security owners according to share transfers. For securities transferred through mutual agreement, succession, donation, compulsory enforcement or administrative allocation, the securities registration and clearing company shall adjust the balances of the relevant securities accounts and change the registration of the list of securities owners.

2.2.1.2.2 Restrictions to transfer by certain shareholders

Article 142 of the *Company Law* restricts the transfer of shares by some shareholders. Shares of a company held by its founder may not be transferred for a period of one year starting from the date of the company's establishment. Shares that have been issued before the public offerings shall not be transferred for a period of one year starting from the date of trading of the company's shares on a stock exchange.

Each year the shares transferred within the term of office of the directors, supervisors and executives of the company shall not exceed 25% of the total shares of the company held by them. Their shares of the company shall not be transferred for a period of one year starting from the date of trading of the company's shares on a stock exchange. If these people leave the company, they shall not transfer the shares of the company held by them for a period of six months from the date of their departure. The articles of association may otherwise provide for restrictions on the transfer of the company shares held by its directors, supervisors and executives that are more restrictive than the *Company Law*.

2.2.1.3 Principle II. A (3): Obtaining relevant and material information on the corporation on a timely and regular basis

Article 97 of the *Company Law* provides that a joint-stock limited company shall maintain its articles of association, the record of shareholders, the corporate bond counterfoils, the minutes of general shareholders', board of directors' and board of supervisors meetings, and its financial and accounting reports on the company's premises. Article 98 provides that a shareholder is entitled to inspect the articles of association, the record of shareholders, the corporate bond counterfoils, the minutes of general shareholders' meetings, the minutes of board of directors' and board of supervisors' meetings, and the financial and accounting reports of the company, and is entitled to make a proposal or enquiry concerning the company's operations. Article 146 provides that a listed company shall make public its financial conditions, operating conditions and major legal actions in accordance with the relevant laws and administrative regulations and shall make public its financial and accounting reports half-yearly in each fiscal year. Article 166 provides that the financial and accounting reports of a joint-stock limited company shall be available at the company's premises for shareholders' inspection as from the twentieth day prior to the annual general shareholders' meeting and that a joint-stock limited company established through a public offering shall make public its financial and accounting reports. In addition, the *Securities Law* requires listed companies

and companies whose bonds are traded on the market to disclose more information to investors. The *Securities Law* provides three types of disclosure obligations, annual reports, half-yearly reports and ad-hoc reports. The *Administrative Measures for the Information Disclosure of Listed Companies* promulgated by the CSRC and the *Listing Rules* of stock exchanges also contain relevant regulation. Details in this regard are provided in Chapter Four – Information Disclosure.

2.2.1.4 Principle II. A (4): Participating and voting in general shareholders' meetings

The *Company Law* has no restriction on shareholders' participation in general shareholders' meetings. According to the *Company Law*, when a shareholder attends a general shareholders' meeting, each share he or she holds is entitled to one vote. Shares held by the company itself do not have voting rights. At present, joint-stock limited companies in China only issue common shares.

Chinese companies that are listed both on the Chinese mainland and overseas may issue both domestic currency denominated shares on the mainland and foreign currency denominated shares overseas. According to Article 85 of the *Articles of Association of Companies Seeking a Listing outside the PRC Prerequisite Clauses*, if required by the rules of the stock exchange where the company is listed, the Articles of Association of the company shall contain clauses, such as "shareholders of domestic investment shares and those of foreign investment shares listed outside of the PRC are regarded as shareholders of different categories". These shareholders will participate in the voting of general shareholders' meetings according to their categories.

Article 8 of the *Code of Corporate Governance of Listed Companies in China* promulgated by the CSRC in 2002 provides that "besides ensuring that general shareholders' meetings proceed legally and effectively, a listed company shall make every effort, including making full use of modern information technology, to increase the number of shareholders attending the shareholders' meetings. The time and location of the shareholders' meetings shall facilitate shareholder participation".

The CSRC started to promote the network voting system in 2004. Now the network voting system is actively implemented at general shareholders' meetings on matters related to material rights and shareholders' interests.

2.2.1.5 Principle II. A (5): Electing and removing members of the board

According to Article 100 of the *Company Law*, the general shareholders' meeting shall exercise the authority to elect and replace members of the board of directors. Shareholders may exercise their right to elect or remove members of the board through participation in general shareholders' meetings.

Furthermore, according to the relevant provisions of the *Company Law*, shareholders holding over 3% of shares (individually or collectively) have the right to propose candidates for the board of directors.

2.2.1.6 Principle II. A (6): Sharing in the profits of the corporation

Article 4 of the *Company Law* provides that the shareholders of a company are entitled to assets' benefits. Accordingly, shareholders may participate in the distribution of profits of the company in proportion to their respective shares. The *Company Law* establishes the "same rights for same shares" principle, according to which each shareholder is entitled to dividends on the basis of his or her proportion of ownership. Shareholders who believe that their rights to share in the profits of the company have been infringed upon by a director or company executive may file a lawsuit according to Article 153 of the *Company Law*.

The CSRC's Provisions on Strengthening the Protection of the Rights and Interests of the General Public Shareholders (2004) make it clear that listed companies should implement proactive profit distribution. Guidance for the Articles of Association of Listed Companies (2006) provides that shareholders of listed companies obtain dividends and other forms of interest distribution according to the proportion of shares they hold. In order to guide and standardise dividend distribution by listed companies, CSRC published Decisions on Amending Certain Provisions on Cash Dividends by Listed Companies, requiring that listed companies state their cash dividends policy explicitly in the articles of association and that the profit distribution policy should maintain continuity and stability.

2.2.2 Principle II. B: Shareholders should have the right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.

According to the *Company Law*, shareholders shall exercise the right to vote on the following matters:

2.2.2.1 Principle II. B (1): Amendments to the articles of association

By law, only the general shareholders' meeting has the authorisation to amend a company's articles of association. According to Article 104 of the *Company Law*, a resolution containing changes to the articles of association has to be adopted by the general shareholders' meeting with a two-thirds majority.

2.2.2.2 Principle II. B (2): Authorisation of changes in capital

By law, only the general shareholders' meeting has the authorisation to increase or reduce registered capital. Such a resolution has to be adopted by an absolute majority of voting rights in favour, accounting for two-thirds or more of the voting rights represented by the shareholders attending the General Shareholders' Meeting. In practice, the board of directors usually proposes a change and provides the information to shareholders in advance before the meeting is convened. Article 41 of the *Measures for the Administration of the Issuance of Securities by Listed Companies* gives detailed provisions on the scope of approval by the general shareholders' meeting regarding the issuance of shares by listed companies.

2.2.2.3 Principle II. B (3): Major transactions

According to Article 122 of the *Company Law*, any purchase or sale of major assets within one year or provision of a security in excess of 30% of the total assets by a listed company shall be deliberated and determined at a general shareholders' meeting and the resolution should be adopted by an absolute majority of voting rights in favour, accounting for two-thirds or more of the voting rights represented by shareholders' attending the meeting. In practice, the board of directors announces the relevant information to the shareholders in advance before a general shareholder' meeting is convened.

2.2.2.4 Principle II. B (4): Mergers, divisions, dissolution and changes to corporate form

The adoption of resolutions on these matters also requires affirmative votes by shareholders representing two-thirds of the voting rights at the general shareholders' meeting.

2.2.3 Principle II. C: Shareholders should have the opportunity to participate effectively and vote in general shareholders' meetings and should be informed of the rules, including voting procedures, which govern these meetings.

2.2.3.1 Principle II. C (1): Shareholders' right to receive information concerning the date, location and agenda of general meetings.

Article 103 of the *Company Law* provides that in order to hold a general meeting of shareholders, notice concerning the time, venue and matters to be considered at the meeting shall be given to each shareholder 20 days in advance. In the event of an interim meeting of shareholders, the notice may be given 15 days in advance.

The *Guidance for the Articles of Association of Listed Companies* amended by the CSRC in 2006 further improves the procedures for convening general shareholders' meetings in that companies may, according to their actual circumstances, decide whether to include in their articles of association a procedure for a public summons. Article 55 of the Guidance provides that the notice shall include the date, location and length of the general shareholders' meeting as well as matters and proposals submitted to the meeting for deliberation. Furthermore, the annotation of Article 55 specially requires that the notice and supplementary notice about a general shareholders' meeting shall give full and complete information about all detailed contents of all proposals and items. Article 56 provides that if the election of directors or supervisors is to be discussed at the general shareholders' meeting, full and detailed information about the candidates shall be disclosed in the notice, at minimum including personal information such as educational background, work experience and concurrent jobs, whether the candidate has any related-party relations with the company, its controlling shareholder or actual controller, the person's holding of company's shares and whether the person has been penalized by the CSRC or other competent departments or disciplined by a stock exchange. Article 57 provides that after the announcement is issued a general shareholders' meeting should not be delayed or cancelled without legitimate reason and items listed in the notice shall not be cancelled. If the meeting has to be delayed or called off, the convener shall make the

relevant public announcement and explain the reasons at least two working days before the original date of the meeting.

The *Listing Rules* of Shenzhen and Shanghai Stock Exchanges also require listed companies to make available on designated websites other information necessary for shareholders to make reasonable judgement on matters to be discussed.

In practice, listed companies in China usually announce specific information such as the date, location and issues to be reviewed of the general shareholder meeting in the media, including on the internet.

2.2.3.2 Principle II. C (2): Shareholders' right to propose resolutions and ask questions

2.2.3.2.1 Right to propose resolutions. According to Article 103 of the *Company Law*, shareholders holding 3% of the shares of the company individually or jointly may, ten days prior to the general meeting of shareholders, submit an extraordinary written proposal to the board of directors. The board of directors shall, within two days of receipt of the proposal, inform other shareholders and submit the proposal to the general meeting of shareholders for deliberation. According to Article 22 of the *Company Law* if the board of directors of a company violates the above, shareholders may file a lawsuit in court for revocation of the resolutions of the relevant meeting.

2.2.3.2.2 Enquiry right. Article 98 of the *Company Law* provides that a shareholder is entitled to make a proposal or enquiry concerning the way the company operates. Paragraph 1 of Article 151 further provides that when the general shareholders' meeting requires a director, supervisor or executive to be present, they shall be present and answer the enquiries of shareholders. Article 29 of *the Rules for the General Meetings of Shareholders of Listed Companies*, promulgated by the CSRC in 2006, provides that the directors, supervisors and senior managers shall provide explanations and responses to the enquiries of shareholders at the meetings.

2.2.3.3 Principle II. C (3): Shareholders' right to participate in corporate governance

According to the *Company Law*, at the general shareholders' meeting, shareholders are entitled to elect directors and supervisors, decide their remuneration, put forward proposals, vote on their proposals, put enquiries to the board of directors and executives, appoint and remove external auditors, and amend the articles of association.

Furthermore, according to Article 37 of the *Measures Governing Equity Incentive Plans of Listed Companies (Trial)*, promulgated by CSRC in 2005, general shareholders' meetings shall vote on the equity incentive plans of the company and the plan shall be adopted with two-thirds of the voting rights represented by shareholders attending the meeting.

2.2.3.4 Principle II. C (4): Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

According to Article 107 of the *Company Law*, a shareholder may attend a general meeting of shareholders by proxy. The proxy holder shall present the proxy statement issued by the shareholder to the company, and shall exercise his or her voting rights to the extent authorised by the proxy.

Article 9 of the *Code of Corporate Governance of Listed Companies* provides that shareholders can either be present at the shareholders' meetings in person or appoint a proxy to vote on their behalf, and both means of voting shall have the same legal effect. Article 10 of the Code further provides that the board of directors, independent directors and qualified shareholders of a listed company may solicit shareholders' rights to vote in a shareholders' meeting. No payment shall be made to shareholders for such solicitation, and adequate information shall be provided to the persons whose voting rights are being solicited.

The CSRC introduced online voting in 2004. At present, active efforts are being made to use online voting for any resolution at the general shareholders' meeting that bears on major rights and interests of shareholders. For further information, see Principle III. A (5) of Chapter 3.

2.2.4 Principle II. D Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

When a shareholder attends the general shareholders' meeting, each share is entitled to one vote. The principle of "one share, one vote" is followed in China.

2.2.5 Principle II. E Markets for corporate control should be allowed to function in an efficient and transparent manner.

2.2.5.1 Principle II. E (1): The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

2.2.5.1.1 Article 85 of the *Securities Law* provides that investors may purchase a listed company by tender offer, agreement or other lawful means. Article 86 of the same law provides that where an investor possesses independently or jointly with other person(s) through agreement or other arrangements 5% of the stocks issued by a listed company through trading on the stock exchange, they shall, within three days, submit a written report to the securities regulatory body of the State Council and the stock exchange, notify the listed company, and make a public announcement. They are prohibited from buying or selling company's stocks in

the period prescribed above. When an investor already possesses individually or jointly with other person(s) through agreement or other arrangement 5% of the stock of a listed company, they shall submit a report or make a public announcement in accordance with provisions of the preceding paragraph when the stocks of that company within their relevant joint possession increase or reduce by 5% of the company's total stocks. They are prohibited from buying or selling stocks of that company during the submission of the report and within two days after they make a public announcement. Article 88 further provides that when an investor, through trading on the stock exchange, possesses individually or jointly with other person(s) through agreement or other arrangement 30% of the stocks issued by a listed company and plans to make more purchases, he or she shall make a tender offer for all or part of the company's shares to all shareholders as is required by law. The offer to purchase part of the shares shall include an agreement that when the amount of shares the shareholders commit to sell exceeds the offered amount to be purchased, the purchaser will make the purchase proportionately.

2.2.5.1.2 The Administrative Measures on Takeover of Listed Companies, promulgated by the CSRC in May 2006, contain detailed procedures and information disclosure requirements for tender offer. To facilitate the acquisition of a listed company, the *Measures* also provide for exemptions. In cases consistent with Articles 62 and 63 of the *Measures*, the acquiring party may apply for an exemption on making a tender offer to the CSRC.

2.2.5.1.3 Article 38 of the *Administration Measures for Significant Asset Restructuring of Listed Companies* provides that the shareholders or actual controllers of the listed company and relevant institutions and persons participating in the planning, negotiating and decision-making of significant asset restructuring shall report the relevant information to the listed company on a timely basis and accurately, and assist the listed company in making a disclosure in a timely, accurate and comprehensive manner. When the listed company has any knowledge of price-sensitive information, it shall apply to the stock exchange for trading suspension and disclose the information on a timely basis.

2.2.5.1.4 The *Listing Rules* of the stock exchanges have similar provisions on information disclosure concerning the purchase and significant asset restructuring of listed companies.

2.2.5.2 Principle II. E (2): Anti-takeover devices should not be used to shield management and the board from accountability.

Article 8 of the *Administration Measures on the Takeover of Listed Companies* provides that the directors, supervisors and senior managers of an acquired company shall fulfil the loyalty and diligence obligations and treat all acquirers fairly. The decisions and measures of the acquired company's directorate shall be conducive to maintaining the interests of the company and shareholders. The directorate shall not abuse its authority by setting unnecessary barriers to the acquisition, use the company's resources to provide

financial aid in any form to the acquirers, or damage the lawful rights and interests of the company and its shareholders.

2.2.6 Principle II. F: The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated. Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have put in place for deciding on the use of their voting rights. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

2.2.6.1 Types of institutional investors in China

Institutional investors in China mainly include securities investment funds, social security funds (administered by the National Council for the Social Security Fund), qualified foreign institutional investors, securities firms and insurance companies. According to statistics from the WIND database, up to 31 December 2009, the market value of A shares held by institutional investors accounted for 46.29% of the total market value of free-floated A shares.

2.2.6.2 Ways for institutional investors to exercise their shareholders' rights

Article 11 of the *Code of Corporate Governance of Listed Companies in China*, promulgated by the CSRC in 2002, provides that institutional investors shall play a role in the appointment of company directors, the compensation and supervision of management and major decision-making processes. At present, securities investment funds in China have been proactive in participating in the governance of listed companies, either directly or indirectly.

2.2.6.2.1 Indirect participation. Institutional investors, as important investors of the company, provide recommendations on decisions regarding company management, issue opinions on major corporate decisions and exercise their influence on the board of directors. Generally, after finding a target company, it is necessary for institutional investors to have effective communication and exchanges with the company management. Before further action is taken, institutional investors tend to solicit support from other major shareholders to convey a message of reform to the management, who is required to reform to increase the value of the company. If the company management pays no heed to such reform plans, a dispute over whether the management should be changed will be difficult to avoid.

2.2.6.2.2 Direct participation. Institutional investors, as major investors of the company, participate in the operation and management of the company through the reorganisation of the board of directors, direct intervention in the company's

major decisions, participation in the operation and management and the exercise of voting rights over proposals at the general shareholders' meeting.

Qualified foreign institutional investors do not usually participate directly in voting at the general shareholders' meeting. When convened to a general shareholders' meeting, they often entrust the board of directors of the listed company to vote on their behalf by delegating via the custodian bank.

2.2.7 Principle II. G: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

2.2.7.1 The Company Law provides that the shareholders of a limited liability company or a joint-stock limited company that individually or jointly hold 1% of the total shares may request in writing that the board of supervisors or the supervisors of a limited liability company without a board of supervisors file suit before a people's court. Shareholders holding 3% of the total shares may put forward proposals, while and shareholders holding 10% of the total shares may convene a general shareholders' meeting.

2.2.7.2 Right to solicit voting rights. Article 10 of the Code of Corporate Governance of Listed Companies in China provides that the board of directors, independent directors and qualified shareholders of a listed company may solicit the shareholders' rights to vote in a shareholders meeting. No payments shall be made to the shareholders for such solicitation, and adequate information shall be provided to persons whose voting rights are being solicited.

Chapter 3

The equitable treatment of shareholders

3.1 Introduction to the equitable treatment of shareholders

There are two types of conflict of interest in corporate governance, one between majority and minority shareholders and the other between management and shareholders. These two types of conflicts of interest are manifested in different ways in different ownership structures. Generally, when ownership is spread among many shareholders, the conflict of interest between management and shareholders is more prominent. When the ownership is relatively more concentrated, the conflict of interest between majority and minority shareholders becomes comparatively more prominent. Although the level of ownership concentration decreased after the 2005 non-tradable share reform of the capital market, when Chinese listed companies are compared with those in the UK and the US, they show fairly concentrated ownership structures. Consequently, dealing with conflicts of interest between majority and minority shareholders is a core corporate governance question in China, in order to ensure that shareholders are treated equitably.

There are three aspects to China's institutional framework for the equitable treatment of shareholders.

Firstly, the regime to ensure shareholders' equitable participation in corporate governance includes, but is not limited to: equal voting power, low-cost participation in corporate governance by shareholders, inspection and enquiry rights, cumulative voting rights and the right to make proposals.

Secondly, mechanisms to prohibit or regulate related-party transactions of majority shareholders include withdrawing voting rights from shareholders in a related-party guarantee, forbidding loans to related parties and the duty to compensate if damage is caused in related-party transactions.

Thirdly, when the rights of medium and minority shareholders are infringed upon, mechanisms to ensure effective compensation and remedies include their rights to request the confirmation of the resolutions of general shareholder meetings' and board meetings as null and void and thereby revoke them. They may also request compensation for damage done by controlling shareholders, compensation for damage done by directors or executives of the company, and are entitled to file derivative suits when the company's interest is damaged by other person(s).

3.2 China's practices compared with OECD principles

3.2.1 Principle III. All shareholders of the same series of a class should be treated equally

3.2.1.1 Principle III. A (1): Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares that are negatively affected.

The *Company Law* only provides for common shares and does not include preferred stock, deferred stock or golden shares. Hence in practice, there are no meetings for certain classes of shareholders. Article 104 of the *Company Law* provides that each share a shareholder holds is entitled to one vote.

However, for companies listed not only on the Chinese mainland but also in the US, Hong Kong or elsewhere, shareholders may simultaneously hold A shares and H shares or A shares and N shares. In this situation, these companies need to hold shareholders' meetings for owners of different shares such as A, H or N for resolutions to be adopted separately. According to Article 79 of the *Articles of Association of Companies Seeking a Listing outside the PRC Prerequisite Clauses*, if the Company intends to change or abrogate the rights of shareholders of different categories it may do so only after such changes or abrogations have been approved by way of a special resolution of the general shareholders' meeting and by a separate shareholders' meeting convened by the affected shareholders of the relevant categories.

3.2.1.2 Principle III. A (2): Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.

3.2.1.2.1 Right to convene general shareholders' meetings

Exercising voting rights at general shareholders' meetings is the key channel for shareholders to exercise their rights. Therefore, when the rights and interests of minority shareholders are abused, whether they are entitled to convene a general shareholders' meeting and then exercise their voting rights at the meeting is a key indicator of the level of systematic protection of minority shareholders' rights. Article 102 of the *Company Law* provides that where the board of directors or board of supervisors is unable or does not fulfil its duty to convene a general shareholders' meeting, shareholders individually or jointly holding 10% of the company's shares for 90 consecutive days or more may convene and chair a general shareholders' meeting.

3.2.1.2.2 Cumulative voting rights

According to Article 106 of the *Company Law*, the general shareholders' meeting shall adopt a cumulative voting system when voting on the election of directors or

supervisors in accordance with the articles of association or the resolution adopted by the general shareholders' meeting.

Article 82 of the Guidance for the Articles of Association of Listed Companies and Article 32 of *Rules for the General Meetings of Shareholders of Listed Companies* provide that when the general shareholders' meeting votes on the election of directors or supervisors, the cumulative voting system may be implemented according to the provisions of the articles of association of the company or the resolution of the general shareholders' meeting. Both documents require that companies make provisions in their articles of association pertaining to the method and procedure of appointing directors and supervisors and on cumulative voting rights. Certain Chinese listed companies have already included the cumulative voting system in their articles of association.

3.2.1.2.3 Right to make proposals or motions and the right to proxy voting

Article 103 of the *Company Law* provides that shareholders individually or jointly holding 3% of the shares of the company may, ten days prior to the general meeting of shareholders, submit a temporary written proposal to the board of directors. The board of directors shall, within two days of receiving the proposal, inform other shareholders and submit the proposal to the general meeting of shareholders for deliberation. Article 107 provides that a shareholder may attend a general shareholders' meeting by proxy, on condition that the proxy holder present the proxy statement issued by the shareholder to the company, and exercise the voting rights to the extent authorised by the proxy.

3.2.1.2.4 Voting rights on major matters

According to Articles 104 and 122 of the *Company Law*, a resolution adopted by the general meeting of shareholders requires affirmative votes by a majority of the shareholders attending the meeting. The resolution with regard to an amendment to the articles of association, an increase or reduction of registered capital, a merger, division or dissolution of the company or change in the form of the company as well as any purchase or sale of major assets within one year or provision of a security in an amount in excess of 30% of the total assets for a listed company, should be adopted by an absolute majority of voting rights in favour accounting for at least two-thirds of the voting rights represented.

3.2.1.2.5 Equitable treatment of shareholders during the acquisition of a listed company

3.2.1.2.5.1 Mandatory tender offers. According to Articles 88 and 96 of the *Securities Law*, when an investor, either through trading on the stock exchange or by agreement, owns 30% of the stocks issued by a listed company and plans to make more purchases, he or she shall make either a general or partial offer for a further shareholding increase to the company's stockholders as is required by law. The provision protects minority shareholders from discriminative treatment in the process. The *Administrative Measures on Takeovers of Listed Companies stresses*

that if the acquirer makes a partial offer, the shares of shareholders who accept the offer must be acquired proportionately.

3.2.1.2.5.2 Compulsory buy-outs. According to Article 97 of the *Securities Law*, upon the expiration of a tender offer, where the share distribution of the target company fails to fulfil the listing requirements, the listing of stocks of the said listed company shall be terminated by the stock exchange according to law. Shareholders who still hold the shares of the target company have the right to sell their shares pursuant to equal terms as stipulated in the relevant tender offer. The purchaser shall make the purchase.

3.2.1.2.6 Repurchase request rights of dissenting shareholders.

According to Article 143 of the *Company Law*, where shareholders of the company oppose the decision to merge or divide the company made at a general shareholders' meeting, they may request the company to purchase the shares they hold.

3.2.1.2.7 Shareholder voting avoidance system in security provision to related party

According to Article 16 of the *Company Law*, the security provided by a company to its shareholders or actual controller shall be determined by the shareholders meeting or the company's general shareholders' meeting. Such shareholders or the shareholders headed by the actual controller shall not participate in the voting process on the relevant matters. The vote on such matters shall be adopted by more than half of all the other shareholders attending the meeting.

3.2.1.2.8 System of law suits filed by shareholder representatives

According to Article 152 of the *Company Law*, when a director or executive is involved in the situation as described in Article 150, the shareholders of a limited liability company or a joint-stock limited company that individually or jointly hold 1% of the total shares for 180 consecutive days may make a written request to the board of supervisors to file suit before a People's Court. Where a supervisor is involved in the circumstances described in Article 150, aforesaid shareholders may also make a written request to the board of directors to file suit before a People's Court. Where the board of supervisors or the board of directors refuses to file suit after receipt of the written request mentioned above, or does not file suit within 30 days of receipt of the same, or comes across an emergency where, if no immediate actions are taken, the company's interests shall be incurably impaired, then the shareholders may, in the interest of the company and on their own behalf, directly file suit before a People's Court. Where the company's legal rights and interests are violated by others and in the event of any losses incurred, the shareholders defined above may file suit before a People's Court in accordance with the first two paragraphs of this Article.

3.2.1.2.9 Rights to compensation.

Article 20 of the *Company Law* provides that the shareholders of a company shall exercise their shareholders' rights in compliance with laws, administrative rules and regulations as well as the articles of association of the company. They shall not abuse their shareholders' rights or go against the interests of the company or other shareholders. Where the abuse of shareholders' rights causes any loss to the company or other shareholders, the shareholder who caused abuse shall be liable for compensation in accordance with the law. The law thereby establishes a fiduciary duty obligation for the controlling shareholders or actual controllers towards minority shareholders to prevent them from abusing their shareholders' rights. Article 5 of the

Guidance for the Controlling Shareholder and de Facto Controller of Companies Listed on SME Board issued by the Shenzhen Stock Exchange provides that the controlling shareholder and de facto controller shall shoulder loyalty and diligence obligations towards the listed company and minority shareholders. If their own interest is in conflict with that of the listed company or the minority shareholders the interests of the latter should be placed above their own.

3.2.1.3 Principle III. A (3): Votes should be cast by custodians or nominees in a manner agreed upon with the owner of the shares.

According to Article 107 of the *Company Law*, a shareholder may attend a general shareholders' meeting by proxy. The proxy holder shall present the proxy statement issued by the shareholder to the company, and shall exercise the voting rights to the extent authorised by the proxy. Article 9 of the *Code of Corporate Governance of Listed Companies in China* further provides that shareholders may either be present at the general shareholders' meetings in person or appoint a proxy to vote on their behalf. Both means of voting have the same legal effect.

3.2.1.4 Principle III. A (4): Impediments to cross-border voting should be eliminated.

Foreign shareholders of Chinese listed companies may directly participate in voting. There is no legal restriction to prevent this.

3.2.1.5 Principle III. A (5): Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

3.2.1.5.1 Rights to be informed about notice of a general shareholders' meeting

Notices of general shareholder meetings are all published in media available to the public. Minority shareholders may receive notices of general shareholders' meetings at a low cost. Chinese law places do not require a shareholder to hold a particular number of shares to be eligible to attend a general shareholder meeting.

3.2.1.5.2 Right to make proposals

Article 103 of the *Company Law* provides that shareholders individually or jointly holding 3% of the shares of the company may, ten days prior to the general shareholders' meetings submit a written proposal to the board of directors.

3.2.1.5.3 Rights to online voting

In order to protect the legitimate rights and interest of public shareholders, in December 2004 the CSRC promulgated the *Regulations on Safeguarding Public Investors' Interests*. This document requires listed companies to provide an online voting platform for its shareholders when the general shareholders' meeting discusses the following matters:

(1) A public offering of new shares of the listed company (including overseas listed foreign shares or other types of warrants with a nature of shares), a public offering of corporate convertible bonds, and attribution of new shares to existing shareholders (except where the shareholder holding de facto control undertakes to make full cash subscriptions for the new shares before the general shareholders' meeting is convened);

(2) A major asset restructuring in which assets are acquired at a premium of more than 20% of the audited net assets value;

(3) Repayment of debt owed by a shareholder in the form of equity reduction;

(4) Overseas listing of subsidiaries that are significant to the parent company. According to the relevant provisions of the *Guidance for the Articles of Association of Listed Companies in China,* all listed companies in China have included in their articles of association clauses pertaining to providing facility for shareholders to attend general shareholders' meetings via the internet. In 2004, both stock exchanges issued *Detailed Rules on the Implementation of Online Voting at General Shareholder Meetings of Listed Companies*, providing detailed rules for public shareholders to vote online.

3.2.2 Principle III. B: Insider trading and abusive self-dealing should be prohibited.

3.2.2.1 Principle III. B (1): Prohibition of insider trading

By the end of the first half of 2010, the CSRC had investigated and taken action against 59 cases of insider trading. However, to date, there have been no civil suits involving insider trading.

3.2.2.1.1 The *Securities Law* makes the "prohibition of insider trading" a basic principle (Articles 5 and 73). Article 76 of this law clearly provides that any insider who has access to insider information or has unlawfully obtained any insider information on securities being traded may not purchase or sell the securities of the relevant company, or divulge such information, or advise any other person to purchase or sell such securities. Where any insider trading incurs any loss to investors, the person responsible shall be subject to the liabilities of

compensation according to law. To define insider trading, the *Securities Law* also gives detailed provision on the scope of insiders and insider information (Articles 74 and 75).

3.2.2.1.2 Criminal liabilities of insider trading. According to Article 180 of the *Criminal Law of the People's Republic of China*, any insider who possesses inside information about any stock exchange transactions or anyone who illegally obtains such information, prior to the publication of the information that concerns stock issuing or trading or that has a vital bearing on the stock price, buys or sells the very stock or divulges the very information shall be subject to criminal detention and/or confiscation of any illegal gains. If the circumstances are serious, they may be sentenced to fixed-term imprisonment of no more than five years.

3.2.2.1.3 Administrative liability. According to Article 202 of the *Securities Law*, if an insider who has access to insider information of securities trading, or any person who has obtained insider information purchases or sells the securities, divulges the relevant information or advises any other person to purchase or sell the securities before disclosure of the information regarding the issuance or trading of securities or any other information that may have any significant impact on the price of the securities, he or she shall be ordered to dispose the securities as illegally held thereby according to law. The illegal proceeds shall be confiscated and a fine of 1 to 5 times the illegal proceeds shall be imposed. Where there are no illegal proceeds or the illegal proceeds are less than CNY 30 000 (EUR 3 255), a fine of CNY 30 000 (EUR 3 255) up to CNY 600 000 (EUR 65 100) shall be imposed. If an entity is involved in any insider trading, the person in charge and any other person directly responsible shall be given a warning and imposed a fine of CNY 30 000 (EUR 3 255), up to CNY 300 000 (EUR 32 550).

Any official from a securities regulatory body that conducts any insider trading shall be given a heavier punishment.

3.2.2.2 Principle III. B (2): Regulation of related-party transactions

3.2.2.2.1 Shareholder voting avoidance system. Article 16 of the *Company Law* provides that where the company provides guarantees to its shareholders or actual controller, the shareholders or shareholders controlled by the actual controller shall not vote on the matter.

3.2.2.2.2 Prohibition of lending to related parties. Article 116 of the *Company Law* provides that a joint-stock limited company must not lend money to its directors, supervisors or executives either directly, or through its affiliate companies.

3.2.2.2.3 Decisions and disclosure of remuneration to the directors, supervisors and executives. According to Article 100 of the *Company Law*, the remuneration of the directors, supervisors and executives of shareholding companies shall be

determined by general shareholders' meetings. Article 117 of the law further provides that a joint-stock limited company shall disclose the remuneration of its directors, supervisors and executives on a regular basis.

3.2.2.2.4 Director voting avoidance system. According to Article 125 of the *Company Law*, the director of a listed company related to the enterprise involved in the matters discussed by the board of directors shall not exercise his or her own voting rights, or represent other directors to exercise voting rights on such matters. The meeting of the board of directors may be held when more than half of the unrelated directors are present. The resolution made by the board shall be adopted by more than half of all such directors. Where there are not more than three unrelated directors, the relevant matters shall be forwarded to the general meeting of shareholders for deliberation.

3.2.2.2.5 General prohibition of related-party transactions by directors and executives. Article 149 of the *Company Law* provides that the director and executive may not execute any contract or engage in any transaction with the company in violation of the articles of association or without the approval of the general shareholders' meeting.

3.2.2.2.6 Damage compensation liability. Article 21 of the *Company Law* provides that the controlling shareholders, actual controllers, directors, supervisors or executives of a company shall not take advantage of their affiliations with others in an attempt to harm the company's interests and where any losses are incurred in related violation, shall be liable for compensation.

3.2.2.2.7 Criminal liability. The Amendment 6 to the *Criminal Law* adopted in 2006 provides that where any director, supervisor or senior manager of any listed company goes against his or her fiduciary duty to the company and takes advantage of his or her position to manipulate the company in unfair, inequitable related-party transactions to transfer assets of the listed company resulting in it suffering serious loss, he or she shall be sentenced to fixed-term imprisonment of no more than three years, or detention, and/or shall be fined. If the listed company suffers from extremely serious losses, the person shall be sentenced to fixed-term imprisonment of no fewer than three years but no more than seven years, and shall be fined.

3.2.3 Principle III. C: Members of the board and key executives should be required to disclose to the board if they have a material interest in any transaction or matter directly affecting the corporation, either directly, indirectly or on behalf of third parties.

Article 21 of the *Company Law* provides that the controlling shareholders, actual controllers, directors, supervisors or executives of a company shall not take advantage of their affiliations with others in an attempt to harm the company's interests and, where any losses are incurred in related violation, the company shall be liable for compensation. Article 149 of the *Company Law* contains a non-compete clause, prohibiting transactions with the company in violation of the articles of association and other prohibitions. Article 48 of the *Administrative Measures on Information Disclosure by Listed Companies* promulgated by the CSRC provides that the directors, supervisors, executives,

shareholders with 5% or more of shares, and persons acting in concert with such shareholders and de facto controllers of a listed company shall submit a list of the listed company's interested parties and an explanation of the interested-party relationships to the board of directors of the listed company. The listed company shall perform review procedures for interested-party transactions and strictly implement a system of vote abstention in interested-party transactions. The parties involved in an interested-party transaction must not circumvent the listed company's interested-party transaction review procedures and information disclosure obligations either by concealing the interested-party relationship or by any other means.

Chapter 4

Information disclosure

4.1 Introduction to information disclosure

Disclosing information is a legal obligation for listed companies. This does not only directly influence transparency and pricing efficiency – the critical basis upon which investors make investment decisions – on the securities market, but also serves as the lawful foundation of its principles "openness, fairness and impartialness" and the core of supervision over the market. In the course of capital market development and corporate governance reform, all the Chinese legislative bodies and relevant government agencies, regulatory institutions and self-regulatory organisations have attached great importance to the development of corporate information disclosure, and actively promoted its improvement in terms of quality and transparency. Some positive progress has been achieved in the form of an Omni-directional and multi-tier information disclosure regulatory framework. The laws that make up the bulk of this framework are supplemented by regulatory documents, such as relevant administrative laws and provisions, as well as ministerial rules and regulations. The regulations are consistent with international practices regarding normative principles, operational specifications, and disclosure methods and contents. Overall, information disclosure by listed companies has improved year by year, with constant progress in terms of the accuracy, scope and depth of disclosed information as well as its use by investors and intermediaries.

At the same time, Chinese accounting standards and auditing standards are of a high quality and have met recognised international standards. The Chinese Accounting Standards Board signed the joint declaration with the International Accounting Standards Committee, indicating that Chinese accounting standards have achieved substantial convergence with international financial reporting standards.

4.1.1 Basic principles of information disclosure

Information disclosure is not only a legal obligation for listed companies but also the key channel for investors to keep track of them and for regulatory agencies to supervise them. Listed companies must take responsibility for the veracity, accuracy and completeness of the disclosed information. Article 63 of the *Securities Law* stipulates that the information disclosed by issuers and listed companies in accordance with the law must be authentic, accurate and complete, and may not contain false records, misleading statements or major omissions. Listed companies shall observe the following principles in disclosing information:

1. Principle of authenticity. The information disclosed by listed companies must be objective, consistent and standardised and may not contain false records.
2. Principle of accuracy. The information disclosed by listed companies must be accurate and may not use vague expressions or misleading statements that cause confusion.
3. Principle of completeness. Listed companies must make public the relevant information in compliance with laws, regulations and rules of securities regulatory institutions and stock exchanges and no major omissions are allowed.
4. Principle of timeliness. Listed companies must disclose relevant information insofar as is possible without delay.
5. Principle of fairness. Listed companies must treat all their investors in the same manner and must not disclose information to some certain investors only.

4.1.2 Basic contents of information disclosure

The *Administrative Measures on Information Disclosure by Listed Companies* stipulate that if the occurrence of a significant event is likely to have a marked impact on the trading prices of a company's securities and derivatives, and the investors have yet to be informed, the listed company shall make a timely disclosure to declare the cause, the current status and the likely effect of the event. Thus, information disclosure shall not only refer to the reports that shall be disclosed regularly in accordance with the law, but also those transactions, which require timely disclosure by law.

4.1.2.1 Information disclosure relating to issuance

The Company Law, Securities Law, Administrative Measures on Information Disclosure by Listed Companies and the Standards on the Contents and Formats for Information Disclosure by Companies Offering Securities to the Public have made provisions on information disclosure related to issuance, including the disclosure of important documents such as prospectuses, statements of public security offerings by listed companies, statements of public bond offerings by listed companies, plans for private stock offerings and outcome reports, reports of major asset reorganisations by listed companies and the listing particulars.

The main contents that should be disclosed are: basic information on the issuance and the issuer, major risk factors, the main business of the issuer and the industrial circumstances, horizontal competition and related-party transactions, the remuneration, irregular income, etc. of directors, supervisors, senior management and core technology personnel, corporate governance, financial and accounting conditions, discussions and analysis of management and business development targets, the situation of funds obtained through public or private offering and dividend policies.

4.1.2.2 Regular reports

The *Company Law* and *Securities Law* stipulate that listed companies shall disclose regular reports on a timely basis. These include annual reports, half-yearly reports and

quarterly reports. *Administrative Measures on Information Disclosure by Listed Companies* and the *Standards on the Contents and Formats for Information Disclosure by Companies Offering Securities to the Public*, the Rules of Contents and Formats for Information Disclosures by Companies Offering Bonds to the Public, etc. contain detailed stipulations on the contents and formats of regular reports.

4.1.2.2.1 Annual reports. Listed companies and companies whose bonds are traded on stock exchanges shall submit annual reports to the CSRC and stock exchanges, and announce them within four months after the end of every accounting year. Annual reports shall disclose the basic information about the company, key accounting data and financial indices, information on shareholders, information on the appointment of directors, supervisors and executives, changes to their shareholdings, their annual remuneration, operating conditions, major events, the board of directors' report, management discussions and analysis, the financial accounting report and auditing report, etc.

4.1.2.2.2 Semi-annual reports. Listed companies and companies whose bonds are traded on stock exchanges shall submit half-yearly reports to the CSRC and stock exchanges. These reports should be announced within two months of the end of every first-half of each accounting year. The half-yearly report shall disclose basic information about the company, main accounting data and financial indices, and any changes among the controlling shareholders and actual controlling parties of the company, management discussions and analysis, major matters in litigation or arbitration, and other significant events that occurred during the reporting period and their effect on the company, the financial accounting reports, etc.

4.1.2.2.3 Quarterly reports. A quarterly report shall be compiled and disclosed within one month of the end of every quarter. The time of publication of the first quarterly report shall not be earlier than the time of publication of the annual report for the preceding year. A quarterly report shall include basic information about the company, main accounting data and financial indices, etc.

4.1.2.3 Ad-hoc reports

Unlike regular reports, ad hoc reports are one-off announcements. The *Administrative Measures on Information Disclosure by Listed Companies* require that where the occurrence of a significant event is likely to have a marked impact on the trading prices of a company's securities and derivatives, and the investors have yet to be informed, the listed company shall make a disclosure to declare the cause, the current status and the likely effect of the event on a timely basis. These events may be divided into transactions and non-transactions, and transactions may be divided into general transactions and related-party transactions.

4.1.2.3.1 Transactions. Transactions refer to the activity of transferring resources or obligations between the listed company or its holding subsidiaries and trading partners. These transactions are not usually directly connected to the company's

production or operations and occur in a non-recurrent (or sporadic) manner. They include: activities outside the company's daily business operations, such as asset purchases and divestments, external investments, providing financial aids and guarantees, asset renting and leasing, management contracts, donations, debt restructuring and the transfer of R&D projects. Detailed standards for accounting transactions that require disclosure are clearly stipulated in the *Administrative Measures on Information Disclosure by Listed Companies* and the *Measures for the Administration of Material Asset Reorganisations by Listed Companies*, the *Listing Rules* made by the stock exchanges. The information disclosed includes the announcement of transactions, relevant agreements and contracts. If there are related board decisions, government approvals, financial reports of the transaction, appraisal reports, auditing reports, legal opinion papers or financial consultation reports issued by intermediaries, they should also be disclosed.

4.1.2.3.2 Related-party transactions. Related-party transactions refer to the transfer of resources or obligations to and from the listed company, its subsidiaries and related-party entities. The *Securities Law* and *Administrative Measures on Information Disclosure by Listed Companies*, etc. prescribed requirements for undertaking related-party transactions. A related-party transaction shall disclose the voting results of the board of directors, the time at which an agreement is signed, the time and place of the transaction, the relationship between all the related parties, the subject of the transaction, pricing policies, main contents of the contract, the purpose of the transaction, its implications for the listed company and conditions enabling the transaction to come into effect, etc. More specifically, it should include the opinions of independent directors, reports by relevant intermediaries, the situation concerning to the withdrawal of related directors from board voting, special explanations by the board on whether this related-party transaction is beneficial for the listed company, board of directors' decisions, the agreement on the related-party transaction, records of disagreement or reservations on the part of directors who do not wish to speak at the board meeting.

4.1.2.3.3 Announcement of non-transactions. Non-transactions mainly include information on shareholders, the board of directors, the board of supervisors, the announcement of decisions taken at the shareholders' meeting, the distribution of dividends, converting the reserved funds into increased capital, changes to issued funds, significant matters on litigations and arbitrations, business result forecasts, etc. The scope of significant events is stipulated in the *Securities Law, Administrative Measures on Information Disclosure by Listed Companies, Listing Rules*, etc.

4.1.2.3.4 Information disclosure on acquisition.

In accordance with the *Administration Measures on the Takeover of Listed Companies*, if shares held by an investor represent 5% of a listed company's issued shares, the investor shall make a report on the alteration to share entitlement within three days after the fact, submit a written report to the supervisory bodies, notify the listed company and make a public announcement. Investors may not buy or increase the stocks

of the aforementioned listed company again before making the public announcement. Once shares held by an investor reach 5% of a listed company's issued shares, or if the shares in question increase or decrease by 5% in securities transactions on the stock exchange, the investor shall provide a report and make an announcement within three days after the fact, and shall not buy shares within five days and may not increase shares before making a public announcement. When a purchaser holds 30% of shares, and continues to increase the stake, a general or partial tender offer is required, unless exemption is obtained from the CSRC.

In addition to the above conditions, the Shenzhen and Shanghai Stock Exchanges have both issued documents entitled *Guidance on Internal Control of Listed Companies*, with a chapter dedicated to information disclosure regarding internal control. The chapter provides that a listed company should report to its board of directors on a timely basis when it finds major flaws or risks in internal control during its inspection or supervision process. The matter should be reported to the relevant stock exchange by the board of directors on a timely basis. Upon confirmation by the stock exchange, the board of directors should issue a public notice, in which the relevant flaw in internal control, its consequence, accountability and proposed remedies should be described.

4.1.3 The Construction of Extensible Business Reporting Language (XBRL)

Stock exchanges have been receiving annual reports submitted by listed companies through XBRL since December 2008. The Shanghai Stock Exchange can even receive half-yearly reports and quarterly reports through XBRL. At the Shenzhen Stock Exchange, the XBRL service platform has the function to search and display information and customers can download the XBRL documents with regular reports of all listed companies.

4.2 China's practices compared with OECD principles

4.2.1 Principle V. A Disclosure should include, but not be limited to information on: 1. companies' financial and operating results; 2. company objectives; 3. major share ownership and voting rights; 4. remuneration policy for members of the board and key executives, and information on directors, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board; 5. related-party transactions; 6. foreseeable risk factors; 7. issues regarding employees and other stakeholders; 8. governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.

4.2.1.1 Principle V. A (1): Financial and operating results of the company

4.2.1.1.1 Regularly published financial reports

Article 165 of the *Company Law* stipulates that a company shall prepare its financial reports and accounts after the end of each financial year, and they shall be audited by an accounting firm in accordance with the law.

When disclosing annual financial reports, Chinese listed companies are required to observe the *General Regulations on Financial Reports* issued by the CSRC. Chinese law stipulates that annual reports shall be audited by accounting firms qualified to carry out audit securities and futures activities, and the auditing reports shall be stamped by the aforesaid firms and (?) stamped or signed by two or more of their registered accountants. The annual reports of the company compiling and consolidating financial statements, consolidated companies and special purpose entities (SPEs), as well as those of affiliated companies and joint ventures, which have enormous influences upon a company's annual reports, shall be audited by the accounting firm qualified to audit the items pertaining to securities and futures activities. Financial statements disclosed shall include the balance sheet, profit statement, cash flow statement, and statement of any changes in equity. The company that compiles consolidated financial statements shall also provide the financial statements of its parent company separately. The listed company shall compile and publish notes to financial statements. The principle of priority shall be applied in compiling and disclosing those notes. Notes to financial statements shall provide clear, accurate and comprehensive explanations on transactions and events mentioned therein.

In accordance with the *Administrative Measures on Information Disclosure by Listed Companies*, besides publishing annual reports, half-yearly reports must be prepared and disclosed within two months of the end of the first half of each fiscal year; and quarterly reports shall be prepared and disclosed within one month of the end of each fiscal year's third and ninth months. The half-yearly reports and quarterly reports do not need to be audited by external accountants, but they have to comply with the contents and formats set by the CSRC.

4.2.1.1.2 Regular disclosure of management discussions and analyses

The *Standards on Contents and Formats for Annual Reports* and the *Standards on Contents and Formats for Half-yearly Reports* stipulate that listed companies shall discuss and analyse major events that occur in the reporting term in the Director's Report section to facilitate investors' understanding of operating results and financial conditions. These discussions and analyses shall not merely repeat the contents of financial reports, but focus on major events and uncertainties, which may cause difficulties, and which are difficult for financial reports to reflect. These may concern the company's future operating results and financial conditions and matters that influence them, but also matters that have a significant effect on the reporting term, but not on the future.

4.2.1.2 Principle V. A (2): Company objectives

A company is an organisation set up to make a profit through business activities or for other purposes. The *Company Law* stipulates that in seeking to make a profit, a company shall also take into consideration the interests of its creditors, employees and the general public, and assume its social responsibility.

Often, the objectives of a company are recorded in its Articles of Association. The *Guidance for the Articles of Association of Listed Companies* stipulates that a listed company shall explicitly define its business aims when developing its Articles of Association.

In addition to the Articles of Association, the *Standards on the Contents and Formats for Annual Reports* stipulates that a listed company shall describe in the Director's Report section of its annual report its vision for the company's future, including its strategy for corporate development in the future, new business, new products to be developed, new projects requiring investment, as well as the related plans for financing and funding. Moreover, the company shall also disclose all possible risks, which may adversely influence the corporate development strategy and the achievement of its business goals.

4.2.1.3. Principle V.A (3): Major ownership and voting rights

4.2.1.3.1 Information disclosure requirements for Initial Public Offerings (IPO)

In accordance with the *Securities Law* and relevant CSRC regulations, and before making an IPO and going public, a company shall provide detailed information in its prospectus on the founder, the major shareholders holding 5% or more of the shares, the actual controllers, the controlling shareholders, and other enterprises controlled by the controlling shareholders and actual controllers, and changes to stock ownership since the establishment of the company. The *Company Law* defines an actual controller as anyone who is not a shareholder but is able to hold actual control over a company's acts by means of investment relations, agreements or other methods. Opinion No.1 in *The Application of Securities and Futures Laws: the Interpretation and Application of "no alteration of the actual controller"* in Article 12 of the *Measures for the Administration of Initial Public Offering and Listing of Stocks*, the control of a company refers to the power to exert an influence on the resolutions of shareholders' meetings or to control the company as a result of direct or indirect equity investment in the company. In this connection, in order to determine the control of a company, corresponding equity investments should be reviewed and analysis should be made concerning the substantive influence by the relevant persons on the decisions of shareholders' and board meetings and on the nomination and appointment of directors and senior executives according to the specific situations. Any information disclosure concerning a company's actual controllers shall be extended to the persons, state-owned asset management bodies or other organisations, or persons who have reached certain agreements or assented to certain arrangements among the shareholders, including the situation where actual control is realised by means of trust.

4.2.1.3.2 Information disclosure requirements for periodic reports

In line with relevant CSRC regulations, all listed companies shall disclose information on the ownership and voting rights of its major shareholders in annual reports and half-yearly reports. This information should include: the total number of shareholders by the end of the reporting period, basic information and shareholding information for shareholders holding 5% or more of the company's stock, as well as changes in shares within the reporting period. Any listed company, when disclosing its annual report, shall disclose the information on the actual controllers and the property and control relationships between the company and its actual controllers.

4.2.1.3.3 Information disclosure requirements for major equity changes

All listed companies in China shall disclose information when certain thresholds of ownership are passed. In accordance with the *Administration Measures on the Takeover of Listed Companies*, a change-in-equity report should be compiled when the equity of an investor and persons acting in concert with that investor reaches 5% or more of a listed company's total issued shares by trading on the stock exchanges, within three days after the fact. Moreover, a written report shall be submitted to the CSRC and the stock exchanges, and a copy filed to the CSRC branch(es) in the place where the listed company's headquarters are located. The listed company shall also be informed, and a change-in-equity announcement made.

When the equity of an investor and persons acting in concert with that investor reaches 5% of a listed company's total issued shares, this must be reported and announced in line with the preceding paragraph, when shareholdings are increased or decreased by 5% through trading on the stock exchanges.

The said investor and persons in concert with that investor may not purchase or sell company shares until the report and announcement are made.

4.2.1.4. Principle V.A (4): The remuneration policy for members of the board and key executives, and information on directors, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.

4.2.1.4.1 Basic information on directors, supervisors and senior managers

The *Standards on Contents and Formats for Annual Reports* stipulate that any listed company shall disclose certain information on its directors, supervisors and senior managers, including:

- Their names, gender, age, term of office, shares held at the beginning and end of the reporting year, stock options, amount of restricted shares conferred, changes in shares within the reporting year and reasons for the changes.
- The directors, supervisors and senior managers shall meet the qualifications provided by the *Company Law* and the *Guidance for the Articles of Association of the Listed Companies* (see "Chapter V Responsibilities and Supervision of the Board of Directors (V) Principle VI.E").
- If a director is independent, this shall be indicated separately. For more information about the independent director standards and system, please refer to "Chapter V Responsibilities and Supervision of the Board of Directors (V) Principle VI.E".
- Major working experience over the past five years. If any director holds a position in a shareholder's company, his duties in the company and directorships in other companies shall also be indicated.

4.2.1.4.2 Qualifications and independence

Article 147 of the Company Law provides that a person in any of the following categories may not serve as a director, supervisor, or senior executive of a company: (1) a person without civil capacity or with limited civil capacity; (2) having been sentenced to criminal punishment for crimes of embezzlement, bribery, conversion of property, misappropriation of property, sabotage of socialist market economic order in the previous five years, or having been deprived of political rights as a result of a criminal conviction in the previous five years; (3) having served as a director, factory chief, or general manager of a company or enterprise, which filed for bankruptcy or liquidation and being personally responsible for such bankruptcy in the previous three years; (4) having served as the legal representative of a company or enterprise whose business licence was revoked due to violation of the law and being personally responsible for such revocation in the previous three years; or (5) in default of personal debt of a significant amount. The *Guiding Opinion on the Establishment of the Independent Directors' System by Listed Companies* (2001) provides qualifications for independent directors of listed companies. The CSRC *Notice on General Managers and Executives of Listed Companies May Not Hold Concurrent Positions in the Organisations of Controlling Shareholders* states clearly that the general manager of a listed company must work full-time and may not hold any post other than a director in the organisation of the controlling shareholder and that general managers and executives (deputy general manager, chief financial officer and secretary of the board of directors) must be remunerated by the listed company and may not receive a salary from the controlling shareholder.

4.2.1.4.3 Remuneration of directors, supervisors and senior managers

The *Company Law* stipulates that a company shall disclose to its shareholders the payment received by its directors, supervisors and senior managers.

The *Standards on Contents and Formats for Annual Reports* provide that the total pre-tax remuneration (including basic pay, bonuses, allowances, subsidies, welfare benefits, insurance premiums, accumulation funds, annuities and other forms of payment by the company) received by the directors, supervisors and senior managers of a listed company within the reporting period shall be disclosed. Moreover, stock options shall also be indicated separately in line with the volume of outstanding shares, volume of strike shares, the strike price and market price by the end of the reporting period.

Apart from remuneration information, all listed companies shall also disclose information on the decision-making process concerning the remuneration of directors, supervisors and senior managers, the basis on which remuneration is established, and the actual payment of the remuneration.

The *Code of Corporate Governance of Listed Companies* stipulates that the board of directors of a listed company may establish a remuneration and appraisal committee in accordance with the resolutions of the shareholders' meetings. It shall be composed solely of directors and chaired by an independent director, and independent directors shall constitute the majority of the committee. The main duties of the remuneration and appraisal committee are to study the appraisal standard for directors and management personnel, to conduct an appraisal and make recommendations, and to study and review the remuneration policies and schemes for directors and senior managers.

Senior managers of a listed company may not receive payment from any other company controlled by the controlling shareholders and actual controllers of the listed company. In case the directors and supervisors do not receive any payment or subsidies from the company, it must be explicitly indicated whether they receive any payment or subsidies from the shareholders' companies or any other associated organisations.

In accordance with the *Administration Measures on Equity Incentives of Listed Companies,* a listed company's equity incentive plan shall be approved by a vote of more than two-thirds of the directors attending the shareholders' meeting, and the resolution and related documents shall be disclosed on a timely basis. A listed company shall disclose the implementation of the equity incentive plan in its periodic report within the reporting period, including: the scope of incentives within the reporting period; the aggregate amount of rights and interests granted, exercised and invalidated within the reporting period; all previous adjustments to the granted price and strike price within the reporting period; exercise of incentive rights objects; equity changes due to the exercise of incentive rights objects; and accounting methods dealing with equity incentives.

4.2.1.4.4 Election of directors, supervisors and senior managers

The *Company Law* stipulates that the non-employee directors and supervisors of a joint-stock company shall be elected during the shareholders' meeting; all employee representatives who serve as a director or supervisor shall be elected by employees through the employee representatives' meeting. CSRC has laid down the requirements and standards for the election and appointment process of directors and supervisors. These stipulate that a listed company shall provide for the election and appointment process of directors and supervisors in its Articles of Association. Detailed information on candidate directors and supervisors shall be disclosed in advance before the shareholders' meeting is convened in order to ensure that the shareholders have sufficient information about the candidates when voting. The resolution of the shareholders' meeting on the election of directors and supervisors shall be announced in a timely manner in the newspapers and on the websites designated by the stock exchanges.

The *Company Law* provides that the board of directors shall decide on the employment of managers and their remuneration, as well as the employment of other senior managerial personnel in line with nominations put forward by managers. Any decision of the board of directors on the employment and appointment of managers and other senior managerial personnel shall be announced in the newspapers and on the websites designated by the stock exchanges on a timely basis.

The *Code of Corporate Governance of Listed Companies* stipulates that the board of directors may establish a nomination committee in accordance with the resolutions of the shareholders' meetings. It shall be composed solely of directors, chaired by an independent director, and independent directors shall constitute the majority of the committee. The main duties of the committee are to study standards and procedures for the election of directors and make recommendations, to extensively seek qualified candidates for directorship and management, and to review the candidates for directorship and management and make recommendations.

4.2.1.5 Principle V.A (5): Related-party transactions

4.2.1.5.1 Affirmation of related-party relationship

Related-party transactions are a key issue for the corporate governance and supervision of China's listed companies. The *Company Law* stipulates that the related-party relationship refers to the relationship between company's controlling shareholders, actual controllers, directors, executives and the enterprises it controls directly or indirectly, and other relationships which may influence the company's current shareholding structure. However, state-owned holding enterprises are not considered to be in a related-party relationship merely because they are controlled by the state as well.

The affirmation of related-party relationships has been stipulated in the *Listing Rules* of the stock exchanges in detail: the connected persons of the listed companies shall include the connected legal personalities or entities and natural persons or individuals, among which:

The connected legal personalities shall include: (1) the legal person directly or indirectly who controls the listed company; (2) and the directly or indirectly controlled legal person (excluding the listed company and its subsidiaries); (3) the legal person directly or indirectly controlled by the connected natural person of the listed company or taking the positions as directors and executives (excluding the legal person from the listed company and its subsidiary); (4) the legal person holding more than 5% of the shares of the listed company; (5) and other legal persons determined by the CSRC, stock exchanges or listed companies in accordance with the principal of "substance overweighs forms" having a special relationship with the listed company, which may result in the interests of the listed company favouring them.

The connected individuals shall include: (1) the natural person who directly or indirectly holds more than 5% of the shares of the listed company; (2) the directors, supervisors or executives of the listed company; (3) the directors, supervisors or executives of the connected legal persons; (4) the family members having a close relationship with the persons mentioned in Item (1) and (2) of this Article, including the spouse, parents, parents of the spouse, brothers and sisters and their spouses, the children aged 18 years old or above and their spouses, brothers and sisters of the spouses, as well as parents of their children's spouses; (5) other natural persons determined by the CSRC, stock exchanges or listed companies according to the principal of "substance outweighs forms" having a special relationship with the listed company, which may result in the interests of the listed company favouring them.

In addition, those who qualify as the above-mentioned connected legal persons and natural persons within the next 12 months or previous 12 months shall also be considered as connected persons.

The *Accounting Standards for Enterprises No.36—Disclosure of Related Parties* also require *the* affirmation of the connected parties, when: a party controls, jointly controls or exercises significant influence over another party, or when two or more parties are under the control, joint control or significant influence of the same party, related-party relationships are constituted. In accordance with accounting standards, the following parties constitute related parties of an enterprise: (1) the parent company thereof; (2) the subsidiaries thereof; (3) other enterprises under the control of the same parent company; (4) investors having joint control over the enterprise; (5) the investors with significant influence upon the enterprise; (6) joint ventures thereof; (7) the associated enterprises

thereof; (8) the main individual investors and the close family members thereof. A main individual investor refers to an individual investor who can control or jointly control an enterprise, or has significant influence thereof; and (9) key managerial personnel refers to those who have the power of and responsibility for planning, directing and controlling the activities of the enterprise. The close family members of a main individual investor or of a key managerial person refer to the family members who may influence or be influenced by that individual in handling transactions with the enterprise; (10) other enterprises significantly influence by the main individual investors, key managerial personnel, or close family members of such individuals.

4.2.1.5.2 Affirmation of related-party transactions

As in the regulations in the *Listing Rules* of stock exchanges, the related-party transactions of a listed company refer to matters concerning transferring resources or obligations between the company/its subsidiary and the connected person(s), which include purchasing or selling assets; investments (including consigned financing, consignment loan, investment in subsidiary, etc.); providing financial aid; providing a guarantee; renting or leasing assets; signing a management contract (including entrusted operations, trustee operations, etc.); granting or donating assets; credit or debt restructuring; transferring of R&D projects; purchasing raw materials, fuel and power; sales of products and commodities; rendering or receiving labour services; trustee sales; joint investment by both the connected parties; and other matters that may result in transferring resources or obligations through the agreement.

The *Administrative Measures on Information Disclosure by Listed Companies* stipulate that the term "related-party transaction" refers to an event in which a transfer of resources, labour services or obligations takes place between related parties, irrespective of whether money is charged. The types of related-party transaction usually include the following: (1) purchases or sales of goods; (2) purchasing or selling assets other than goods; (3) rendering or receiving labour services; (4) guaranteeing; (5) providing capital (including loans or equity contributions); (6) leasing; (7) acting as an agency; (8) transfer of research and development projects; (9) licence agreements; (10) settling debts on behalf of an enterprise or by an enterprise that represents another party; and (11) remuneration for key managerial personnel.

4.2.1.5.3 Disclosure of related-party transactions

A company shall satisfy the conditions of operational independence before an IPO, i.e., the business of issuers shall be independent of the controlling shareholders, actual controllers and other enterprises controlled by it, and shall not conduct horizontal competition or unfair related-party transactions with the aforesaid parties. Issuers shall fully disclose the relationship between the connected parties and appropriately disclose the said transactions in accordance with the materiality principle. The related-party transactions shall ensure fair prices and not allow for a situation in which profits are manipulated through the transactions.

After the companies are listed, the *Administrative Measures on Information Disclosure by Listed Companies* stipulates that directors, supervisors, executives, shareholders with 5% or more of shares and persons acting in concert with such

shareholders and de facto controllers of a listed company shall submit, on a timely basis, a list of the listed company's related parties and an explanation of the relationships to the board of directors of the listed company. The listed company shall perform review procedures for interested-party transactions and strictly enforce a system of vote abstention in interested-party transactions. The parties to an interested-party transaction must not circumvent the listed company's interested-party transaction review procedures and information disclosure obligations by concealing the interested-party relationship or by any other means.

In accordance with the regulations of the *Listing Rules* stipulated by the stock exchanges, the *Report on Disclosure of Related Party Transactions by Listed Companies* shall be fixed with the official seal of, and issued by, the company's board of directors. If a listed company engages in a transaction with the related natural persons of more than CNY 300 000 (EUR 32 550), and if a listed company engages in a transaction with the related legal persons of more than CNY 3 million (EUR 325 500), which accounts for more than 0.5% of the absolute value of the latest audited net assets of the company, it shall disclose such matters promptly.

The *Standards of Related-Party Transactions,* which are required to be submitted to the board of directors for review, shall be formulated in accordance with the company's articles of association. The *Listing Rules* stipulate that the said standards that need to be examined by the general meeting of shareholders shall be formulated as follows: if a listed company engages in a related-party transaction (unless the listed company is accepting the donation of cash assets and providing the guaranty) with the related parties of more than CNY 30 million, accounting for more than 5% of the absolute value of the latest audited net assets of the listed company, it shall, apart from disclosing such matters promptly, also arrange for an intermediary institution qualified to conduct securities and futures businesses to conduct the audit and evaluation of the transaction target and submit the transaction to the shareholders general meeting for deliberation. When the board of directors or shareholders' general meeting of the listed company examines the relevant matters of related-party transactions, the connected directors or shareholders shall withdraw from voting. The related-party transactions (according to the terms of the above-mentioned standards) shall be partly disclosed in the financial statements of the annual report.

The *Accounting Standards for Enterprises No.36–Disclosure of Related Parties* stipulate that an enterprise shall, in its financial statements, disclose relevant information on all related-party relationships and the transactions among them. If it offers consolidated financial statements to outsiders, it is not required to disclose the transactions among the enterprises that have been included in the consolidation, but it shall disclose the related-party relationships and transactions beyond the scope of consolidation.

If a listed company avoids information disclosure and reporting obligations by concealing related-party relationship or taking other measures, it shall be punished by the CSRC in accordance with Article 193 of the *Securities Law*.

4.2.1.6 Principle V.A (6): Risk factors

The *Standards on Contents and Formats for Information Disclosure of Prospectus*, issued by the CSRC, require that companies applying for an IPO shall abide by the

materiality principle in its prospectus, since disclosing according to priority may directly or indirectly have a significant adverse impact upon issuers' production and operation status, financial situation and sustained profitability. The company shall disclose its risk factors, which shall be described in a complete, accurate and specific manner based upon its actual conditions. It shall conduct a quantitative analysis on the risk factors disclosed and make a targeted qualitative description of those without access to quantitative analysis.

The *Standards on Contents and Formats for Annual Reports* stipulate that a listed company shall comply with the materiality principle in the Director's Report section of the Annual Report, disclose all the risk factors (including macro-policy risk, market and business operation risk, financial risk, technical risk, etc.) that may exert an adverse impact upon the realisation of its future development strategies and business objectives. The company shall disclose risk factors in light of its own characteristics, and the contents disclosed shall be complete, accurate and concrete. In addition, the company may introduce, based upon its actual situation, the countermeasures and solutions adopted or to be adopted with specific contents and operability.

In the process of the acquisition and major asset reorganisation of a listed company, the acquirer or the listed company intending to conduct material asset reorganisation shall disclose the influences and risks of such an acquisition or reorganisation to the listed company, in accordance with the Standards on Contents and Formats for Acquisition Reports of Listed Companies and the Standards on Contents and Formats of the Application Documents for Material Asset Reorganisation by Listed Companies.

4.2.1.7 Principle V.A (7): Employees and stakeholders

A listed company shall disclose at length in its prospectus and annual reports its staff situation, including the quantity, major composition (i.e. production staff, sales personnel, technicians, financial staff, administrative staff) and the educational background of the in-service employees, as well as the number of retired workers, the costs for whom shall be borne by the company.

In order to promote sustainable socio-economic development and encourage listed companies to actively assume their social liabilities, the Shanghai Stock Exchange and Shenzhen Stock Exchange have drawn up the *Code of Corporate Governance of Listed Companies*. The Code describes the listed companies' social responsibilities for the overall national and social development, natural environment and resources as well as with regard to stakeholders, such as shareholders, creditors, employees, clients, customers, suppliers, and communities. A listed company shall actively fulfil its social responsibilities and regularly evaluate such fulfilment. It may also disclose its CSR (corporate social responsibility) report.

4.2.1.8 Principle V.A (8): Corporate governance structure and decision-making procedure

According to the relevant rules prescribed in the *Company Law*, the CSRC requests that a listed company periodically disclose its governance status.

Meeting the relevant corporate governance requirements is one of the pre-conditions for a company to conduct an IPO and go public. The prospectus shall disclose in detail the establishment, improvement and operation of the shareholders' meeting, the board of directors, the supervisory board, independent directors and the board of directors' secretariat, and explain the duties and responsibilities of the abovementioned bodies and personnel.

The *Guidance for the Articles of Association of Listed Companies* stipulates that a listed company shall specify in its articles of association, the governance structure and decision-making procedure of the shareholders' meeting, the board of directors, the supervisory board and senior managerial personnel. The Guidance has provided the essential and compulsory requirements on the contents to be included in the articles of association of a listed company.

As per the *Annual Report Standards*, a corporate governance report shall be included in the annual report disclosed by a listed company on a regular basis. In accordance with the *Code of Corporate Governance of Listed Companies*, the company shall state, at the beginning of the governance report, whether discrepancies exist between the actual governance conditions and the requests of the Code, and explicit statements shall be made in the case of discrepancies. Furthermore, the company shall also successively describe the performance of independent directors' duties within the reporting period, whether there is a separation between the company and its controlling shareholders in terms of business, personnel, assets, bodies, finance, etc., the establishment and improvement of internal control systems with regard to production and operation, financial management, information disclosure, the appraisal and incentive mechanism for senior managerial personnel during the period, and the establishment and implementation of the award /incentive system concerned.

4.2.2 Principle V.B Information should be prepared and disclosed in accordance with high-quality standards of accounting, financial and non-financial disclosure.

4.2.2.1 The new system of Accounting Standards for Business Enterprises tends to converge with international standards

Relevant Chinese laws, regulations and department rules explicitly state that a listed company shall prepare and disclose its financial statement in its prospectus, annual report and list of particulars in accordance with unified accounting standards. At present, China has high-quality accounting standards, which have been internationally recognised.

Article 8 of the *Accounting Law* states that China shall implement a uniform accounting system drawn up and issued by the Ministry of Finance. On February 15, 2006, the new system of *Accounting Standards for Business Enterprises* enacted by China's Ministry of Finance, which came into force among listed companies on January 1, 2007, signified the formal establishment of China's enterprise accounting standards system and the CPA auditing system. The new system has drawn substantially from and is hence similar to the International Financial Reporting Standards. As a comprehensive accounting standards system, Standards are composed of a total of 39 items covering the accounting changes of all types of economic transactions and affairs of various enterprises. Many directors and technical experts from the China Accounting Standards

Committee (CASC) and the International Accounting Standards Board (IASB) have conducted item-by-item comparisons, studies and in-depth discussions, and reached a consensus on convergence. A joint statement has been signed between CASC and IASB, indicating that China's accounting standards have achieved substantial convergence with international financial reporting standards.

4.2.2.2 Requirements of financial information disclosure

According to the new system of *Accounting Standards for Business Enterprises*, the financial statement disclosed in the prospectus, the annual report and the particulars of the listed company shall meet four requirements, to: (1) be comprehensive; (2) be understandable to investors; (3) reflect the uniformity of accounting standards application; (4) be comparable for all accounting periods.

4.2.2.2.1 Comprehensiveness

Essential information related to business finance may be guaranteed for disclosure in accordance with the new accounting standards and the requirement of CSRC-related information disclosure standards. The *Accounting Standards for Business Enterprises – Basic Standards* stipulate that a financial statement is made up of a financial statement and annotations. The statement includes: a balance sheet, profit statement, cash flow statement and statement of changes in ownership equity, etc. The specific standards for business enterprise accounting not only provide for the confirmation and measurement of accounting items, but also specify disclosure-related requirements. The *General Provisions on Financial Reporting* further stipulate that the financial statement disclosed shall include a balance sheet and cash flow statement, as well as a statement of changes in ownership equity. The Provisions also detail disclosure requirements of financial statement annotations.

4.2.2.2.2 Understandable to investors

The new accounting standards require that financial statements facilitate investors' comprehension and its application. Article 14 of the *Accounting Standards for Business Enterprises – Basic Standards* stipulate that "The accounting information provided by enterprises shall be clear for users to understand and apply".

4.2.2.2.3 Reflecting the uniformity of accounting standards application

The application of new accounting standards must be consistent.

The *Accounting Standards for Business Enterprises No.28 – Changes in Accounting Policies and Estimates and Corrections of Errors* specify that identical accounting policies shall be adopted by enterprises to tackle the same or similar transactions or items. The accounting policies adopted by enterprises shall be consistent for each accounting period and any earlier and later stages without arbitrary changes. If any change is required, relevant details shall be disclosed in accordance with the provisions of the standards, which specify that the application of the accounting standards should be harmonised.

4.2.2.2.4 Comparable for all accounting periods

The new accounting standards specify that accounting information should be comparable from one accounting period to another.

Article 15 of the *Accounting Standards for Business Enterprises – Basic Standards* stipulate that the accounting information provided by enterprises shall be comparable and consistent, that accounting policies shall be adopted for identical or similar transactions or items incurred in one company during different periods without arbitrary changes. Any change, if required, shall be stated in the annotations. Accounting policies shall be adopted for identical or similar transactions or items incurred in different enterprises to ensure the uniformity and comparability of accounting information.

For the incurred changes in accounting policies and corrections of errors, as stipulated by the *Accounting Standards for Business Enterprises No.28—Changes in Accounting Policies and Estimates and Corrections of Errors*, a retrospective approach shall be adopted to adjust preliminary comparable data and earlier restatements shall be adopted to correct important preliminary errors and financial statements, if more reliable and relevant accounting information is provided by the changes in accounting policies.

Listed companies that correct preliminary errors shall make announcements and audits and disclose the corrected financial statements in accordance with the *Correction and Relevant Disclosure of Financial Information* promulgated by the CSRC.

4.2.3 Principles V.C & V.D: An annual audit should be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements represent the financial position and performance of the company fairly in all material respects. External auditors should be accountable to the shareholders and are duty-bound to the company to exercise due professional care in conducting the audit.

4.2.3.1 New accounting standards and international convergence

The audited financial statement in the prospectus, annual report, and listing particulars of the listed company shall be audited in accordance with comprehensive auditing criteria. China's auditing standards are of a high quality and have now reached the standards that are accepted internationally.

In 2006, the Ministry of Finance promulgated a new 48-point auditing standards system—*China Auditing Standards for CPA*. The system took effect in all domestic accounting firms on January 1, 2007. These new auditing standards cover almost all items of international auditing criteria, including the auditing objective and principle, evaluation and risk management, access to auditing evidence and evidence analysis, drafting and report of auditing conclusions, as well as formulation of professional responsibilities. The new standards are based on the structure of international auditing standards and cover nearly all of its items. They adopt all the basic principles and core procedures of the international standards. Major aspects such as the auditing objective and principle, evaluation and risk management, access to auditing evidence and evidence analysis, drafting and report of auditing conclusions, as well as formulation of professional responsibilities are in conformity with international auditing standards. China's auditing standards now substantially converge with international auditing standards.

4.2.3.2 Auditors' professional qualifications

4.2.3.2.1 Qualifications

Auditors require a CPA certificate to practice in China. Acquiring a CPA certificate requires passing the CPA examination and completing registration. The *Law of the People's Republic of China on Certified Public Accounts* stipulates that the unified examination system for certified public accountants is implemented nationwide. Article 8 lists the relevant qualifications for applicants sitting the examination i.e. Chinese with college degree or above; or with accounting or other related majors with mid-level professional and technical titles or more. Article 9 states that applicants, who pass the national examination for certified public accountants and have participated in the auditing business for two years or more, are entitled to apply to the provincial associations of CPAs for registration. Eligible applicants shall be approved for registration by the provisional association of CPAs, who report to the Ministry of Finance.

4.2.3.2.2 Revoking qualification

An auditor who is unable to maintain the specified qualifications and competency standard or does not apply moral or auditing standards, shall lose his or her qualification. Article 13 of the *Law of the People's Republic of China on Certified Public Accounts* specifies the situation in which auditor qualifications will be cancelled.

4.2.3.3 The independence of the external auditor

All China's related laws, statutes and departmental ordinances require that a CPA be independent.

Article 45 of the *Securities Law of the People's Republic of China* stipulates that securities service agencies and personnel offering auditing reports for stock issuance are not entitled to trade those stocks within their underwriting periods and for six months after they expire. In addition to the provisions above, securities firms and personnel who provide auditing reports for listed companies are not entitled to trade those stocks from the date they were hired until five days after the said documents are published.

Article 22 of the *Law of the People's Republic of China on Certified Public Accounts* prohibits CPAs from conduct that would undermine their independence, including trading stocks and bonds of the audited units, charging for premiums outside the contract, etc. The *Basic Standards of Professional Ethics for China's Certified Public Accounts* and *Guidance on the Standards of Professional Ethics for China's Certified Public Accounts* also require auditors to be independent and stipulate that certified public accounts shall maintain their independence in form and substance. Chapter Two of the Basic Standards of Professional Ethics for China's Certified Public Accounts states that certified public accountants shall maintain their independence in form and substance for auditing or other verification work. Accounting firms whose independence may be undermined by clients are not entitled to undertake commissioned auditing or other verification work. Certified public accountants, who conduct auditing or other verification work and are in conflict with clients on possible impacts to their independence, shall make an announcement to their accounting firms and abstain from such activity. Certified public accountants are not entitled to incorporate additional businesses or concurrently hold other posts that are

incompatible with auditing or other verification work conducted. Certified public accountants, when conducting business, shall be practical and realistic and not be influenced by others nor let personal interests affect the objectivity of their analysis and judgment. Certified public accountants shall be forthcoming, honest and impartial in handling conflicts of interest. Articles 8 to 12 of the *Guidance on the Standards of Professional Ethics for China's Certified Public Account*s describe the factors that may undermine their independence, including economic interest, self-evaluation, connections, relationships and external pressure. They also describe the situations that risk affecting auditors' independence. Furthermore, Article 13 and 15 define specific measures to be adopted in order to ensure independence.

The *Provision on Regular Rotation of Certified Public Accountants That Sign the Audits of Securities and Futures* (2003), promulgated by the CSRC, contains explicit clauses on the independence of the responsible certified public accountants. Normally, a certified public accountant should not provide auditing services to a specific company for five consecutive years. The continuous auditing services provided to a given company by the same certified public accountant who signs the accounts while serving different accounting firms should be considered together. The period of continuous auditing services to a listed company whose listing was handled by the same certified public accountant who provided auditing services to the relevant company's IPO should be no more than two complete fiscal years.

4.2.3.4 Procedures for the designation, appointment and replacement of external auditors

According to the *Relevant Questions Concerning the Hiring and Changing of Accounting Firms (Audit Firms) by Listed Companies*, published by CSRC, any issues concerning the employment, dismissal or discontinuing further employment of accounting firms shall be determined by shareholders' meetings, and the decisions taken shall be implemented. Furthermore, in accordance with the regulations of the "Special Committee of the Board of Directors" (Chapter Six of the *Code of Corporate Governance of Listed Companies*), an audit committee reporting to the board of directors of a listed company shall be responsible for proposals on the employment or changes to the employment of external auditing firms. Most of the auditors working for external audit firms shall be independent. The convener of the meetings shall be independent and at least one independent director shall be a professional accountant.

4.2.3.5 The legal responsibilities of external auditors

Article 173 of the *Securities Law* states that when an auditing firm produces auditing reports for listed companies, it shall be diligent and responsible, and examine and verify the authenticity, accuracy and integrity of the contents of the documents it is working on. If any false records, misleading statements or major omissions in the documents produced, incur any loss to any other person, the institution shall bear joint liability together with the relevant issuer and listed companies, unless the auditing institution is able to prove it is not at fault. Article 223 of the *Securities Law* states that when a securities service institution fails to fulfil its accountability in a diligent manner, resulting in documents containing false records, misleading statements or major omissions, it shall be ordered to correct it. The proceeds generated from this business shall be confiscated

and its securities business licence suspended or revoked. A fine of one to five times its related business income shall be imposed. The person in charge and any other person directly responsible shall be given a warning and imposed a fine of CNY 30 000 to CNY 100 000 and the relevant securities practice qualifications shall be revoked. In addition to the sanctions imposed by the *Securities Law*, the *Administrative Methods on Information Disclosure by Listed Companies* stipulate that the CSRC may adopt such supervisory measures as ordering corrections, supervising discussions, sending warning letters and making records in the "credit records" to the above securities service agencies in accordance with law. When administrative sanctions are imposed, the CSRC shall enforce the sanction by law.

In addition to the liability for damage of civil affairs, related personnel shall be held criminally responsible for the serious false content of auditor reports. Article 229 of the *Criminal Law* states that a person of an intermediary organisation performing such functions as asset evaluation or examination, certificate examination, accounting, auditing, legal services, who provides intentionally false documentary evidence, shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention, and fined concurrently if the circumstance is serious. A person who extorts another person's property or accepts another person's property illegally, thus committing a crime under the preceding paragraph, shall be sentenced to fixed-term imprisonment of not less than five years and not more than ten years and fined. A person who seriously neglects his or her duty and provides documentary evidence which is inconsistent with the facts, thus causing a serious consequence, shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention, and fined.

4.2.4 Principle V.E: Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.

4.2.4.1 The principle of equal and timely access to information

The *Securities Law* and *Administrative Methods on Information Disclosure by Listed Companies* stipulate that a listed company shall do their best to fulfil the obligation of information disclosure, and disclose all the major events that may have a significant impact on its share trading price. CSRC announced further requirements in the *Notice on Regulating Disclosure of Listed Companies and the Acts of All the Related Parties*, prescribing not only that a listed company shall strive to fulfil the obligation of information disclosure, but also disclose all sensitive and major events that may have a great impact on the stock price to all its investors fairly, to give them all access to the same information. It shall not disclose information selectively or to specific persons in advance. Such persons include – but are not limited to – the institutions and individuals that engage in securities investment, securities analysis, consultancy or other securities service industries, and the related parties of the said institutions and individuals. CSRC branches and stock exchanges shall supervise and oversee the implementation of the principle of equity of information disclosure by listed companies. Listed companies and any other relevant person responsible who violate the regulations shall be investigated and dealt with in accordance with the law.

The *Securities Law* and *Administrative Methods on Information Disclosure by Listed Companies* and other relevant laws and regulations state that the listed companies shall undertake the obligations of continuous information disclosure, and disclose the

information to investors that may have a great impact on their decision-making on a timely basis. Information may be disclosed in two forms: periodic reports and temporary reports (see details in "V.A material information" in this chapter). The *Company Law* prescribes that listed companies shall set up a secretariat for the board of directors, acting as a senior manager of a company, specialised in dealing with information disclosure to guarantee continuous and timely information disclosure.

4.2.4.2 Timely and low-cost information dissemination channels

The CSRC has made detailed provisions regarding dissemination channels for information disclosure. The *Administrative Methods on Information Disclosure by Listed Companies* stipulate that the information disclosed shall be published through the media designated by the CSRC. Information shall not be published on corporate websites or any other media prior to this designation. Press releases and Q&A interviews may not be used to replace the reporting and announcing obligation, not shall periodic reports replace extraordinary reporting.

Newspapers and websites are the media designated by CSRC, ensuring the convenient and low-cost information dissemination to all the investors.

4.2.4.2.1 Newspapers and periodicals

The newspapers and periodicals used for listed companies designated by the CSRC include the following: China Daily, China's Reform Report, Securities Journal, China Securities Journal, Shanghai Securities News, Securities Times, Financial Times and Securities Market Weekly. The initial disclosure of important information from listed companies, periodic reports and temporary reports, shall be published at least in one designated newspaper or periodical. When the CSRC, stock exchanges, securities firms and other market participants release major news or important measures, they also need the media's cooperation on reporting.

4.2.4.2.2 Websites

Information to be disclosed by listed companies to stock exchanges shall be disclosed free of charge on the stock exchange website. Investors and other users can access them free of charge on those websites.

The Growth Enterprise Market (GEM) established at the Shenzhen Stock Exchange makes further efforts to promote paperless information disclosure through the full use of information technologies characterised by low costs and high efficiency. The following five websites are designated for GEM information disclosure: CNINFO, CS, CNSTOCK, SECUTIMES, CCSTOCK. These designated websites shall provide specialised platforms for legal information disclosure of GEM-listed companies and publish free of charge all the GEM listed companies' prospectus, listing particulars, temporary announcements, periodic reports and other information such as relevant policies and law regulations published by the CSRC and the Shenzhen Stock Exchange.

4.2.5 Principle V.F: The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to investors' decisions, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

4.2.5.1 Qualifications of security consultancy agencies, and information disclosure requirements

In order to strengthen management of the securities and futures investment consultancy business, the CSRC released the *Interim Procedures on the Administration of Securities and Futures Investment Consultancy*. This focuses on the activities of the agencies and their consultants engaged in the securities and futures consultancy business, which include direct or indirect paid consultancy services for securities and futures investors or clients with securities and futures investment analyses, forecasts or proposals and other services. These activities involve: (1) accepting the entrustment of an investor or client and providing securities and futures investment consultancy services; (2) holding seminars, lectures and analysis meetings on securities and futures investment consultancy; (3) publishing articles, commentaries and reports on securities and futures investment consultancy in newspapers and periodicals, and providing securities and futures investment consultancy services through the mass media (radio stations, television stations, etc.); (4) providing securities and futures investment consultancy services through telephone, fax, computer networks and other telecommunications systems; (5) other forms authenticated by the CSRC. In China, the above-mentioned investment consultancy businesses must obtain the permission of the CSRC. No institution or individual may engage in the above-mentioned business without permission.

A person who engages in the securities and futures investment consultancy business must obtain the relevant employment qualifications and join an agency with operational qualifications for securities and futures investment consultancy before engaging in the business. He or she must have at least a university education, pass the qualification examinations for securities and futures and have more than two years' experience in the securities or futures business before obtaining the employment qualifications for securities and futures investment consultancy.

Interim Procedures on the Administration of Securities and Futures Investment Consultancy stipulates that a securities and futures investment firm and its investment consultants shall provide their services to investors and clients with the required attitudes of the trade: discretion, honesty, diligence and fulfilment of responsibility. They shall use the relevant information and materials completely, objectively and accurately to provide investment analyses, forecasts and proposals, and must not quote or alter relevant information and materials out of context. They shall provide the sources and copyright owners when quoting relevant information and materials. A securities and futures investment firm and its investment consultants must not provide investment analyses, forecasts or proposals to investors or clients on the basis of false information, market rumours or inside information. When publishing articles, reports or views on investment consultancy in newspapers, periodicals, radio stations, television stations or other media, a securities and futures investment consultant must provide the name of the securities and futures investment consultancy agency in which the person is employed, give the person's real name and a detailed explanation of investment risks. A securities and futures investment firm must provide the name and address of the agency, the telephone

number(s) and the name(s) of the contact when providing securities and futures investment consultancy faxes to investors or clients.

In order to avoid a conflict of interest between the investment consultancy agency or its investment consultants and investors, the *Securities Law* requires that no securities and futures investment firm and its investment consultants may engage in the following activities:

1. Securities and futures buying and selling as an agent of investors;
2. Agreement with investors on the sharing of returns or losses of the investment;
3. Buying and selling of stocks and other securities and futures on their own behalf;
4. Manipulating the market or engaging in insider trading by exploiting the consultancy services in collaboration with others;
5. Other fraudulent acts in securities and futures prohibited by laws, rules and regulations.

Investment firms and rating organisations engaged in the securities service business shall charge fees according to standards prescribed by the State Council's relevant administrative departments.

The investment analyses, forecasts or proposals provided to different clients on the same issue by a securities and futures investment firm shall be consistent. Securities firms with a consultancy business shall be consistent in providing suggestions on the same question to the consultancy business and to the public. It shall not mislead the public in the interest of profit-gaining for its own benefit. The underwriter, sponsor or relevant securities firm of the company whose public issuance of shares has been approved by the CSRC may not publish in the mass media its investment analysis report written for clients.

Recently, the CSRC took action to regulate the behaviour of securities research institutes when publishing research reports. Securities firms are required to act in strict accordance with the provisions of the *Securities Law, Rules on Supervision over Securities Companies, Interim Measures for the Administration of Securities and Futures Investment Consultancy, Provisions on Strengthening the Administration of Securities and Futures Information Communication, Guidance for Internal Control of Securities Firms* and *Notice on Several Issues Concerning Standardisation of the Business of Securities Investment Consultancy for Public*. They are required to standardise the publication of their research reports and strengthen management over participation in securities programmes in the media. Securities firms are banned from manipulating securities prices, interest transfer, engaging in securities trading with insider information or misleading investors. While publishing research reports and participating in securities programmes in the media, securities firms should observe the principle of being independent, objective, equitable, respecting their fiduciary duty and be professional when making comments on the macro economy, industrial analysis and market trends, and exercise prudence on opinions when analysing specific securities. They must not spread false, partial or misleading information or make definitive judgments on the rise or fall of securities prices or market trends.

4.2.5.2 Brokers

In order to bolster the supervision and administration of securities brokers, standardise their professional behaviour and protect the legitimate rights and interests of their clients, the CSRC formulated the *Interim Regulations on the Administration of Securities Brokers* (2009), which clearly defines securities brokers as the natural persons outside securities companies who accept the commissions of the securities companies to engage in activities including client solicitation and services on their behalf. Securities brokers, who are securities practitioners, must pass the examination to qualify as securities practitioners and meet the stipulated professional conditions. Securities companies can engage in certain activities including client solicitation and services through their staff or by entrusting persons external to the companies. Securities brokers are required to follow the *Rules on Supervision of Securities Companies* to entrust activities to external persons. Securities companies shall establish a sound administration system for securities brokers, take effective measures, implement centralised and unified management towards the securities brokers and their practice, guarantee the basic professional ethics and business qualities of the securities brokers, and prevent the securities brokers from breaking the laws and regulations, acting beyond the agency authority and going against clients' legal rights and interests.

4.2.5.3 Credit-rating agencies

In order to promote the standardised development of the securities market credit-rating business, enhance the efficiency and transparency of the securities market and protect the legitimate rights and interests of investors and social public interests, the CSRC published the *Interim Measures for the Administration of the Credit-Rating Business Regarding the Securities Market* (2007). Credit-rating agencies should apply to the CSRC for a securities rating business permit, without which no organisation or individual may engage in the securities rating business. Securities rating agencies should follow the consistency principle while engaging in the securities rating business, i.e., consistent rating criteria and work procedures should be followed for subjects of the same category or in follow-up ratings on the same subject. When rating criteria is readjusted, full disclosure should be conducted. Securities rating agencies should formulate scientific rating methods and a fully fledged quality control system, follow industrial standards, professional ethics and code of business conduct with fiduciary duties, and be diligent in carrying out their duties and prudent in their analyses.

4.2.5.4 Asset appraisal institutions

In order to strengthen the administration of asset appraisal institutions engaging in the securities and futures-related business, maintain order on the securities market and protect the legitimate rights and interests of investors and public, the Ministry of Finance and the CSRC jointly issued the *Notice on Issues Concerning Asset Appraisal Agencies Engaging in Business Relating to Securities and Futures,* requiring asset appraisal institutions to obtain the relevant qualifications to engage in securities-related business. The following asset appraisal agencies may not apply for securities rating qualifications: a) those that have been penalised criminally or administratively in business operations (for three years upon completion of penalty), or b) those whose qualification was revoked on the grounds that they obtained securities appraisal qualification by deception or other irregular means

(for three years after their rights were revoked), or c) those whose application was not accepted or approved on the grounds that information was concealed or false (for three years after the issuance by the authority of a non-acceptance or non-approval document).

4.2.5.5 Legal obligations

The *Securities Law* stipulates that any investment consultancy agency, financial consultancy agency, assets evaluation organisation and accounting firm that engages in the securities service business without permission shall be ordered to suspend business and will be confiscated of the illegal gains and imposed a fine greater than the value of its illegal gains and less than five times the value of illegal gains.

Chapter 5

Board and supervisory board: responsibility and supervision

5.1 Overview of the board of directors and supervisory board system in China

The *Company Law* governing listed companies in China was promulgated in 1993. It introduced boards of directors and supervisory boards, and clearly provided that companies limited by shares should set up shareholders' meetings, a board of directors and a supervisory board. Since then, Chinese listed companies have made great progress in the establishment of a board system, gradually introducing an independent director system and a specialised committee system and laying the foundations for the board's independence and effective operations. Meanwhile, the establishment of mechanisms such as the election, terms of reference and responsibility investigation has paved the way for the board to provide strategic guidance, effective supervision over management and protection of the interests of companies and shareholders. In the creation and construction of the supervisory board, the *Company Law* amended in 2006 expanded the functions and power of the supervisory board, enabling it to play its role of supervision to the full.

5.1.1 The main features of the Chinese board system

5.1.1.1 Strengthening the board's loyalty, due diligence and protection of the benefits of companies and shareholders

In 2006, the *Company Law* was revised for the first time and clearly presented the primary function of the board: "to abide by the law, administrative laws and regulations, and articles of incorporation and have the duty of loyalty and diligence to companies". The meaning of the duty of loyalty and diligence indicates that Chinese law and regulations are designed to protect the benefits of companies and shareholders.

Hereafter, the Listed Company Director Selection and Conduction Guidance and SME Board Listed Company Director Conduct Guidance, both issued by the Shenzhen Stock Exchange have more detailed and specific requirements on the directors' duty of loyalty and diligence.

5.1.1.2 Establishing mechanisms for the board's supervision and restraints over management

The *Company Law* provides that limited companies should have managers, who are hired and dismissed by the board. The corporate board may decide that a member of the board can also serve as a manager. On the one hand, the board may evaluate and supervise the operation and achievements of management by selecting managers. On the other hand, centralised power makes management teams realistically emphasise the efficiency of decision-making to improve companies' performance.

By hiring independent directors, establishing management's remuneration and setting up an audit committee, nomination committee and remuneration and appraisal committee, listed companies supervise and motivate managers. Companies also regularly disclose directors', supervisors' and senior managers' remuneration to shareholders.

5.1.1.3 The establishment of the independent director system

An independent director is a director who holds no other position than that of an independent director in the company. He or she has no relations that prevent them from making an independent and objective judgment. An independent director shall perform his or her duty independently and not be influenced by the main shareholders, actual controllers, or other entities or individuals which have significant relations with the listed company.

In China, an independent director may in principle serve on the board of at most five listed companies as an independent director and ensure that he or she has enough time and energy to effectively perform the duty of an independent director. The *Code of Corporate Governance of Listed Companies* in China stipulates that independent directors shall account for more than one-third of the board in a listed company. Independent directors shall be independent of their employer and the company's main shareholders. Independent directors shall hold no other position but that of independent directors.

5.1.1.4 Establishing special committees of the board

In China, special committees of the board on the one hand take charge of the daily operations and decisions in comparatively independent fields, and on the other hand, provide consultation and suggestions to the board on important decisions in the field. To a large degree, the special committee is the extension of the independent director system and is good for improving the independence and effectiveness of the board's operations as well as controlling risks.

The *Code of Corporate Governance of Listed Companies* in China stipulates that according to the resolution of the general shareholders' meeting, a listed company's board may set up special committees on strategy, audit, nomination, remuneration and appraisal, etc. All of the special committee members are directors. Thereinafter, independent directors shall account for more than half of the committee members and act as conveners in audit committees, nomination committees and remuneration and appraisal committees. In audit committees, at least one independent director should have an accounting background.

5.1.2 The main features of the supervisory board

5.1.2.1 Strengthening the basic duties of the supervisory board: loyalty, diligence and protection of the interests of companies and shareholders.

In China, the supervisory board is also obliged to be loyal and diligent and to protect the interests of the company and shareholders. The *Company Law* revised in 2006 clearly provides that the supervisory board is obliged "to abide by the law, administrative laws and regulations and the articles of association of the company and have the duty of loyalty and diligence for companies".

The Shenzhen Stock Exchange has issued Guidance on the Operation of Companies Listed on the Main Board, Guidance on the Operation of Companies Listed on the SME Board and Guidance on the Operation of Companies Listed on the Growth Enterprise Board, defining more detailed and specific requirements on the supervisors' duty of loyalty and diligence.

5.1.2.2 Establishing mechanisms of supervision and restraint over the board of directors and the management by the supervisory board

The supervisory board is a permanent supervisory body under the leadership of, and responsible to, the shareholders' meeting. It exercises its supervisory power over the board of directors, management and the whole company independently. To ensure the independence of the supervisors and supervisory board, the supervisors may not concurrently take the office of director or senior executive. The supervisory board carries out comprehensive supervision of the company's operations and management including: inspecting the company's financial status, supervising the performance of duty by directors and senior executives, and proposing to remove from office any director or senior executive that has violated the law, regulations, articles of association or resolution of the shareholders' meeting, requesting directors and senior executives to rectify their behaviour when it undermines company interest, initiating ad hoc shareholders' meetings, calling upon and presiding on shareholders' meetings when the board of directors fails to do so, according to law, tabling draft resolutions for the shareholders' meetings and filing suit against directors and senior executives under certain conditions.

5.1.2.3 Mutual complementarily with the role of independent directors

Independent directors and the supervisory board both act as a company's internal supervision mechanisms. They each have their respective features and attend to their own duties and are mutually complementary rather than conflicting with each other. Relatively speaking, independent directors, an important component of the company's decision-making body, are in a position to take up in the decision-making process over major company affairs and therefore provide ex ante supervision. The supervisory board mainly plays a role of ex post supervision.

5.2 China's practices compared with the OECD principles

5.2.1 Principle VI. A states that directors and supervisors should act on a fully informed basis, in good faith, with due diligence and care and in the best interests of the company and its shareholders

This OECD Principle points out the two key elements of the responsibilities of directors and supervisors, two duties: care and loyalty. The *Company Law* and a number of regulations issued by the stock exchanges all clearly require the two duties on the part of board members.

Article 148 of the *Company Law* provides that the board of directors and supervisory board are required "to abide by the law, administrative laws and regulations and the articles of association of the company and have a duty of loyalty and diligence to companies. The directors shall not, by taking advantage of their positions and powers, accept bribes or other unlawful incomes, nor may they misappropriate the property of the company."

5.2.1.1 Duty of loyalty

Article 149 in the *Company Law* stipulates that directors shall comply with the duty of loyalty to the company and shall not commit any of the following acts. The company will confiscate any unlawful income if the regulation is not followed, for example:

5.2.1.1.1 Directors shall not divert, misappropriate or lend the company's capital, or serve as guarantors of the company's capital. They shall not misappropriate the company's funds, deposit the company's assets in their own personal accounts or in personal accounts of other individuals in violation of the company's articles of association and without the consent of the general shareholders' meeting or the board of directors. They shall not lend the company's funds to others or use the company's property to provide a guarantee to others.

5.2.1.1.2 Directors shall not enter into contracts or conduct transactions with the company in violation of the company's articles of association or without the consent of the shareholders' meeting, the shareholders' general meeting or the board of directors, They shall not take advantage of their positions, seek for themselves or others a commercial opportunity that should fall to the company, or conduct the same business as the company for themselves or others. They shall not accept a commission in a transaction between others and the company.

5.2.1.1.3 Directors shall not disclose the company's secrets without authorisation or commit other acts in violation of their duty of loyalty to the company.

Article 97 in the *Guidance for the Articles of Association of the Listed Companies* also follows the regulation on directors' duty of loyalty in the *Company Law*, and points out that if a director causes damage to the company, he or she shall assume their compensation liability. The company may, in accordance with specific circumstances, add other requirements in the Articles of Association upon the directors' behalf. Article

136 of the *Guidance for the Articles of Association of the Listed Companies* provides for the supervisors' duty of loyalty, while Article 141 prohibits supervisors from undermining company interests by using their affiliations, and provides that where a supervisor causes damage to the company, he or she shall assume the responsibility of compensation.

Chapter 3 of the *Guidance on Appointment and Activities of Directors of Listed Companies of the Shanghai Stock Exchange* specifies the duty of loyalty stipulated in the *Company Law*. Firstly, directors shall not harm the interest of a listed company due to a third party's interest; and if discovering that the behaviour of a listed company or the third party may harm the company's interest, directors shall require them to explain and correct the damage and make a report to the board on a timely basis. When necessary, the convening of the directors is advised for the review. Secondly, a director shall disclose to a listed company matters such as horizontal competition, business contact, debtor-creditor relationship, shareholding and other business connections or conflicts of the director himself and his close relatives. Related directors shall avoid voting. Thirdly, a director shall keep a listed company's secrets and shall not release material information that a listed company has not released to the public through designated media.

Article 4 of the *Shenzhen Stock Exchange Small and Medium Enterprise Board Director Conduct Guidance* sets out the basic principles of the duty of loyalty: a director shall be loyal to the company, its shareholders, and their interests, exercising power within the scope of their functions and powers with the company's interest as a starting point, and strictly avoiding conflict between their own and the company's interests.

5.2.1.2. Duty of care

Articles 150 and 151 of the *Company Law* stipulate that the director, supervisor and top managerial personnel shall be liable, if they violate any regulations, laws, administrative rules or articles of association of the company and caused damage to the company when they exercise their functions on behalf of the company. The shareholders' meeting or the general shareholders' meeting requires that the director, the supervisor and top managerial personnel shall be present at the meeting and that the director, the supervisor and top managerial personnel shall accept the shareholders' enquiry. The director and top managerial personnel shall provide the board of supervisors with the true relevant situation and materials and shall not prevent the board of supervisors from exercising their power.

Article 98 of the *Guidance for the Articles of Association of Listed Companies* stipulates that the director is also responsible for the company's duty of diligence. This involves: ensuring that the company's behaviour complies with the laws, administrative regulations and various economic policies in China, that commercial activity not exceed the business scope stipulated by the business licence, and that shareholders be treated fairly. The director is also required to know the company's operational and management situation on a timely basis and draft signed, written confirmation opinions regularly that ensure that the information disclosed by the company is true, correct and complete, and the company may add more requirements on the company's duty of diligence in its articles of association according to the specific situation. Article 136 of the *Guidance for the Articles of Association of Listed Companies* provides for the supervisors' duty of diligence, while Article 141 provides that any supervisor violating the law, regulation, department decree or the company's articles of association in the performance of his or

her duty and causing damage to the company shall assume the responsibility of compensation.

Chapter 4 of the *Guidance on Appointment and Activities of Directors of Listed Companies of the Shanghai Stock Exchange* provides the details of the director's duty of diligence and points out that claiming for removing exemption from an obligation is not allowed except in the case of unfamiliarity with the business or unawareness of relevant items.

Article 4 of the *Shenzhen Stock Exchange SME Board Listed Company Director Conduct Guidance* prescribes the basic principles of the director's duty of diligence. Directors shall be diligent and responsible, shall positively strive to perform their duties using their knowledge, skills and experience, help the company abide by laws, regulations, rules, the related rules of the Exchange and the articles of association of the company, and endeavour to protect the rights and interests of the company, shareholders, and especially the public shareholders.

5.2.1.3 Report on the board of directors' work

Articles 28 and 29 of the *Rules for the General Meetings of Shareholders of Listed Companies* stipulate that at the annual shareholders' meeting, the board of directors and supervisory board shall report their work conducted during the year running up to the meeting and every independent director shall report on his or her work. The directors and supervisors shall offer explanations and clarification to shareholder enquiries. These annual reports on the work of the board of directors and the supervisory board provide an institutional mechanism for the two boards to effectively implement their duties.

5.2.2 Principle VI. B: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

Article 113 and 148 of the *Company Law* stipulates that directors shall carefully carry out the duties prescribed by the relevant laws, regulations and articles of association of the company, ensure that the company should abide by them, treat all the shareholders fairly and take into account the interests of other stakeholders.

5.2.2.1 Directors prohibited from voting at board meetings

Directors are prohibited from voting at board meetings in China in the case of related-party transactions. Article 125 of the *Company Law* stipulates that where any director of a listed company has a related-party relationship with enterprises related to matters to be resolved at the board of directors' meetings, the director is not entitled to exercise his or her voting rights upon such resolutions nor exercise the voting rights on behalf of other directors. Board of directors' meetings may be held only if more than half of the directors having no such related-party relationship attend the meetings.

5.2.2.2 Requirements on the minimum number of unrelated directors

Article 125 of the *Company Law* stipulates that the resolution made at the board of directors' meeting shall be passed by more than half of directors having no related-party relationship. Where the number of attending directors having no such related-party relationship is less than three, such matters shall be submitted to the shareholders' general meeting for examination and discussion.

5.2.2.3 Cumulative voting system

Article 106 of the *Company Law* stipulates that when a shareholders' general meeting elects directors, the cumulative voting system may be practised in accordance with the provisions of the articles of association or the resolution of the shareholders' general meeting. The cumulative voting system referred to in this Law comes into play when a shareholders' general meeting elects directors. Each share has the voting rights equal to the number of directors to be elected, and the concentrated use of the voting rights held by a shareholder is permitted.

When a shareholder votes for directors, the total vote is the product of the number of the person's shares and the number of directors to be elected. In the process of voting, shareholder may concentrate their votes on one or several director candidates. With the partially concentrated voting method, minority shareholders are able to elect directors in line with their own interests and avoid the appointment of all directors being monopolized by majority shareholders. This is to ensure that the board of directors acts on behalf of the interests of all shareholders.

5.2.3 Principle VI. C: The board of directors and the supervisory board should apply high ethical standards. They should take stakeholders' interests into account.

5.2.3.1 Employee directors and supervisors should play their due role in safeguarding the rights and interests of employees.

According to Article 109 of the *Company Law*, the board of directors of a company limited by shares may include representatives from among the staff and workers of the company. The inclusion of an employee representative on the board may to a certain extent guarantee the presence of workers' representatives and therefore their interests in its decision-making process. Article 118 of the same law provides that a company limited by shares shall have a supervisory board composed of no fewer than three members, that the supervisory board shall include representatives of shareholders, the staff, and workers of the company in an appropriate proportion and no fewer than one-third of the total number of supervisors as determined by the company's articles of association, and that the representatives of the staff and workers on the supervisory board shall be democratically elected by the staff and workers of the company at a conference or general meeting, or similar occasion of the representatives of the staff and workers.

Article 85 of the *Code of Corporate Governance of Listed Companies* stipulates that a listed company shall encourage feedback from its employees regarding the company's operating and financial situations and important decisions affecting employees' benefits

through direct communications with the board of directors and the supervisory board. This encourages employees to actively express their opinions to the board of directors and supervisory board to be taken into consideration in the decision-making process.

5.2.3.2 Respect the rights and interests of the stakeholders and provide the necessary conditions to safeguard their rights and interests

Chapter 6 of the *Code of Corporate Governance of Listed Companies' Stakeholders*, and Article 81, in particular, stipulate that a company shall respect the legal rights of its stakeholders, including banks and other creditors, employees, customers, suppliers, and the community. As the decision-making board of a company, the board of directors shall take into consideration and respect the benefits of stakeholders when making decisions.

In addition, Chapter 6 also stipulates that a company shall provide the necessary means to ensure the legal rights of its stakeholders, who shall be entitled to the opportunities and channels for redress of any infringement upon their rights. A company shall provide the required information to banks and other creditors to enable them to make judgements and decisions about the company's operating and financial situation.

5.2.4 Principle VI. D: The board should fulfil certain key functions

5.2.4.1 Principle VI. D 1: The key functions of the board are: reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditure, acquisitions and divestitures.

Article 47 of the *Company Law* stipulates that the functions and powers to be exercised by the board of directors include: deciding the business plans and investment plans of the company; drawing up the annual financial budget plan and final accounts plan; formulating plans for mergers, divisions, dissolutions or changes to the company's corporate form; convening shareholders' meetings and reporting on its work therein; implementing the resolutions of the shareholders' meetings; formulating plans for profit distribution, and for making up for corporate losses; formulating plans for the increase or reduction of the registered capital and issue of company bonds; deciding on the establishment of the company's internal management bodies; formulating the company's basic management system, and; exercising other functions and powers prescribed in the company's articles of association.

Article 124 of the *Guidance for the Articles of Association of Listed Companies* stipulates that the manager and deputy manager are employed and can be dismissed by the board of directors. Article 106 stipulates that, within the scope authorised by the shareholders' meetings, the board of directors decides on the matters concerning the company's external investment, buying and selling assets, etc. Article 110 stipulates that the board of directors shall set forth the scope of external investment, buying and selling assets, establish strict procedures of examination and decision-making. Major investment items shall be subject to the evaluation of the relevant experts and professionals and be submitted to the shareholders' meeting for approval.

5.2.4.2 Principle VI. D 2: Monitoring the effectiveness of the company's governance practices and making changes as needed.

Through the selection and replacement of executives, the board of directors may adjust the company's operations and governance practices. It is stipulated in the *Code of Corporate Governance of Listed Companies* that the key functions of the nomination committee include: studying the criteria and procedures for selecting directors and managers as well as making suggestions; extensively seeking qualified directors and manager candidates and; examining director and manager candidates and making suggestions.

On June 28, 2009, the *Basic Standard for Enterprise Internal Control* was released jointly by the Ministry of Finance, the National Audit Office, the CSRC, CBRC and CIRC. Article 12 stipulates that the board of directors is responsible for the establishment, improvement and effective implementation of internal control; Article 13 specifies that an enterprise shall establish an audit committee reporting to the board of directors. The audit committee shall be responsible for examining the internal control of the company, overseeing the effective implementation and self-evaluation of internal control, coordinating the internal control auditing and other relevant matters. Article 45 stipulates that an enterprise shall formulate its policy to identify weaknesses in its internal control, analyse the nature and causes of the internal control defects discovered during the monitoring process, put forward the improvement plans and report to the board of directors, board of supervisors and managerial personnel on a timely basis and in an appropriate manner.

5.2.4.3 Principle VI. D 3: Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

Article 47 of the *Company Law* stipulates that the board of directors may decide on matters concerning the recruitment or dismissal of the company's manager and their remuneration, and decide, based upon the manager's appointment, on the recruitment or dismissal of the company's deputy manager(s) and persons in charge of financial affairs as well as matters concerning their remuneration.

Articles 77-80 of the *Code of Corporate Governance of Listed Companies* provide that a listed company shall establish an incentive mechanism linking the managerial personnel's remuneration with the company's performance and the individuals' performance. The performance assessment of management personnel shall become a basis for determining the compensation and other rewarding arrangements for the person reviewed. The managerial personnel's remuneration distribution plan shall be subject to approval by the board of directors, explained at the shareholders' meeting and disclosed. The company shall specify in its articles of association the managerial personnel's duties and responsibilities. If the managerial personnel violate laws, regulations and the company's articles of association, and cause damages to the company, the board of directors shall actively take measures to investigate and pursue the legal liabilities of such personnel.

5.2.4.4 Principle VI. D 4: Aligning key executive and board remuneration with the longer-term interests of the company and its shareholders.

Article 56 of the *Code of Corporate Governance of Listed Companies* stipulates that the main duties of the remuneration and appraisal committee are (1) to study the appraisal standard for directors and managerial personnel, to conduct appraisals and make recommendations; and (2) to study and review the remuneration policies and schemes for directors and executives.

Articles 69-70 stipulate that a listed company shall establish fair and transparent standards and procedures for the assessment of the performance of directors, supervisors and executives. The evaluation of the directors and executives shall be conducted by the board of directors or by its remuneration and appraisal committee. The evaluation of the performance of independent directors shall be conducted through a combination of self-review and peer review.

5.2.4.5 Principle VI. D 5: Ensuring a formal and transparent board nomination and election process.

Article 28 of the *Code of Corporate Governance of Listed Companies* stipulates that a company shall establish a standardised and transparent procedure in its articles of association for the election of directors to ensure the openness, fairness, impartialness and independence of the election.

Articles 29-30 stipulate that detailed information regarding the candidates for directorship shall be disclosed before the shareholders' meeting is convened to ensure that shareholders have adequate knowledge about the candidates at the time they vote. Candidates for directorship shall accept their nomination in writing, to warrant the authenticity and completeness of the information provided to the candidate and publicly disclosed, and shall promise to perform their duties in earnest once elected.

Articles 31-32 specify that the election of directors shall fully reflect the opinions of minority shareholders. A cumulative voting system shall be advanced in shareholders' meetings for the election of directors. Listed companies with over 30% their shares owned by controlling shareholders shall adopt a cumulative voting system. These companies shall stipulate the detailed implementation of rules and regulations for the cumulative voting system in their articles of association. Appointment agreements shall be entered into by a listed company and its directors to clarify such matters as the rights and obligations between the company and the director, the term of the directorship, the director's liabilities in the case of a breach of laws, regulations or articles of association, and compensation from the company in case it violates the appointment agreement and terminates the contract earlier than planned.

5.2.4.6 Principle VI. D 6: Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related-party transactions.

In order to prevent conflicts of interest, the *Company Law* stipulates that the related directors shall avoid voting on certain matters (see details VI.B of this chapter).

Articles 12-14 stipulate that written agreements shall be entered into for related-party transactions between a listed company and its connected parties and the relevant matters shall be disclosed. Listed companies should adopt efficient measures to prevent related parties from interfering with the company's operations and damaging the company's interests by monopolising purchase or sales channels. The company shall adopt efficient measures to prevent its shareholders and their related parties from misappropriating or transferring capital, assets or other resources of the company through various means.

The Fifth Part of the Guiding Opinions on the Establishment of the Independent Director System by Listed Companies (Listed Companies Should Fully Exploit the Role of Independent directors) specifies that major connected transactions (namely proposed connected transactions between the listed company and a connected person with a total value of more than CNY 3 million (EUR 325 500) or more than 5% of the listed company's most recently audited net asset value) should be submitted to the board of directors for deliberation after approval by independent directors;

Article 96 of the Guidance for the Articles of Association of Listed Companies allows the manager or other top managerial personnel to serve concurrently as the director. However, such directorship concurrently assumed by the manager or other senior managerial personnel or employee representatives shall not exceed half the total number of board of directors. The conflict of interest caused by the situation in which the board of directors is controlled by management can be effectively prevented by limiting the number of members of the board and the managerial personnel on the board who overlap.

5.2.4.7 Principle VI. D 7: Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place for risk management, financial and operational control, and compliance with the law and relevant standards.

The board of directors' audit committee shall ensure the effectiveness of enterprise internal control and the authenticity and accuracy of financial data.

Article 54 of the Code of Corporate Governance of Listed Companies lays down that that the main duties of the audit committee are: (1) to recommend the engagement or replacement of the company's external auditing institutions; (2) to review the internal audit system and its implementation; (3) to oversee the interaction between the company's internal and external auditing institutions; (4) to inspect the company's financial information and its disclosure; and (5) to monitor the company's internal control system.

The amended *Company Law* (2006) grants the supervisory board the right to carry out an investigation when it finds the company operation abnormal and, when necessary, to hire accounting firms to assist in its investigation, with the company covering their expenses. Article 60 of the *Code of Corporate Governance of Listed Companies* also provides that the supervisory board may independently hire intermediary institutions to offer professional opinions.

5.2.4.8 Principle VI. D 8: Overseeing the process of disclosure and communications

Article 3 of the *Administrative Measures on Information Disclosure by Listed Companies* states that the directors of issuers and listed companies shall perform their duties faithfully and diligently, and ensure the veracity, accuracy, completeness, timeliness and impartiality of the information disclosed. Article 24 stipulates that the directors of a company shall sign and endorse regular reports. If directors are unable to ensure the veracity, accuracy and completeness of a regular report or differing views are held, their reasons and opinions shall be stated and disclosed.

Article 90 of the *Code of Corporate Governance of Listed Companies* specifies that the secretary of the board of directors shall be in charge of information disclosure, including drawing up rules for information disclosure, receiving visits, providing consultation, contacting shareholders, providing publicly disclosed information about the company to investors. Articles 87-89 stipulate that information disclosure is an ongoing responsibility for listed companies. A listed company shall disclose information truthfully, accurately, completely and in a timely manner, as required by laws and regulations and the company's articles of association. In addition to disclosing mandatory information, a company shall also voluntarily disclose all other information that may have a material effect on the decisions of shareholders and stakeholders, and shall ensure equal access to information for all shareholders, on a timely basis. Information disclosed by a listed company shall be easily comprehensible. Companies shall ensure cost-effective, convenient and speedy access to information through various means (such as the Internet).

5.2.5 Principle VI. E: The board should be able to exercise objective independent judgement on corporate affairs

5.2.5.1 Principle VI.E.1: Boards should consider assigning a sufficient number of non-executive board members capable of offering independent judgement when there is a potential for conflict of interest, for example, in ensuring the integrity of financial and non-financial reporting, reviewing related-party transactions, nominating board members and key executives, and board remuneration.

5.2.5.1.1 The significance of independent directors

The first part of Guiding Opinion on the Establishment of Independent Director Systems by Listed Companies (Listed Companies Should Establish Independent Director Systems) claims that the term "independent director of a listed company" means a director who does not hold any position in the company other than director and who has no relationship with the listed company or its principal shareholders that could hinder him or her from making independent and objective judgements.

An independent director has a fiduciary obligation and an obligation of diligence toward the listed company and all its shareholders. An independent director should safeguard the company's overall interests and, in particular, the lawful rights and interests of minority shareholders. An independent director should perform his duties and responsibilities independently, without interference from the main shareholders or actual controllers, or other entities or individuals that have a material interest in the listed company.

5.2.5.1.2 The quantity and independent standard of independent directors

The Guiding Opinion requires that at least one-third of the members of the board of directors should be independent directors, and at least one of the independent directors should be a professional accountant.

In order to ensure that independent directors be truly independent, the *Guiding Opinion* stipulates that the following persons may not hold the position of independent director: persons holding a position in the listed company or a subsidiary thereof and their lineal relatives and major social relations (the term "lineal relatives" meaning spouses, parents, children, and the term "major social relations" meaning siblings, parents-in-law, children-in-law, siblings' spouses, spouse's siblings); individual shareholders who directly or indirectly hold not less than 1% of the issued shares of the listed company or who rank in the top ten shareholders of the listed company, and their lineal relatives; persons who hold positions in entities that directly or indirectly hold not less than 5% of the issued shares of the listed company or that rank in the top five shareholders of the listed company, and their lineal relatives; persons who, at some time in the previous year, have joined one of the three above categories ; persons who provide financial, legal, consultancy or similar services to the listed company or its subsidiaries.

5.2.5.1.3 Independent directors' special functions and powers

In the *Guiding Opinion*, independent directors are clearly required to safeguard the company's overall interests and, in particular, to ensure that the lawful rights and interests of minority shareholders are not prejudiced. Listed companies should grant independent directors a number of other tasks and powers, in addition to their legal functions and powers. Once independent directors have approved a major transaction, they should submit their decisions to the board of directors for deliberation. Before pronouncing their decision, independent directors may engage an intermediary organization to issue an independent financial report for use as a basis for their judgement. They should submit their decisions to the board when they propose the engagement or dismissal of an accounting firm, convene a meeting or an extraordinary shareholders' general meeting, engage external auditing institutions and consultancies or openly solicit shareholders' voting rights before a shareholders' general meeting.

Independent directors should obtain the consent of at least half their number before exercising the afore-mentioned functions and powers. If any of the aforementioned proposals are not accepted or any of the afore-mentioned functions and powers could not be exercised normally, the listed company should disclose the details thereof.

An independent director should express his or her independent opinion on six categories of significant matters such as the nomination, appointment and removal of directors, the engagement or dismissal of executives. Independent opinions can be expressed by agreement; reservation and reasons; objection and reasons; no comments and obstacles. The listed company should make a public announcement of the above independent opinions. If the independent directors fail to reach a consensus in their opinions, the listed company should disclose each of the independent directors' respective opinions.

According to the provisions of the *Guiding Opinion on the Establishment of Independent Director Systems by Listed Companies*, listed companies should provide the necessary conditions to ensure the effective performance of functions and expression of independent opinions by independent directors. Firstly, listed companies should make

sure that their independent directors enjoy the same rights to information as other directors. On all matters to be decided upon by the board of directors, the law requires that a listed company must inform its independent directors in advance and provide them with sufficient materials at the same time. Independent directors may request extra materials when they find them insufficient. Secondly, the secretary of the board of directors should actively brief the independent directors on the relevant situation and provide materials. Meanwhile, other personnel of the listed company should actively support the independent directors in their performance of duty. Thirdly, independent directors may hire intermediary institutions and solicit opinions from independent external consultants, the cost of which shall be borne by the listed company, as are the costs related to the performance of their functions.

5.2.5.2 Principle VI. E. 2: When committees of the board are established, their mandate, composition and working procedures should be well-defined and disclosed by the board.

It is stipulated in the *Code of Corporate Governance of Listed Companies* that the board of directors of a listed company may establish a corporate strategy committee, audit committee, nomination committee, remuneration and appraisal committee and other special committees in accordance with the resolutions of the shareholders' meetings. The Code gives clear descriptions of the functions of special committees. Article 58 stipulates that each special committee shall be accountable to the board of directors. All proposals by special committees shall be submitted to the board of directors for review and approval.

Article 52 stipulates that all committees shall be composed solely of directors. Independent directors shall chair the audit committee, the nomination committee and the remuneration and appraisal committee, and independent directors shall constitute the majority of the committees. At least one independent director from the audit committee shall be an accounting professional.

5.2.5.3 Principle VI. E. 3: Board and supervisory board members should be able to commit themselves effectively to their responsibilities.

5.2.5.3.1 Training of the members of the board of directors and the supervisory board.

The CSRC has issued a number of regulations related to the training of members of the board, such as Guidance for the Training of Senior Managerial Personnel in a Listed Company, Implementing Regulations on the Training of the Board Chairman and General Manager in a Listed Company, Implementing Regulations on the Training of Directors and Supervisors in a Listed Company, Implementing Regulations on the Training of Independent Directors in a Listed Company and Implementing Regulations on the Training of Board Secretaries in a Listed Company.

Article 4 of *Guidance for the Training of Senior Managerial Personnel in a Listed Company* stipulates that executives of a listed company shall accept the ongoing education and training, and obtain a training certificate when they hold their positions. The Department of Listed Company Supervision of the CSRC provides guidance and

coordination for the training, and organises training in collaboration with CSRC agencies and stock exchanges. The trainees include the chairman of the board of directors, directors, supervisors, independent directors, general managers, chief financial officers and secretary of the board of directors. The training is designed for these senior executives to gain a better understanding of the relevant laws and regulations and the securities market, improve their business level, strengthen awareness of self-discipline and standard operations and improve the corporate governance structure of listed companies. Trainers are professionals from the CSRC, stock exchanges, higher education institutions and other professional institutions. The CSRC records the training for listed companies executives and their training examination results into a credit records database.

5.2.5.3.2 The qualification of directors and supervisors

To ensure that the company directors and supervisors are able to effectively exercise their functions and duties, the laws and regulations in China include a series of regulations on the qualification of the board members.

Article 95 of the *Guidance for the Articles of Association of Listed Companie*s stipulates that a person may not act as a director if: they are without civil capacity or with limited civil capacity; they have been sentenced to prison for embezzlement, bribery, conversion of property, misappropriation of property, sabotage of social economic order, and completed the sentence less than five years earlier; they have been deprived of political rights as a result of a criminal conviction, and completed repaying the sanction less than five years earlier; they have served as a director, factory manager, or the manager of a company which went bankrupt as a result of mismanagement, were personally responsible for the bankruptcy, and completed the liquidation less than three years ago; they have served as the legal representative of a company whose business license was revoked due to a violation of the law, were personally responsible for such revocation, which occurred less than three years ago; they have an unpaid personal debt of a significant amount; they have been banned by the CSRC from access to the securities market and the ban has not expired. Article 135 provides that the stipulations on disqualifications of directors also apply to supervisors. The directors, general manager and other senior executives may not concurrently serve on the supervisory board.

Article 23 of the *Code of Corporate Governance of Listed Companies* stipulates that in the case where a member of a controlling shareholder's senior management concurrently holds the position of director of the listed company, he or she shall ensure adequate time and energy to perform the work required by the listed company. Article 52 stipulates that an independent director shall chair the audit committee, the nomination committee and the remuneration and appraisal committee, and independent directors shall constitute the majority of the committees. At least one independent director from the audit committee shall be an accounting professional. Article 64 provides that supervisors shall have professional knowledge or work experience in areas such as law and accounting, and that the members and the structure of the supervisory board shall ensure its capability to independently and efficiently supervise its directors, managers and other senior management personnel and supervise and examine the company's financial matters.

5.2.5.3.3 Laws and regulations provide constitutional protection for the board of directors and the supervisory board to effectively fulfil their duties

A series of laws, regulations and self-disciplinary rules such as the *Company Law, Code of Corporate Governance of Listed Companies, Guidance for the Articles of Association of Listed Companies, Shanghai Stock Exchange Guidance on Appointment and Activities of Directors of Listed Companies, Shenzhen Stock Exchange Small and Medium Enterprise Board Director Conduction Guidance, Shenzhen Stock Exchange Guidance on Standard Operations of Companies Listed on the Main Board, Shenzhen Stock Exchange Guidance on Standard Operations of Companies Listed on the SME Board and Shenzhen Stock Exchange Guidance on Standard Operations of Companies Listed on Growth Enterprise Board* define the responsibilities and duties of the members of the board of directors and the supervisory board, ensuring the performance of functions by the two boards in accordance with the laws.

5.2.6 Principle VI. F: In order to fulfil their responsibilities, directors and supervisors should have access to accurate, relevant and timely information.

5.2.6.1 The audit committee is responsible for the accuracy of corporate financial information

Article 52 of the *Code of Corporate Governance of Listed Companies* stipulates that at least one independent director from the audit committee should be an accounting professional. Article 54 stipulates that the main duties of the audit committee are to inspect the company's financial information, disclose that information and monitor the company's internal control system to ensure that the board of directors obtains the correct financial information. The audit committee is a special committee of the board of directors. The expertise of its personnel and the inspection of the internal control system, including the financial system, ensure that directors may obtain correct information.

5.2.6.2 Timely and adequate information for directors and supervisors

Article 46 of the *Code of Corporate Governance of Listed Companies* stipulates that the meetings of the board of directors of a listed company shall be conducted in strict compliance with the prescribed procedures. The board of directors shall send a notice to all directors in advance, at the stipulated time, and shall provide sufficient material, including relevant background material for the items on the agenda and other information and data that may assist the directors in their understanding of the company's business development. When two or more independent directors deem the materials inadequate or unclear, they may jointly submit a written request to postpone the meeting or to postpone the discussion of the related matter, which shall be granted by the board of directors. Article 61 of the *Code of Corporate Governance of Listed Companies* provides that a listed company shall adopt measures to ensure supervisors' rights to learn about company matters, and shall provide the necessary assistance to supervisors for their normal performance of duties. Article 61 insists that no one shall interfere with or obstruct the supervisors' work and that a supervisor's reasonable expenses necessary to perform the duties shall be borne by the listed company. According to Articles 65 to 67 of the *Code*, a listed company shall formulate in its articles of association standardised rules and

procedures for the supervisory board and the supervisory board's meetings shall be convened in strict compliance with the rules and procedures. The supervisory board shall meet periodically and shall convene interim meetings in a timely manner when necessary. If for any reason a supervisory board meeting cannot be convened as scheduled, an explanation shall be made publicly. The supervisory board may ask directors, managers and other senior management personnel, internal and external auditors to attend the supervisory board meetings and to answer the questions that the supervisory board is concerned with.

5.2.6.3 Hiring of external experts for professional opinions

Article 57 of the *Code of Corporate Governance of Listed Companies* stipulates that each special committee may engage intermediaries to provide professional opinions, and the relevant expenses shall be borne by the company. Article 60 provides that supervisors shall have the right to learn about the operating status of the listed company and the corresponding obligation of confidentiality and that the supervisory board may independently hire intermediary institutions to provide professional opinions.

Independent directors should provide objective and fair opinions, especially when the company decision is controlled by internal personnel or there are conflicts of interest with controlling shareholders. In this connection, the independent directors of many listed companies have hired external independent advisors such as professional appraisers, auditors, financial advisors and consultants. In order to allow independent directors to play their role to the full and perform their duty, and protect the rights and interests of minority shareholders, the *Guiding Opinion on the Establishment of Independent Director Systems by Listed Companies* provides that a listed company should grant its independent directors the power to independently hire external auditing and consulting agencies and to make proposals to the board of directors on the hiring or firing of accounting firms.

Article 13 of the *Guidance for Shanghai Exchange Listed Company Corporate Governance* stipulates that independent directors shall provide objective and fair opinions, and especially when the company decision is controlled by internal personnel, and that there are conflicts of interest among shareholders, independent directors may consult external independent advisors. The company shall provide the necessary conditions for this. Article 21 stipulates that the board of the company shall designate the independent director to judge whether the related-party transaction is good for the company in terms of objective standards. When necessary, professional appraisers and independent financial advisors may be employed.

Chapter 6

Stakeholders and corporate social responsibility

After the Chinese government released the Scientific Outlook on Development which puts people's interests first and stresses an all-round, balanced and sustainable development model, and defined the strategic mission of building a harmonious socialist society, Corporate Social Responsibility (CSR) has drawn increasing attention from different sectors across the country. This indicates a crucial transformation in China's development model, a shift from a one-sided focus on the economic growth rate to a scientific development model that stresses balance among economic, social and environmental development and sustainable growth. At the micro-economic level, instead of maximising shareholders' interests alone, companies now take a more holistic view of how their decisions and actions might affect stakeholders and make compensation or repayments accordingly. They have begun to undertake varied forms of social responsibilities across economic, legal, moral and charity issues, resulting in a beneficial interaction with stakeholders and an internal and external environment favourable to their own long-term operations.

Respecting the legal rights and interests of stakeholders, protecting the environment and delivering social responsibility have become a code of conduct for businesses in China. Listed companies, deemed the best among them, have achieved certain progress in CSR enforcement.

6.1 China's legal guarantee for the protection of stakeholder interests

CSR is both an obligation that businesses undertake to account for social communities and stakeholders and a right that social communities and stakeholders are entitled to assert to businesses. A scientific and comprehensive legal system is instrumental for CSR enforcement and to protect the legal rights and interests of stakeholders. Laws and regulations in China contain compulsory provisions on certain fundamental and instrumental CSR issues. A wide range of standards is also in place, including standards for environmental protection, product quality, a minimum wage and workplace safety. Penalties for violation of CSR obligations are defined, including forced closure, revocation of business licences, compensation for economic loss and execution of criminal liability. All this has made the businesses feel more responsible for CSR enforcement.

There are also certain specially designed provisions that provide taxation, credit and other policy incentives for CSR enforcement. For instance, the *Income Tax Law* provides that businesses engaged in approved environmental protection and water or energy conservation projects are entitled to income tax reductions or exemptions. Meanwhile, the

purchasing costs of facilities for the purposes of environmental protection, water or energy conservation, and workplace safety are subject to certain tax allowances.

Stakeholders' participation in CSR and protection of their own interests are also written into China's laws and regulations. For instance, under the *Company Law*, staff representatives are allowed to participate in meetings of board directors and supervisors, and in specific circumstances decisions on major events shall be approved by creditors' meetings.

6.1.1 Provisions on protection of stakeholders' interests

6.1.1.1 Provisions on protection of creditors' interests

Debt financing always accounts for a high percentage of the capital structure of Chinese businesses. It takes the form of short-term loans, short-term financing bills, long-term loans, corporate bonds and convertible corporate bonds. Mechanisms that protect creditors' interests are defined in the *Company Law*, the *Law on Commercial Banks*, the *Securities Law* and the *Law on Enterprise Bankruptcy*.

The *Company Law* bans shareholders from abusing independent entities with legal personality status and their limited responsibilities to the detriment of creditors' interests. Those who do so and evade debt obligations to the serious detriment of creditors' interests shall assume collateral responsibility to respond to the creditors. The company shall cover its previous losses and make allocations to the statutory reserve funds before distributing profits to shareholders. Otherwise shareholders shall return to the company the profit shared in violation of the above provision.

The Law also provides that in the case of a merger, division or registered capital reduction, the company shall prepare a balance sheet and property list and notify its creditors within ten days of the adoption of the resolution and publish a notice within 30 days. Upon receiving the notice, creditors are entitled to protective measures such as claiming full debt payment or requiring assurance of payments from the company.

The Law also provides that a liquidation committee shall be formed within 15 days after the date of the dissolution decision. The committee shall notify the creditors within ten days of its establishment and make a public announcement in the newspaper within 60 days. Creditors may file for their rights with the committee after receipt of the notice. The company shall pay off liquidation expenses, employee payments, insurance fees, statutory compensation and unpaid tax and debts before distributing remaining assets to shareholders.

In 2003 and 2005 the General Office of the State Council issued two documents produced by the State-owned Assets Supervision and Administration Commission on standardising the ownership reform of SOEs, which clearly provides that the reform must explicitly maintain financial creditors' rights and materialise financial debts according to law, and that the reform plan should be agreed upon by the financial institution creditors.

The *Law on Enterprise Bankruptcy* adopted in August 2006 sets out regulations for bankruptcy procedures and the settlement of creditors' rights and obligations. According to the Law, if the company fails to pay off mature debts and has insufficient assets to pay off total debt or evidently lacks the ability to do so, either the debtor or creditor may file for bankruptcy settlement with the People's Court. Article 84 of the *Code of Corporate*

Governance of Listed Companies provides that listed companies shall provide the required information to the bank and its debtors for them to make judgements and decisions on the company's operational status and financial situation. The creditors are entitled to the right to know as necessary.

6.1.1.2 Protection of employee rights

With the growing trend to strive to protect human rights and ensure people's livelihood, the Chinese government has stepped up legislative efforts on the protection of employee rights. A number of laws and regulations have been developed and amended, including the *Company Law, Labour Law, Law on Employment Contracts, Employment Promotion Law, Production Safety Law, Law on Prevention and Control of Occupational Diseases* and *Regulation on the Collection and Payment of Social Insurance Premiums*. The system that protects employees' rights in fair employment opportunity, health and safety, payments and social insurance has gradually been improved. Under the *Company Law*, companies are required to protect the legal rights and interests of their employees by signing work contracts with them, participating in social insurance, and adopting more protective measures for workplace safety. Companies are also required to provide more professional education and training in different forms to enhance employees' qualifications.

In China, employees are allowed to participate in the management of their company through trade unions, the board of directors, the board of supervisors and the employee representative conference. Article 18 of the *Company Law* allows employees to organise trade unions and requires the company to provide operational means for trade union activities. Trade union representatives shall sign a collective contract with the company on issues of payments, working hours, pensions, insurance and workplace safety. In the case of major decisions on reorganisation and operations, and key regulations, the company shall listen to the voice of the trade union and collect views and advice from employees through the employee representative congress or in other forms. Article 4 of the *Law on Employment Contracts* provides that when an employer draws up, revises or decides on rules and regulations or material matters that have a direct bearing on the immediate interests of its employees, such as those concerning compensation, working hours, breaks and leave, workplace safety and hygiene, insurance and benefits, employee training, work discipline or work quota management, these shall all be discussed by the employee representative congress or all the employees. The employee representative congress or all the employees, as the case may be, shall put forward a proposal and comments, whereupon the matter shall be determined through consultations with the trade union or employee representatives conducted on a basis of equality. The *Company Law* allows for the presence of employee representatives at board meetings and requires a minimum one-third share of employee representatives on the board of supervisors. Employee representatives are to be selected by means of democratic elections through the employee representative congress, the employee congress or other forms. The *Law on Enterprise Bankruptcy* requires the presence and opinions of employees and trade union representatives at the debtors' meeting if the company enters a bankruptcy reorganisation phase.

The *Law on Employment Promotion* adopted in August 2007 provides for the right of equal employment opportunities.

6.1.1.3 Regulations on consumer rights protection

China released a great number of laws and regulations on the protection of consumer rights and interests with a view to protecting them and maintaining a proper market order. These include provisions on the social responsibilities that businesses are required to assume for consumers. Directly related laws and regulations are the *Law on the Protection of the Rights and Interests of Consumers, Measures to Handle Fraudulent Behaviours against Consumers, Penalties on Fraudulent Behaviours against Consumers, Interim Measures on Consumer Complaints Handled by Business and Commerce Administrative Authorities*. Laws on product quality include the *Law on Product Quality, Law on Food Safety* and *Pharmaceutical Administration Law*.

6.1.2 Laws and regulations on CSR enforcement

The *Code of Corporate Governance of Listed Companies* provides that while ensuring sustained growth and maximum shareholder interests, listed companies shall also be committed to community welfare, environmental protection and charity issues and be focused on their own social responsibilities. Other laws and regulations also contain detailed provisions on the enforcement of CSR.

6.1.2.1 Provisions on Environmental Protection

According to the Measures for the Administration of Initial Public Offerings of Shares and the Listing Thereof and Administrative Measures for the Issuance of Securities by Listed Companies released by the CSRC, companies that have violated laws and administrative regulations on environmental protection within the recent 36 months and were subject to administrative penalties with serious circumstances shall not be allowed to apply for initial public offerings. Listed companies shall not engage in re-financing. Listed companies' initial public offerings and new share issues shall also meet regulations on environmental protection.

The State Administration on Environmental Protection (SEPA) issued the *Measures on Environmental Information Publicity (on Trial)* in 2007, encouraging businesses to disclose their own environmental information on a voluntary basis. The 2008 SEPA *Guiding Opinion on Strengthening the Regulatory Work on Listed Companies in Respect of Environmental Protection* provides that listed companies shall immediately disclose to investors who have no prior knowledge major events with potential substantial impacts on the transaction price of securities and derivatives, and relevance to environmental protection, illustrating the cause, status quo and possible impacts of the event. In 2008, the Shanghai Stock Exchange issued the *Guidelines on the Disclosure of Environmental Information of Listed Companies*, clarifying the compulsory disclosure requirements for listed companies that appear on the government list of "most seriously polluted companies" or have experienced major environmental events, and the requirements of voluntary disclosure.

6.1.2.2 Regulations against corruption and bribery among businesses

Under the *Law against Unfair Competition* published in 1993, companies are required to observe the principle of voluntariness, equality, justice, honesty and integrity and the agreed commercial morals. In 1996, the *Interim Provision on Banning Commercial Bribery* was published by the State Administration for Industry and Commerce. In 2005, China joined the *United Nations Convention against Corruption* and has enhanced international co-operation against corruption. The *Criminal Law* also defines severe criminal punishments of bribery.

6.1.2.3 Regulations on Donations to Charity

The *Welfare Donations Law* was issued in 1999, proving for donations to charities by individuals, businesses and other organisations. These charity actions include community and individual activities such as disaster relief, poverty relief and reduction and assistance for the disabled; facility-building projects for education, science, culture, healthcare, sports, environmental protection and communities; and non-profit public and welfare activities for the benefit of social progress.

Based on the latest *Corporate Income Tax Law* amended and released in 2007, the proportion of charity and welfare expenses that is within 12% of annual profits shall be deducted from tax payments.

6.2 China's practices compared with the OECD principles

6.2.1 Principle IV. A: The rights of stakeholders that are established by law or through mutual agreements are to be respected.

The principle provisions on the basic content and form of CSR delivery within China's laws and regulations, lay down the legal basis for CSR. Article 5 of the *Company Law* provides that "when undertaking business operations, a company shall comply with the laws and administrative regulations, social morality and business morality. It shall act in good faith, accept the supervision of the government and the general public, and bear social responsibilities". The *Code of Corporate Governance of Listed Companies* stipulates that listed companies shall respect the legal rights of stakeholders such as banks, creditors, employees, consumers, suppliers and communities; create conditions as required for the maintenance of such rights and interests; and arrange compensation which the stakeholders shall have access to and the opportunity to receive whenever their legitimate interests are violated. Apart from legal provisions, the Shanghai and Shenzhen Stock Exchanges have actively played their role as the supervisors of listed companies' self-discipline and made great efforts in to make it easier for listed companies to protect stakeholder interests and fulfil their social responsibilities to the full.

In 2006, the Shenzhen Stock Exchange released the *Guidelines on Social Responsibilities of Companies Listed at the Shenzhen Stock Exchange*, under which listed companies are required to actively protect the legitimate rights and interests of debtors and employees while pursuing economic benefits and protecting shareholder interests; treat suppliers, customers and consumers with good faith; take an active part in environmental protection, community development and other public causes; and develop a balanced and harmonious relationship with the communities. Listed companies are

encouraged to develop social responsibility systems, conduct regular inspection and assessment of the progress made in implementing the systems and issues to be addressed, and regularly draft and release reports on social responsibilities. The TEDA Environmental Protection Index, the first index on social responsibility on China's capital market, was launched by Shenzhen Securities Information Company, a subsidiary of the Shenzhen Stock Exchange.

In 2008, the *Notice on Enhancing CSR Requirements for Listed Companies* was issued by the Shanghai Stock Exchange, which emphasises the non-commercial contribution by stakeholders, society, environmental protection and resource uses. While setting up a CSR strategy, programme and working mechanism, a listed company is encouraged to disclose its special practices and achievements in CSR delivery and release its annual CSR report along with its annual report. It is also encouraged to make public its social contribution value per share, which is the equivalent of additional value per share calculated on the basis of profits per share with the addition of values created for stakeholders including the annual taxes to the country, payments to employees, loan interests to banks or other creditors, and external donations, and the deduction of environmental pollution costs and other forms of social costs. It is designed to give the public a more comprehensive picture of the real value that businesses can create for their shareholders, employees, clients, creditors, communities, and society as a whole. In August 2009, the Shanghai Stock Exchange and China Securities Index Company jointly launched the SSE Social Responsibility Index, which selects from the sample stocks 100 corporate stocks with the highest social contribution value per share and puts them into new sample stocks.

6.2.2 Principle IV. B: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

6.2.2.1 Compensation mechanism for creditors with damaged interests

First, Article 20 of the *Company Law* provides for the denial of the company's legal personality status. In other words, where a shareholder of a company evades the payment of its debts by abusing the independent status of legal personality or the shareholder's limited liabilities, and thus seriously damages the interests of any creditor, it shall bear joint liabilities for company debts. Where any shareholder attempts to transfer or possess the company's property by abusing shareholders' rights, the creditors may demand debt liabilities to be answered for.

Second, creditors may execute their rights of guarantee. The *Guarantee Law* provides that in economic activities such as borrowing, buying and selling, transporting goods, possessing and outsourcing, creditors may initiate a guaranty by way of assurance, mortgage, pledge, lien or down-payment to ensure the fulfilment of their rights as debtors.

Third, creditors may exercise subrogation rights. Article 73 of the *Contract Law* provides that if the debtor delays in exercising its creditor's right against a third person, thereby harming the creditor, the creditor may petition the People's Court for subrogation and the necessary expenses for subrogation by the creditor shall be borne by the debtor.

Fourth, creditors may petition the court to cancel debtors' behaviour of handling abnormal assets. Article 74 of the *Contract Law* provides that where the debtor waives its creditor's right against a third party or assigns its property without reward, thereby harming the creditor's interests, the creditor may petition the People's Court for cancellation of the debtor's act. Where the debtor assigns its property at a low price which is manifestly unreasonable, thereby harming the creditor's interests, and the assignee is aware of the situation, the creditor may also petition the People's Court for cancellation of the debtor's act. The expenses necessary for the creditor to exercise the right to cancel shall be borne by the debtor.

Fifth, debtors may initiate a civil litigation at the Court based on the provisions of the *Civil Procedure Law*. Before or during the process of litigation, debtors may apply for protective measures such as closure, seizure and asset freezing.

6.2.2.2 Settlement mechanism for labour disputes

According to the *Labour Law, Trade Union Law* and the *Law on Mediation and Arbitration of Labour Disputes,* labour disputes between employees and employers may be resolved by filing applications for mediation or arbitration, initiating litigation, or through consultation.

In the case of bankruptcy liquidation, the *Enterprise Bankruptcy Law* provides that bankruptcy property shall first be applied for repayments of wage arrears, healthcare, and subsidies for disabled people and survivor pension. The repayments shall be assigned into employees' pension insurance, health insurance and other forms of compensation before being applied to repay other insurance expenses, taxation and ordinary bankruptcy credits.

6.2.2.3 Settlement mechanism for consumer rights disputes

The *Law on the Protection of Consumer Rights and Interests* provides that consumer rights disputes between consumers and businesses may be settled peacefully through consultation, filing for mediation by a consumer association, filing a complaint with authorities in charge, applying for arbitration and initiating litigation with the court. If the health or property of consumers or other victims suffer from goods defects, they may demand compensation from the sellers and producers. The *Measures against Deceptive Behaviour against Consumers* released by the State Administration for Industry and Commerce in 1996 provides that where fraud is found in goods or services, sellers shall provide additional compensation to make up for the consumer losses of the consumers; the compensation value shall be the same as the purchasing price of the goods or twice the service charge.

6.2.3 Principle IV. C: Performance-enhancing mechanisms for employee participation should be allowed to develop.

6.2.3.1 Means of employee participation in corporate governance

Employees in China can access the management and operation of their companies in different ways. They can be elected into the board of directors or as members of the board of supervisors. The board of supervisors shall have a minimum of one-third of employee representatives. Employees are entitled to a range of rights such as examining the company's financial situation, supervising the behaviours of directors and senior management in delivering their duties, and raising proposals at the shareholders' meetings. The trade union, as an important organisation in the protection of employees' legal rights, also plays a major role in the enforcement of employees' democratic rights, providing guidance to employees on signing collective contracts with the employer and overseeing the enforcement of labour-related laws and regulations by the companies.

6.2.3.2 Employees shall be allowed to be widely engaged in the equity incentive program.

The *Measures for the Administration of the Equity Incentives of Listed Companies (Trial Implementation)* provides that board directors, senior management, core technological (business) professionals and other employees may benefit from these incentives.

6.2.4 Principle IV. D: Stakeholders should have access to relevant, sufficient and reliable information on a timely and regular basis.

Strict requirements on information disclosure by listed companies can be found in a range of laws, regulations and self-disciplinary rules such as the *Securities Law, Administrative Measures on Information Disclosure of Listed Companies* and the *Listing Rules* of the Stock Exchange. Regular and ad hoc reports released by listed companies are published on websites designated by CSRC and one or more nationwide securities newspapers as free public resources. All stakeholders can read this information in real-time and free of charge.

They may also learn from the *CSR Report* issued by listed companies about what has been done to protect employee rights and interests, guarantee product safety, and in the areas of environmental protection, charity and welfare. As required by the *Notice on Producing a Proper Annual Report in 2008 by the Listed Companies*, listed companies that are on *Shenzhen Securities 100 Index* shall follow the regulation in the *Guidance on Social Responsibilities of Listed Companies* to disclose social responsibility reports along with the disclosure of their 2008 annual reports, while encouraging other listed companies to disclose similar reports. In the *Notice on 2008 Annual Reports of Listed Companies*, SSE sample companies, companies with overseas foreign investment offerings, and financial companies shall disclose CSR reports and encourage other listed companies to do so when conditions are ready.

It is estimated that for 2008 162 listed companies in Shenzhen and 290 in Shanghai disclosed their reports.

6.2.5 Principle IV. E Stakeholders should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised because of this.

An important issue in corporate internal control is the possibility for stakeholders to file a complaint with competent institutions within the company regarding illegal or unethical practices existing therein. *Basic Norms on Corporate Internal Control* sets out four basic requirements:

6.2.5.1 Information on internal control shall be sent to different management levels, competent offices and business sections, and shall be communicated to external investors, creditors, customers, suppliers, intermediaries and supervisors requesting their feedback. Issues identified in this way shall be reported and addressed immediately. Key information shall be transmitted to the board of directors, the board of supervisors and management immediately.

6.2.5.2 An anti-fraud mechanism shall be put in place. The principle of punishment and prevention with the focus on prevention shall be adhered to. Key areas, links and institutional obligations shall be clearly defined. Procedures for whistle-blowers, investigation, settlement, reporting and remedies shall be standardised.

6.2.5.3. Systems for whistle-blowing and complaints against and the protection of whistle-blowers shall be put in place. A hot line shall be set up. Handling procedure, time limits and settlement requirements shall be clearly defined to ensure that whistle-blowing and complaints are important means of information-gathering. The abovementioned systems shall be made known to all employees in a timely manner.

6.2.5.4 Self-assessments on the validity of internal control shall be conducted on a regular basis in line with the progress of internal supervision, and reports made accordingly.

The presence of an internal auditing institution is also required for listed companies in China. Directly accountable to the board of directors or the auditing committee, this body is supported by full-time auditors to oversee whether internal control is set up and delivered to the full. When internal or external auditors identify major defects on the internal control of complaints-handling, relevant information shall be reported and communicated to management, the auditing committee and board of directors.

While sending in its IPO application papers to the CSRC, the company shall submit a report confirming the validity of the internal control prepared by certified accountants, who verify that the internal control system is sound, effectively implemented and can ensure the reliability of its financial statements, legitimacy of the company's operations and manufacturing activities and their efficiency and effects. *Rules on the Content and Format of Annual Reports* encourage all listed companies controlled by state-owned enterprises, in the financial sector or otherwise qualified to disclose the self-assessment report on internal control prepared by the board of directors and verified by the auditing

authorities. In its *Notice on Doing a Good Job on 2008 Annual Reports by Listed Companies*, the Shanghai Stock Exchange requires that sample companies on the SSE corporate governance board, companies that issue foreign shares listed aboard and financial companies disclose the self-evaluation reports by their boards of directors, while disclosing the 2008 annual reports. This encourages other viable listed companies to disclose their internal control reports at the same time as their 2008 annual reports, and encourages listed companies to engage audit firms to check and appraise their internal control. The auditor's opinion on such appraisal should also be disclosed. The *Guidance on Internal Control of Companies Listed on the SME Board* requires the companies listed on the small business board to put out a self-assessment report on internal control on an annual basis and the accounting firm to present a verification report on the validity of the report every other year. *No. 1141 of the Auditing Rules of Certified Accountants—Considerations of Bribery in the Auditing of Financial Statements* provides that whenever a certified accountant notices, during the auditing process, major defects in the design or implementation of the company's internal control system, originally designed to prevent or identify bribery, he or she shall inform the management at the appropriate level.

6.2.6 Principle IV. F: The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

The *Company Law* and the *Enterprise Bankruptcy Law* constitute the fundamental legal framework for corporate insolvency. The latter provides for the insolvency procedure, the repayment of property and the basic rights of creditors, introduces the system of bankruptcy managers, standardises the procedures of restructuring and settlement, and ensures the transparency, efficiency and effects of insolvency. In this process, the creditors have a large degree of autonomy. If the company is unable to repay its mature debts, creditors may file applications for restructuring or bankruptcy with the court. On the sidelines of the creditors' meeting, the company is required to be present and answer questions from the creditors. In the selection and overseeing of managers, if the creditors' meeting views the manager unable to perform their duty in a lawful and fair way, or for other reasons, it can apply for a change at the court. While performing their duties, managers are likely to be overseen by the creditors' meeting and creditors' committee. In the reorganisation procedure, creditors may file a direct application with the court, and the creditors' meeting has the right to vote on the draft reorganisation programme, which is subject to a group voting by creditors of different types. *Under the Company Law* and *Enterprise Bankruptcy law*, creditors are entitled to participate in bankruptcy liquidation procedures and in the mechanism of active protection of their own legal rights and interests.

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OECD-China Policy Dialogue on Corporate Governance

Corporate Governance of Listed Companies in China

SELF-ASSESSMENT BY THE CHINA SECURITIES REGULATORY COMMISSION

This report looks at the institutional framework of corporate governance in China through the prism of the *OECD Principles of Corporate Governance* and is a product of the ongoing OECD-China Policy Dialogue on Corporate Governance. By assessing a broad range of laws, regulations and codes, it provides a valuable reference for understanding how much has been achieved in Chinese corporate governance and the main ambitions of future reform efforts.

The report shows that corporate governance has improved significantly since the Chinese stock market was created in 1990, with important achievements in establishing and developing the legal and regulatory framework. The OECD-China Self-Assessment represents a thorough review of all laws, regulations and codes that relate to every principle recommended by the *OECD Principles of Corporate Governance*. It documents the advances in the Chinese Corporate Governance framework. Building on this report, bilateral co-operation between China and the OECD will continue to enhance the understanding of China's corporate governance system and how it impacts on company and investor behaviour.

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