



PEOPLE'S REPUBLIC OF CHINA

FINANCIAL SECTOR ASSESSMENT PROGRAM

DETAILED ASSESSMENT OF OBSERVANCE OF THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

December 2017

This Detailed Assessment of Observance of the Iosco Objectives and Principles of Securities Regulation on the People's Republic of China was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in December 2017.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

**International Monetary Fund
Washington, D.C.**

PEOPLE'S REPUBLIC OF CHINA

FINANCIAL SECTOR ASSESSMENT PROGRAM

December 2017

DETAILED ASSESSMENT OF OBSERVANCE

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

Prepared By
Monetary and Capital
Markets Department, IMF
and Finance and Markets
Global Practice, World Bank

This Report was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in China during November-December 2016 and February-March 2017, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance and Markets Global Practice, World Bank. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>, and www.worldbank.org/fasp.



INTERNATIONAL MONETARY FUND



THE WORLD BANK

CONTENTS

Glossary	3
EXECUTIVE SUMMARY	5
INTRODUCTION	9
INFORMATION AND METHODOLOGY USED FOR ASSESSMENT	9
INSTITUTIONAL AND MARKET STRUCTURE—OVERVIEW	10
A. Regulatory Structure	10
B. Market Structure	13
PRECONDITIONS FOR EFFECTIVE SECURITIES REGULATION	23
SCOPE OF THE ASSESSMENT	24
MAIN FINDINGS	26
A. Authorities' Response to the Assessment	50
DETAILED ASSESSMENT	51
TABLES	
1. Key Market Indicators	13
2. Secondary Market Trading	14
3. Bond Markets	16
4. Future Markets	17
5. CIS under the CSRC	19
6. Nonpublicly Offered Securities Investment Funds Registered with AMAC	19
7. Summary Implementation of the IOSCO Principles—Detailed Assessment	31
8. Recommended Action Plan to Improve Implementation of the IOSCO Principles	45
9. Detailed Assessment of Implementation of the IOSCO Principles	53

Glossary

ABS	Asset Backed Securities
AMAC	Asset Management Association of China
ASBE	Accounting Standards for Business Enterprises
AUM	Assets Under Management
CCP	Central Counterparty
CIS	Collective Investment Schemes
CBRC	China Banking Regulatory Commission
CFA	China Futures Association
CFFEX	China Financial Futures Exchange
CIRC	China Insurance Regulatory Commission
CPA	Certified Public Accountant
CRA	Credit Rating Agency
CSA	China Standards of Auditing
CSDC	China Securities Depository and Clearing Corporation
CSIS	China Securities Internet System Co. Ltd
CSRC	China Securities Regulatory Commission
FCRG	Financial Crisis Response Group
HF	Hedge Funds
ISA	International Standards of Auditing
JMC	Joint Ministerial Conference
MF	Mutual Fund
MMF	Money Market Fund
MoF	Ministry of Finance
NAFMII	National Association of Financial Market Institutional Investors
NDRC	National Development and Reform Commission
NEEQ	National Equities Exchange and Quotations Co. Ltd.
NPC	National People's Congress
PBoC	People's Bank of China

PEOPLE'S REPUBLIC OF CHINA

PFMI	Principles for Financial Market Infrastructure
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
SAC	Securities Association of China
SAFE	State Administration of Foreign Exchange
SC	State Council
SCIB	Securities Crimes Investigation Bureau
SIPF	Securities Investor Protection Fund
SOE	State Owned Enterprise
SSE	Shanghai Stock Exchange
SZE	Shenzhen Stock Exchange
VWAP	Volume weighted average price
WMPS	Wealth Management Products

EXECUTIVE SUMMARY

The authorities' vision of ensuring that the capital markets support China's transformation towards a more market-oriented economy has driven capital markets development and—as the authorities recognize—the regulation and supervision of the markets. In some areas the specific characteristics of the market combined with the vision of capital markets development have prompted the China Securities Regulatory Commission (CSRC), as the main regulator of the securities markets, to adopt different approaches to the regulation and supervision of the market than those adopted in other large markets. At times such an approach has encountered challenges and the balance between market development and stability has been difficult to strike. Moving to more market-based solutions should allow the markets to work more efficiently but this should be done in a carefully sequenced way.

The regulatory framework and supervisory program for the securities markets is largely compliant with the IOSCO Principles. Since 2010, when the previous assessment was conducted, the authorities have implemented several initiatives aimed at protecting China's very large retail investor population. On the CSRC side, this includes strengthening the suitability requirements for intermediaries, investors' ability to exercise their rights, and its investor education program. The CSRC has also expanded authorized activities for some categories of securities intermediaries with the objective of developing an investment banking culture to help capital markets serve the real economy better. At the same time, the prudential and capital requirements applicable to some participants have been reviewed and strengthened. During the last three years the CSRC has strengthened its tools to monitor systemic risk. Following the market volatility of 2015 it has taken actions to curb excess leverage in the market, with some of these actions undertaken jointly with other public authorities. Finally, during the last year the CSRC has also taken a stronger stance on enforcement. By the same token, the China Banking Regulatory Commission (CBRC) has strengthened the regulatory framework for wealth management products (WMPs) in several key aspects, including, for example, by introducing stronger distribution and sales rules, requiring full segregation and separate accounting for each WMP, and imposing stricter rules on eligible investments.

Some innovative approaches taken by the CSRC could serve as a reference for other jurisdictions. The see-through system for clients' accounts, the creation of the China Investor Services Corporation, which can represent investors in court, and the efforts to develop a multilayer mediation system are only a few of the investor protection initiatives that could be followed by emerging markets regulators. As for systemic risk monitoring, the creation of the Capital Markets Statistics and Monitoring Center, the development of the Central Regulatory Information Platform, and the implementation of a universal identification number for investors across the securities and futures markets are leading practices.

However, at the regulatory and supervisory level the authorities face some challenges that require attention. First, the financial authorities should implement the existing agreements aimed at harmonizing the regulation of activities and products currently subject to more

than one regulatory regime and supervisory authority. Priority should be given to the development of harmonized regulations for asset management services, as differences in key operational aspects provide room for regulatory arbitrage, which in turn may have an impact on investor protection and affect the ability of the authorities to monitor systemic risk. Under the Joint Ministerial Conference (JMC), the People's Bank of China (PBoC), the CSRC, the CBRC and the China Insurance Regulatory Commission (CIRC) have reached a consensus to strengthen the regulation of WMPs and are currently working on the development of uniform regulatory rules for the same type of WMPs. Such harmonized framework should address weaknesses identified through this assessment in the areas of disclosure, custody, bankruptcy remoteness and valuation, as appropriate. In addition, coordination arrangements should continue to be enhanced to help ensure that such harmonized regimes are administered in a consistent fashion. By the same token, the authorities should implement agreements reached in the JMC for Bonds concerning the bond markets that aim at harmonizing regulations, and enhancing coordination mechanisms including enforcement actions. In tandem, the authorities should continue working on the harmonization of the regulations for credit rating services, for which a draft regulation has been submitted for consultation. Finally, in the medium term, the authorities should also consider the development of harmonized regulations for asset-backed securities within the framework of the *Securities Law*.

Second, addressing the resource challenges faced by the CSRC should allow it to step up its supervisory and enforcement program as the market continues to grow. The staff quota system and salary scale to which the CSRC—along with the other financial regulatory commissions—is bound are limiting its ability to keep up with a market that is growing in complexity and at a very fast pace. While improvements in off-site monitoring and the use of big data can help, the current market structure characterized by a large presence of retail non-sophisticated investors trading in the market, requires a much more intensive approach to supervision than may be required in other large jurisdictions. In this regard, in general it is important that the coverage of the monitoring programs for all participants be kept under review including that of auditors given their role in the system. Thus, additional resources are needed to ensure that the CSRC can deliver a sufficiently robust program of supervision and enforcement. In addition, consideration should be given to providing the CSRC with greater autonomy to decide on the number of staff and to have a separate salary scale from that applicable to the civil service, as is the case in other jurisdictions.

Third, the enforcement strategy should continue to be enhanced, and the powers to impose appropriate sanctions strengthened so that the CSRC and the criminal authorities can implement an enforcement program that provides confidence to investors. There is evidence that the CSRC is moving towards using administrative measures and sanctions in a more vigorous way, including through the imposition of larger monetary penalties and bans on the full range of market participants, from issuers to intermediaries and including gatekeepers such as sponsors and auditing firms. To ensure it has a lasting effect on market behavior, this approach should be continued and further strengthened. To assist this effort, gaps and inconsistencies in the descriptions of misconduct should be eliminated and the level of fines and penalties available increased for both administrative sanctions and criminal offenses, as appropriate, including in the latter case the terms of imprisonment. In addition, criminal sanctions, in particular imprisonment,

need to be used more vigorously to punish the most egregious violations and send clear deterrence messages to the market.

From a systemic risk monitoring perspective the authorities should continue strengthening mechanisms to ensure they have a holistic view of securities markets and their interconnectedness with the rest of the financial sector. As mentioned above, the CSRC has made impressive progress to improve its tools and processes for systemic risk identification and monitoring. Such efforts should continue with a view to ensuring that the CSRC has effective tools and expertise to monitor all markets under its remit. Given the existence of multiple regulators for key products and markets, it is critical that the current cross-sectoral mechanisms to share information, identify and monitor systemic risk continue to be strengthened. In particular, as agreed by the authorities, data sharing on asset management should continue to be expanded and efforts to standardize data be given full priority. The authorities should also explore whether a more continuous and systemic mechanism to jointly monitor risks stemming from the bond markets is needed.

Further, it is critical that all authorities responsible for the regulation and supervision of key components of the securities markets remain continuously alert to the need to make adjustments to regulation and supervisory practices in a timely fashion. In the case of China, the pace of growth means that practices that today are considered appropriate might be inadequate in a short period of time. Thus, even in areas where the system has been considered fully aligned with the Principles the authorities are encourage to keep a critical eye.

Looking forward, many of the challenges ahead will continue to require a careful balancing of the developmental and stability mandates, which in turn would have an impact on regulation and supervision. In the case of China, many of the challenges ahead stem from the authorities' vision to further develop the markets and the potential approaches to do so in a manner that delivers more market-based solutions, while ensuring investors' protection and financial stability. For example, to further strengthen the role of disclosure in the public markets and the private exercise of rights work would be required on several fronts, including initiatives to (i) strengthen corporate governance of issuers as a key step to improve the quality of their financial disclosure, (ii) ensure that different gatekeepers comply with their responsibilities, (iii) enhance investors' ability to exercise their rights and (iv) foster greater participation of institutional investors in the markets –some of which are not covered by the IOSCO Principles. Further, from a broader perspective a key challenge for the CSRC and the Chinese authorities is to ensure that the multi-tiered market is implemented in a way that it does not adversely affect investors' confidence in the capital markets as a whole. To this end, the CSRC should keep the National Equities Exchange and Quotation Corporation (NEEQ) and the securities companies that operate in it under close monitoring. In addition, as planned by the authorities, standards should be implemented to facilitate the regional trading platforms to develop safely and operate as an effective way to bring local financing to local businesses. In the long run, the authorities should consider the development of a common framework that encompasses all non-exchange trading platforms, while allowing for differences in the role that the CSRC would play in their oversight. Similarly, further development of the futures markets would require consideration of the potential need for a more sophisticated

business model for futures intermediaries and how best to foster the confident participation in the market by end users. This will require the CSRC to assess whether changes are needed in the regulatory framework as well as education programs and continued close monitoring of market activity and risk management practices. Finally, because of the importance of the audit process for the reliability of financial information across the financial sector, it is critical that the authorities unite their efforts to ensure high quality audits and a well-regulated profession. The creation of a single, independent oversight body might be an option to achieve this objective.

INTRODUCTION

1. An assessment of the level of implementation of the IOSCO Objectives and Principles of Securities Regulation (IOSCO Principles) was conducted in the People's Republic of China from November 29 to December 21, 2016 and February 21 to March 1 2017. The assessment was made as part of the IMF-WBG FSAP by Ana Fiorella Carvajal, IMF staff on assignment with the World Bank, Malcolm Rodgers and Thomas Yee, external experts working for the IMF-WBG. The previous IOSCO assessment of the PRC was conducted in 2010.

INFORMATION AND METHODOLOGY USED FOR ASSESSMENT

2. The assessment was made on the basis of the IOSCO Principles approved in 2010 and the Assessment Methodology adopted in 2011. As has been the standard practice, Principle 38 was not assessed due to the existence of a separate standard for financial market infrastructure.

3. The IOSCO Assessment Methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice. The global financial crisis reinforced the need for assessors to make a judgment about supervisory and other operational practices and to determine whether they are sufficiently effective. Among other things, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope and quality of inspections, as well as how the relevant authorities follow up on findings, including by using enforcement actions.

4. The assessment was based on several sources. These comprise (i) a self-assessment and additional written responses prepared by the authorities; (ii) reviews of the relevant legislation and regulations; (iii) meetings with CSRC management team and staff, (iv) and meetings with public officials, including representatives from the PBoC, the CBRC, the CIRC, the National Development and Reform Commission (NDRC), the MoF, and the Ministry of Public Security; and meetings with exchanges, industry associations, the CSDC, the SIPF, and a sample of listed companies, securities companies, fund management companies, future companies, banks, insurance companies, auditors, credit rating agencies, consultancy firms, and law firms.

5. The assessors want to thank the Chinese authorities and market participants for their cooperation and willingness to share information. The views of authorities and market participants on the current status and the best way forward for the regulation and supervision of the Chinese securities markets provided an essential input to the conclusions of the mission.

INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW

A. Regulatory Structure

6. The regulation and supervision of the financial sector in China is set broadly along sectoral lines, whereby the securities industry is mainly regulated by the China Securities Regulatory Commission (CSRC); while the banking industry and the trust company industry is regulated by the China Banking Regulatory Commission (CBRC) and the insurance industry by the China Insurance Regulatory Commission (CIRC). The CSRC was established in October 1992 as a ministry-level government agency directly under the State Council (SC), to which it is accountable. The main governing body of the CSRC is the Chairman, whose position has Ministerial rank. He is currently supported by four Vice-Chairmen and two Assistant Chairmen. The Chairman has responsibilities for all matters; while each Vice-Chairmen and Assistant Chairman has responsibilities to oversee day-to-day operations of specific departments. The executive team is appointed by the State Council (SC).

7. The SC plays a key role providing strategic direction to the CSRC. The regulation and supervision of the capital markets is driven by a capital markets development strategy aimed at ensuring that the capital markets play a larger role in financing the real economy. This strategy emanates from the National People's Congress (NPC) annual meetings and is transformed into actionable points via opinions of the SC. The most relevant opinions are the Opinion on Further Enhancing the Protection of Small Investors' Rights and Interests from 2013 and the Opinion on the Healthy Development of the Capital Markets from 2014. CSRC strategic priorities are driven by such opinions. That said, the CSRC has the opportunity to influence such opinions, as their development is subject to consultation with all relevant stakeholders including the CSRC.

8. In general, the mandate of the CSRC covers the regulation and supervision of the securities and futures markets. Such responsibilities are mainly established by law (the Securities Law and the Securities Investment Fund Law); and complemented by regulations and decisions of the SC. Pursuant to the legal and regulatory framework the CSRC authorizes the public offering of securities and funds, licenses all categories of intermediaries with the exception of private securities investment fund managers (which are only subject to registration with the Asset Management Association of China (AMAC)), licenses futures markets, while the licensing of equity markets falls to the SC acting on the recommendation of the CSRC, and licenses information service providers, including credit rating agencies and auditors that provide services in the securities and futures markets. It has rulemaking powers over all such categories of participants (including private fund managers), and exercises day-to-day supervision of their operations. It also has investigative and administrative enforcement authority in connection with the laws and regulations that it administers and as a result can impose administrative measures on regulated entities and administrative sanctions, including money penalties, on both regulated entities and persons who are in breach of such laws and regulations. Criminal enforcement is a responsibility of the criminal authorities,

although the CSRC and the Securities Crime Investigations Bureau of the Ministry of Public Security play a key role in assisting the investigation of criminal offenses.

9. However, certain activities and products are subject to the regulation and supervision of more than one regulatory authority, as detailed below. As further explained in the detailed assessment in most of the areas listed below the authorities have already reached agreements aimed at working towards the development of harmonized regimes and strengthening coordination and cooperation arrangements.

- The provision of asset management services: there are three regimes. (i) The regime for the provision of individual and collective portfolio management and advisory services by intermediaries under the CSRC. (ii) The regime for the provision of these services by banks and trust companies, which is administered by the CBRC. Pursuant to such regime only banks can offer asset management services to retail investors. (iii) The regime for the provision of asset management plans by insurance asset management companies, which is administered by the CIRC. Pursuant to such regime the plans can only be offered to institutional investors, but in practice they are mainly used by insurance companies to manage their insurance funds.
- The offering, placement and trading of bonds: There are three regimes. (i) The regime applicable to corporate bonds that are issued to the public and which must be listed on the exchanges. Such issuances are subject to the regulation and supervision of the CSRC, and the listing rules of the exchanges. The exchanges are the front-line supervisor of such markets, and supports CSRC supervision of the markets. (ii) The regime applicable to bonds and debt instruments issued by financial and non-financial corporations strictly to institutional investors in the interbank bond market. Issuances in it are subject to the regulation and supervision of the PBoC, and the debt instruments issued by non-financial corporations to institutional investors subject to self-regulation by NAFMII, which in turn is subject to oversight by the PBoC. The market infrastructure providers and NAFMII perform first-line monitoring and self-regulation that assist the PBoC in monitoring the interbank bond market. The CSRC could make investigations and sanctions to violations of the Securities Law such as fraudulent information disclosure, insider trading and price manipulation in the bond market. (iii) The regime applicable to enterprise bonds which are bonds issued for specific projects. The issuance is subject to the regulation and supervision of NDRC. Enterprise bonds can be traded on the exchanges or in the interbank bond markets and as a result are subject to supervision as per the applicable market.
- The offering, placement and trading of asset backed securities (ABS): Under the current framework credit ABS are under the regulations of PBoC/CBRC and enterprise credit ABS under the regulations of CSRC. In addition, asset backed notes (ABN) are registered and issued through NAFMII and subject to self-regulation by NAFMII. All such products can only be issued to qualified investors.
- The provision of credit rating services: PBoC is the lead regulator for credit rating services. All credit rating agencies must fulfill the record filing procedures regulated by the PBoC. In

addition, CRAs are subject to licensing or recognition by the corresponding regulator(s) depending on the type of bond to which they provide services.

10. To exercise its responsibilities the CSRC's central office in Beijing is complemented by its 38 regional offices. In general, the CSRC central office is responsible for (i) preparing market development plans; (ii) formulating, amending and revising regulations and rules concerning the securities and futures markets; (iii) carrying out the approval function in key matters such as public offerings and licenses of intermediaries; (iv) guiding and coordinating efforts on risk prevention and mitigation; (v) coordinating supervisory actions, (vi) organizing investigations and enforcement activities in relation to cases involving misconducts or material violations of securities and futures laws; and (vii) coordinating and planning investor protection initiatives. The CSRC regional offices are the frontline supervisors of their respective jurisdictions, and as such are responsible for the supervision of entities and activities under their jurisdiction, along with the investigation of misconduct, and the corresponding enforcement actions, and the implementation of investor protection initiatives, including investor education. There are different mechanisms through which coordination takes place, including annual statewide meetings to discuss supervisory and enforcement priorities.

11. The CSRC is supported by 19 affiliated institutions, which include the stock and futures exchanges as well as industry associations including the Securities Association of China (SAC), the China Futures Association (CFA) and AMAC. Both the exchanges and the industry associations exercise self-regulatory functions assigned to them by Law. The exchanges have listing authority and as such have a key role in the monitoring of listed companies' compliance with listing obligations including disclosure obligations; they also have an important role in member regulation and market surveillance with a view to ensuring orderly trading and supporting the identification of unfair trading practices. Membership in the industry associations is mandatory for specific categories of intermediaries: securities companies must be members of SAC; futures companies of the CFA and private securities investment fund managers of AMAC. The industry associations have two main roles: the development and administration of a system for the qualification of practitioners (individual persons that exercise specific functions in the securities and futures industry) and the development and monitoring of rules for the industry, which in practice have come to provide additional granularity to CSRC regulations. Notwithstanding the existence of the industry associations, the CSRC has the licensing authority over all intermediaries, and has developed supervisory programs for all categories of intermediaries; thus the programs of the industry associations complement CSRC programs. The only case where there is a difference in approach relates to the managers of private securities investment funds and the private funds themselves, whereby they are not subject to licensing by the CSRC nor approval of the funds by the CSRC, but only to registration with AMAC. That said, the CSRC has regulatory powers over them and in practice it has its own supervisory program to oversee their operations.

B. Market Structure

Cash Markets

Equity markets

12. The Chinese authorities are pursuing a strategy of building a multi-tiered equity market to ensure access to capital for a wide range of business enterprises. In practice, they have been actively involved in the establishment of the different types of markets and trading platforms described below.

13. At the top are the Shanghai and Shenzhen Stock Exchanges. The Shanghai Stock Exchange (SSE) has only one board, and caters mainly to blue chip SOEs. The Shenzhen Stock Exchange (SZSE) has three levels: the main board, the SME board and the Growth Enterprise Board (GEB), also known as ChiNext. The GEB is considered a second board, catering to innovative growth enterprises. Listing requirements are scaled, with the GEB having the least stringent financial and performance requirements. The Shenzhen Stock Exchange has mainly catered to private (non SOEs) companies. Companies that have publicly offered shares can be listed on any of these boards. As of the end of 2015 there were 2827 companies listed on the two exchanges, for a total market capitalization of RMB 53.15 trillion which is equivalent to 78.54% of China's GDP.

Table 1. China: Key Market Indicators

	Number of companies			Market capitalization (RMB trillion)			Number of new listings		
	2013	2014	2015	2013	2014	2015	2013	2014	2015
Shanghai	953	995	1081	15.12	24.40	29.52	0	43	89
Shenzhen	1536	1618	1746	8.79	12.86	23.63	0	82	130
Total	2489	2613	2827	23.91	37.25	53.15	0	125	219

Source: CSRC.

14. Arrangements have been established to allow cross-border trading in shares between the Chinese Mainland and Hong Kong. Before November 17, 2014, foreign investors only had exposure to Chinese equities via Chinese listings on the Hong Kong Stock Exchange. Only institutional investors were given access to the Shanghai and Shenzhen stock exchanges via the Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) programs. Onshore retail investors could only own investments outside of China through onshore Qualified Domestic Institutional Investor (QDII) products. These barriers came down with the implementation of Shanghai-Hong Kong Stock Connect (Stock Connect). Stock Connect allows direct mutual market access between the Shanghai and Hong Kong exchanges using their local brokers and clearing houses, within certain volume caps. A similar arrangement between the Shenzhen Stock Exchange and the Hong Kong Stock Exchange commenced operations in December 2016, except that there are no total volume caps for it. Trading through these mechanisms is jointly supervised by the exchanges and regulators in each of the jurisdictions.

15. Secondary market trading has grown significantly since the previous assessment.

There was a very significant increase in market trading in 2015, accompanied by large swings in market prices. As noted below, concerning trading in the secondary markets, the level of direct participation by retail investors is very high by international standards and participation by institutional investors remains small compared to other large markets. This is one factor that likely contribute to high levels of market volatility, for example in 2015, as retail investors tend to react in large numbers to information or market rumors, and the market discipline that could be provided by institutional investors is largely absent.

Table 2: China: Secondary Market Trading

Year	Annual Turnover (RMB billion)			Average daily trading volume (million contracts)			Average daily turnover (RMB billion)		
	2013	2014	2015	2013	2014	2015	2013	2014	2015
Shanghai	23,027	37,563	132,559	1.12	1.74	4.17	97	153	543
Shenzhen	23,846	36,675	122,495	0.91	1.26	2.84	100	150	502
Total	46,873	74,239	255,054	2.03	3.00	7.01	197	303	1,045

Source: CSRC.

16. In accordance with the Securities Law and under the approval of the SC, the National Equities Exchange and Quotations (NEEQ), also known as the “New Third Board”, was established in 2013 as a national trading venue to cater to innovative, entrepreneurial and growth micro, small and medium enterprises (MSMEs). It is a national platform for the transfer and trading of securities subject to the regulation of the CSRC. Companies in NEEQ may have more than 200 investors (the threshold for a public offering), however they are only allowed to sell their shares to qualified investors, which are experienced investors with at least RMB 5 million in financial assets. Trading in NEEQ is also restricted to qualified investors. Companies in NEEQ are subject to a set of disclosure requirements and corporate governance requirements in light of their nature as non-listed “public” companies. Compliance by issuers with such requirements is monitored by the NEEQ. There are no financial indicators that NEEQ companies must comply with. In practice, at the time of the assessment the percentage of companies that exceeded 200 investors was not material. As of the end of 2016, 10,163 companies were listed on NEEQ, and market capitalization was approximately RMB 4.06 trillion. The NEEQ's annual turnover was RMB 814 million in 2013, RMB 13,036 million in 2014, and RMB 191,062 million in 2015 and RMB 191.229 million in 2016 respectively.

17. In addition to the nationally regulated markets, there are 40 regional “trading platforms” that operate as OTC markets to raise capital, and that are restricted to qualified investors. Regional equity platforms are established mainly in accordance with the Decision of the SC on Rectifying Various Trading Venues to Effectively Prevent Financial Risks (Guo Fa [2011] No. 38), the Opinions of the General Office of the SC on Implementing Efforts to Rectify Various Trading Venues (Guo Ban Fa [2012] No. 37) and the Notice of the General Office of the SC on Regulating the Development of Regional Equity Markets (Guo Ban Fa [2017] No.11, the “Notice”). Pursuant to

these instruments each regional platform should only trade companies located in the region. Companies trading on these platforms cannot engage in a public offering of securities; they are only allowed to sell their securities to qualified investors through a private placement. Thus, as per the definition of public offering, they cannot have more than 200 shareholders. Secondary market trading also is restricted to qualified investors. As per recent guidance issued by the SC such investors must be institutional investors or individuals with more than 500,000 RMB in financial assets. Trading mechanisms vary; but pursuant to the SC instruments no trading platform may establish a market-making system or provide a continuous auction or electronic matching capability, and a lapse of 5 days must take place between the moment that an investor buys a securities and the moment in which he/she sells it. At the end of 2016, there were about 17,400 companies listed in these platforms. In 2016, companies raised RMB 287.1 billion through various financing activities on the system.

18. There is also an inter-institutional quotation system administered by SAC The China Securities Internet System Co., Ltd. ("CSIS") is a financial institution established on February 27, 2013 with the approval of CSRC and administered by SAC in accordance with market-based principles. CSIS is licensed to (a) provide quotation, offering, and transfer services for non-publicly offered products; (b) facilitate, through building business alliances, the exchange of information and the interconnection of trading networks in the private market such as the OTC market of securities companies and regional equity markets; (c) provide the depository, clearing, settlement, and third-party collateral management services in respect of non-publicly offered products; (d) provide services relating to the monitoring and statistical analysis of the private market, and develop, promote, study, investigate, and advise on the private market and its operations. CSIS is a well-functioning company with growing membership and business operations.

Bond markets

19. There is a multilayered system also for the bond markets, comprised of the exchange and the interbank bond market. Before 1997, the securities exchange was the main market for bonds. After 1997, with the approval of the SC, the inter-bank bond market was established and regulated by PBoC. It is an OTC market, positioned as a market for institutional investors, which term includes various types of financial institutions, legal entities, and their financial products.

20. The bond markets have experienced considerably growth during the last years; however, of the two markets, the interbank bond market is by far the larger one. In 2016, roughly 90 percent of the new issuance of bonds are originated and traded in this market. As of December 2016, the inter-bank bond market consisted of debt instruments worth more than 56.3 trillion yuan.

21. The ABS markets are incipient. Currently ABS can only be offered to qualified investors. As of end 2016, outstanding ABS issued by banking financial institutions in the interbank bond market stood at RMB 487.8 billion; while outstanding ABS issued on the exchanges reached RMB 541.9 billion up by 233% year on year.

Type of bonds	Issuances in 2015 (RMB in billions)	Issuances in first half of 2016 (RMB in billions)
Government securities	2105.8	1367.8
Local government bonds	3835.1	3575.5
Central bank bills	0	0
Financial bonds	10209.5	8838.6
Of which: Financial bonds issued by the China Development Bank and policy financial bonds	2605.1	2002.4
Inter-bank certificates of deposit	5302.4	6021.6
Corporate issuances	6842.3	4329.6
Of which: Debt-financing instruments of non-financial enterprises	5432.6	2737.2
Enterprise bonds	503.1	325.7
Corporate bonds (issued in exchange market)	906.6	1256.1
International bonds	—	10.6
Total	22992.7	18111.5
Source: CSRC.		

22. The local government bonds' market has experienced rapid growth. By the end of 2016, the outstanding volume was around RMB 10 trillion, which is close to the size of the treasury bond market. There are guidelines of MoF pertaining to the issuance of local government bonds by way of a public offering. Those guidelines require initial as well as ongoing disclosure. As per current guidelines, such documents are filed with the MoF. Only the local government bonds listed in the exchange market could be offered to retail investors. This segment of the market remains small.

23. Banks can offer a limited number of bond products over the counter. However, they cannot be offered to retail investors, only to high net worth individuals.

Futures Markets

24. There are three commodities futures exchanges and one financial futures exchange in the Chinese Mainland. The Shanghai Futures Exchange, the Dalian Commodity Exchange and the Zhengzhou Commodity Exchange trade only in commodity based futures contracts. They are all mutualized exchanges. As at the end of 2015, there were 46 commodity futures contracts traded on the markets covering commodities such as gold, oil, copper, aluminum, zinc, steel, rubber, rice, corn, soybeans and sugar. The China Financial Futures Exchange (CFFEX), which is owned by the other commodity futures exchanges and the two stock exchanges, trades only financial futures contracts. As at the end of 2015, three stock index futures and two Treasury bond futures traded on the CFFEX. Separately, there is one ETF options contract traded on the Shanghai Stock Exchange.

25. Trading in futures contracts has seen significant growth in recent years. In the commodities markets, the Chinese futures markets have now become the global reference point for the pricing of some commodities. Market growth has been most striking in the financial futures

market operated by CFFEX, and there is market demand for an increasing range of new products. As in the equity markets, there is a high level of retail participation in futures trading and this may in part account for market volatility that is sometimes high by international standards. Contracts in the commodities markets allow physical delivery; but in practice physical delivery is low, estimated at 1-3 percent.

Table 4. China: Future Markets				
		2013	2014	2015
Shanghai Futures Exchange (SHFE)	Number of contracts	242	270	313
	Turnover (100 million RMB)	604,167.73	632,353.25	635,552.63
	Trading volume (10,000 contracts)	64,247.40	84,229.42	105,049.41
	Open positions (10,000 contracts)	209.39	239.34	385.02
Zhengzhou Commodity Exchange (ZCE)	Number of contracts	183	239	265
	Turnover (100 million RMB)	188,978.30	232,399.31	309,794.68
	Trading volume (10,000 contracts)	52,524.92	67,630.63	107,022.37
	Open positions (10,000 contracts)	199.87	262.9	247.8
Dalian Commodity Exchange (DCE)	Number of contracts	224	303	315
	Turnover (100 million RMB)	471,527.27	414,944.32	419,359.74
	Trading volume (10,000 contracts)	70,050.08	76,963.70	111,632.34
	Open positions (10,000 contracts)	315.39	384	532.54
China Financial Futures Exchange (CFFEX)	Number of contracts	20	23	52
	Turnover (100 million RMB)	1,410,066.21	1,640,169.73	4,177,604.71
	Trading volume (10,000 contracts)	19,354.93	21,758.11	34,086.93
	Open positions (10,000 contracts)	12.32	23.7	12.96
Source: CSRC.				

Cross Trading

26. There is no cross-listing of securities or futures traded on regulated financial markets, and products trade on only one market. An exception to this is bonds traded on one or other of the stock exchanges and on the interbank bond market, including government and local

government bonds, and bonds issued by financial institutions and enterprise bonds. In practice, trading of bonds on the public markets accounts for a relatively small percentage of overall bond trading.

Investors in the Exchanges

27. An important feature of China's securities and futures markets is the degree of retail investors' participation in secondary market trading, and a relatively lower level of institutional participation compared to many other jurisdictions. Retail investors with less than RMB 500,000 account for well over 90 percent of trading accounts on the stock exchanges, about 80 per cent of trading activity and 35 per cent of market value. Similarly, in futures markets, retail accounts (accounts held by natural persons) were over 95 per cent of the total as of February 3, 2017. In futures markets, retail trading accounts for about 79 per cent of trading (68 per cent in June 2015), and 50 per cent of open interest. In 2015, there were almost 215 million stock accounts held by over 99 million investors; and 1.268 million futures accounts held by 1.075 million futures investors.

28. There is limited participation of foreign institutional investors. As of the end of June 2016, there were 297 QFIIs, with a combined QFII quota of USD 81.18 billion and QFII assets of RMB 561.103 billion; there are 207 RQFIIs, with a combined RQFII quota of RMB 507.968 billion and RQFII assets of RMB 149.865 billion.

Asset Management Services

Fund management companies

29. At the end of June 2016, fund management companies in China were managing 3,115 mutual funds (MFs) that were offered to the public (retail investors), with AUM of RMB 7.95 trillion. While growing, the collective investment scheme (CIS) industry is still relatively small in size and underdeveloped in terms of the type of products that are offered to the public. The bulk of the assets are in open-end funds; and in particular in money market funds (MMFs). Bond funds, including MMFs, experienced considerable growth in recent years, particularly as a result of the volatility on the equity markets that lowered investors' risk appetite. MFs suffered important redemption pressures in late 2016 as a result of the stress situation experienced in the bond markets.

30. Retail investors have an important participation in CIS. As of the end of June 2016, individual investors accounted for 99.96% of the total number of active accounts in open-end funds, and institutional investors accounted for only 0.04%. Individual investors and institutional investors accounted for 46.01% and 53.99%, respectively of the net value of holdings.

Type of Fund	Number of Funds	AuM (RM billion)
Close-end	205	275.7
Open-end	2910	7,674.2
Of which:		
Equity funds	615	665.5
Hybrid Funds	1400	1,903.7
Money market	234	4,200.9
Bond Funds	550	813.6
QDII Funds	11	90.4
Total	3115	7,949.9
Source: CSRC.		

31. In addition to CIS, fund management companies are authorized to manage assets for individual clients. As of June 2016, the total AUM of fund management companies and subsidiaries that provide asset management services for specific clients was RMB 15.3 trillion.

Fund management companies managing private funds

32. There are a significant number of private funds; but only a few could be considered hedge funds (HFs). Under the current legal and regulatory framework there is not an official definition of HF. Managers of private securities investment funds and the private funds themselves are required to register with AMAC. As of the end of December 2016, AMAC had a total of 17,433 private fund managers on its register and was keeping records on 46,505 private funds with a combined paid-in AUM of RMB 7.89 trillion. A breakdown of such funds is provided below. In practice, as per conversations with authorities and market participants, very few of such funds would meet the characteristics commonly associated with a HF (in terms of their investment strategies, use of derivatives and/or use of leverage), and they are not yet important in terms of their size. Overall about 90% of the investors in these funds are natural persons (high net worth individuals).

Type	Number of managers	Number of funds	AUM (RMB trillion)
Private securities investment funds	7,781	27,015	2.77
Private equity	7,988	15,789	4.32
Venture capital	1,218	2,143	0.36
Others	446	1,558	0.44
Source: CSRC.			

Banks and trust companies

33. Banks offer asset management services to all types of investors. A key component are WMPs, some of which constitute CIS offered to the public (retail investors). At the end of June 2016, there were 454 banking institutions offering WMPs. There were a total of 68,961 products and the total value of WMPs was RMB 26.28 trillion. Of these WMPs those that involve a guarantee of the principal (and in some cases also of return) accounted for 23.2 percent of total value. These products are on the balance sheets of the issuing banks and are not CIS. Of the remainder, some products are offered only to high net worth individuals, institutional or private banking clients. Collective products which involve managing a pool of assets for retail clients amounted approximately to RMB 8 trillion in AUM.

34. Trust companies offer assets management services, in particular trust plans, but to qualified investors only. The collective money trust products provided by trust companies are offered only to qualified investors including institutional investors and natural persons who meet the relevant criteria.¹ A collective money trust product may not have more than 50 individual investors whose investment is smaller than RMB 3 million. There is no limit regarding the number of investors whose investment exceeds that amount. As per conversations with authorities and market participants, at the time of the assessment they did not have the characteristics commonly associated with HFs. First, current regulations do not allow trust companies to engage in debt businesses other than interbank borrowing (subject to credit limits). In addition, their investment strategies did not involve complex techniques or use of derivatives. As at December 2016 there were 68 trust companies licensed by the CBRC with assets of about RMB 7.34 trillion. Less than 40 percent of trust assets are held by collective trust products.

Insurance companies and insurance asset management companies

35. Insurance companies offer certain products that have some characteristics of a CIS, but that provide a protection component. In particular they offer unit-linked insurance products. However, pursuant to CIRC regulations they must have an important protection component (the sum insured must be at least 120 percent, 140 percent or 160 percent of the premium paid or account value depending on the age profile). Unit-linked insurance products are on balance-sheet items, thus are under the regulation of the new C-ROSS solvency framework.

36. Insurance asset management companies manage asset management plans; which constitute CIS but can only be offered to institutional investors. In practice they are mainly used by insurance companies to manage their insurance funds. As a result, at the time of the

¹ Pursuant to the Rules for Collective Money Trust Products an eligible investor refers to a person who satisfies any of the following criteria as is able to identify, judge and undertake the risks associated with a trust plan: (i) a natural person or institutional investors whose minimum investment in a trust plan is at least RMB 1 million; (ii) a natural person whose aggregate individual or family financial assets exceed RMB 1 million at the time of subscription; or a (iii) a natural person whose annual income exceeds RMB 200,000 in the recent three years or who earns with his/her spouse over RMB 300,000 annually in the recent three years.

assessment, they did not meet the characteristics commonly associated with HFs. The balance of their insurance AUM amounted to approximately RMB 13.513.4 trillion as of December 2016.

Intermediaries

Specialized securities intermediaries

37. There are four types of specialized licenses to carry out securities market activities: securities companies, futures companies, fund management companies and securities and futures investment consultancy firms. Under the current regulatory framework securities companies are the only type of intermediary that is authorized to engage in “principal” business including proprietary trading, margin trading and securities financing; they can provide these services both in the regulated and the OTC markets. That said, overall the regulatory approach to intermediaries is evolving. While in the past each category of intermediary was only allowed to conduct a set of specific activities associated with the corresponding license, increasingly they are being allowed to provide additional services either via an expansion of authorized activities for such license or through subsidiaries. All this in line with a strategy of the authorities to create an investment banking culture that can propel the capital markets to serve the real economy better.

- **Securities companies:** As of the end of June 2016, there were 127 securities companies (including 2 in a preparatory stage). Out of such number 95 of these companies are standalone securities companies, and the other 30 are asset management, investment bank or regional subsidiaries of securities companies.
- **Fund management companies:** As of the end of June 2016, there were 117 mutual fund managers in China, composed of 104 fund management companies, 12 securities companies or securities asset management companies that are licensed to manage mutual funds, and 1 insurance asset management company. Additionally, there are 79 subsidiaries of fund companies providing asset management services to specific clients.
- **Futures companies:** As of the end of 2015, there were 149 futures companies in China, all of which hold licenses for commodity futures brokerage, 147 hold licenses for financial futures brokerage, 108 hold licenses for investment consultancy firms, and 16 hold licenses for fund distribution. In addition, securities companies can act as introducing intermediaries in the market. As of 2015 there were 88 securities companies that act as introducing brokers for futures business.
- **Consultancy firms:** As of end of June 2016, there were 84 securities investment consultancy businesses that hold only a securities investment consultancy license (i.e. they are not securities companies or futures companies). Except for securities investment consultancy service, these companies do not engage in other securities activities such as brokerage, underwriting, sponsorship, and margin trading.

38. Securities intermediaries require the approval of the CSRC to establish subsidiaries overseas. As of end 2015:

- **Securities companies:** 29 securities companies have set up subsidiaries overseas, including 27 in Hong Kong SAR, 1 in Laos and 1 in Singapore. In addition, 3 companies have been approved for establishing or acquiring businesses in Hong Kong SAR, but so far they have not reported the completion of the establishment or acquisition.
- **Fund management companies:** 25 fund management companies have set up subsidiaries overseas, all of which are in Hong Kong SAR.
- **Futures companies:** 18 futures companies have been approved to set up 19 overseas subsidiaries, including 18 in Hong Kong SAR and 1 in the U.S.

39. At present China does not allow foreign authorized/registered/licensed securities companies, fund management companies and futures companies to directly participate in the domestic market. Foreign investors, however, may hold stakes in domestic securities companies, fund management companies and futures companies in accordance with the *Law on Securities Investment Funds*, the *Rules for Establishment of Securities Companies with Foreign Investment*, the *Measures for the Administration of Futures Companies*, among other relevant laws and regulations. As of the end of June 2016, 11 of the 127 securities companies; 44 of the 104 fund management companies and 2 of the 149 futures companies were joint ventures with foreign investors.

Other intermediaries that can provide securities markets activities

40. Banks can undertake a series of securities markets activities. The main activities are (i) the provision of asset management services (individual and collective portfolio management and advisory services) to both retail investors and high net worth individuals for which they are subject to the regulation and supervision of the CBRC; (ii) market making and trading of bonds in the interbank bond markets, for which they are mainly under the regulation and supervision of the PBoC and self-regulation of NAFMII and the regulation and supervision of the CBRC; and (iii) distribution of funds, for which they are subject to the regulation and supervision of the CSRC and the CBRC, (iv) and custody services for which they require license by both the CBRC and CSRC. In addition, as discussed below, there currently is a pilot program to allow banks to establish a fund management company as its subsidiary to undertake fund management activities under the regulation and supervision of the CSRC and consolidated supervision of the CBRC. Banks are not allowed to invest in equity.

41. Trust companies can provide asset management services. In addition to collective trust plans, trust companies can provide individual and collective portfolio management and advisory services, but only to qualified investors as defined above. In these activities they are subject to the regulation and supervision of the CBRC.

42. Insurance asset management companies can provide asset management services but exclusively to institutional investors. As indicated earlier, in practice the asset management plans of these companies are used by insurance companies to manage their insurance funds; and by a few other institutional investors (banks, annuity companies) to get long-term products. These plans are subject to the regulation and supervision of the CIRC.

Information Services Providers

43. CRAs are required to fulfill filing requirements with the PBoC which is their lead regulator. In addition, CRAs are required to be licensed or recognized by the regulatory authority of the market in which the company rated will issue the securities. In practice there is significant overlap in the lists of recognized CRAs. As of June 2016 there were 7 CRAs licensed by the CSRC to engage in securities markets services.

44. Auditors providing their services in relation to the securities and futures market are required to obtain approval from the CSRC and the MoF. The MoF is the competent authority for certified public accountants (CPAs). All auditors that want to provide services in the securities and/or the futures markets must obtain a license that is issued jointly by the CSRC and the MoF. In addition, they are subject to the ongoing supervision of the CSRC. As of end 2016 there were 40 audit firms authorized to conduct securities service business in China.

PRECONDITIONS FOR EFFECTIVE SECURITIES REGULATION

45. Some of the preconditions for effective securities market regulation are in place, although challenges remain in a few areas.

- Overall the Company Law is considered sound; however, it still allows the use of unregistered stock, which is essentially bearer shares; and companies are not required to maintain a record of the names of the holders of an unregistered stock. This poses challenges to the verification of ownership of companies. In March 2014 the State Administration for Industry and Commerce (SAIC) established an Enterprise Information Disclosure Regime (EIDR), which created a database that provides access to information on all businesses and companies, including business registration, chattel mortgage, equity pledge, administrative penalties, and annual reports. It is important to highlight that the challenge above does not apply to companies listed on the exchanges and the NEEQ. Shares of these companies are dematerialized, registered and deposited at CSDC. As a result, ownership information is not only up-to-date but also available at the ultimate investor level, because China adopts a direct holding system and beneficiary ownership is limited to a few programs including the Stock Connect.
- The Enterprise Bankruptcy Law contains restructuring procedures to be guided by the courts. The assessors understand that out of the courts restructuring procedures are not permitted; although this issue is under consideration by the Supreme People's Court.
- The role of the judicial system in effective resolution of disputes is still a challenge. The exercise of private rights is still evolving, and the Judiciary has yet to develop more expertise in securities markets matters. However, the CSRC has taken an active role in developing mechanisms aimed at enhancing the ability of investors to exercise their rights. In particular, the Investor Services Corporation (CSISC), created in 2014, can provide support for small and medium size investors in bringing civil lawsuits against violators; although class actions suits are not permitted. As of

the time of the assessment the CSISC had already taken such role in three lawsuits. In addition, a pilot program has been implemented whereby the CSISC has bought a small package of shares (100 shares) from a number of listed companies, which in turn allows it to exercise rights as a shareholder. In this way it is seeking to educate shareholders as to the way to exercise their rights and to indirectly influence governance practices of listed companies. In addition, the CSRC jointly with the Supreme Peoples' Court have taken steps to enhance the use of mediation services as an alternative mechanism to solve disputes. To enhance the binding effect of mediation, according to the laws and regulation as well as the notice jointly issued by the CSRC and the Supreme People's Court, the mediation agreements reached through notarization, arbitration and the judicial system, can apply for compulsory enforcement by the people's court.

- The accounting and auditing standards have been recognized by the international standard setting body as converged with those international standards. All CPAs are subject to the oversight of the MoF and auditors that provide services in the securities and futures markets to approval of CRSC and the MoF. That said, the quality of financial disclosure by issuers and of auditing work remains an issue of concern.

SCOPE OF THE ASSESSMENT

46. The way the assessors have applied the IOSCO Principles and Methodology vis-à-vis the market structure and the structure of financial regulation in China requires explanations, which are summarized below:

- Regarding the Principles for the regulator, enforcement and cooperation the assessment has relied on the framework for the CSRC given its position as the main regulator and supervisor of the securities and futures markets; except when the scope of a particular principle demanded a broader approach. That has been the case of Principles 1, 6 and 12. In all other cases, the participation of other authorities in the regulation or the supervision of a specific component of the securities and/or futures markets has been assessed under the corresponding sectoral principles.
- Regarding the Principles for issuers, the assessment focuses on issuers whose securities are offered to retail investors or that are traded in platforms open to retail investors given the focus of the IOSCO Methodology. As a result, companies in NEEQ and the regional platforms were outside of the scope of the assessment given that they can only offer their securities to qualified investors, and the platforms in which they trade are restricted also to qualified investors –although the assessors recognized the differences in nature and regulation between the companies quoted in NEEQ and in the regional trading platforms. For the same reason, issuers that raise funding in the interbank bond market were outside of the scope of the assessment, as they can only be offered to institutional investors and trading is also restricted to such type of investors. Local governments can also issue bonds by way of a public offering; however, given the size of this market at the time of the assessment, their regime was not covered.

- Regarding the Principle for credit rating agencies, the Principle covers rating services in the securities markets as a whole. That said, the assessment relied mainly in a review of the regulation and supervisory program of CRAs subject to CSRC supervision, due to the important level of overlap among the lists of authorized CRAs by the different authorities.
- Regarding the first four Principles for collective investment schemes (CIS), the assessment has covered the regime applicable to all products with the character of CIS offered to retail investors, which is in keeping with the Methodology. As a result, the regime for non-guaranteed wealth management products (WMPs) offered by banks to retail investors has been covered in Principles 24-27, along with the regime for traditional MFs. Conversely, the regime applicable to trust plans offered by trust companies and the regime applicable to asset management plans managed by insurance asset management companies were outside of the scope of the assessment given that such plans are only offered to qualified and institutional investors respectively. Unit-linked insurance products were also outside of the assessment due to the fact that they have a significant protection (i.e. insurance) component and as a result they cannot be fully assimilated with CIS
- Concerning the Principle for Hedge Funds (HFs), the assessment focuses on the regime for private investment securities funds and their managers because out of all the CIS currently offered to investors, only a subset of these funds seem to meet the characteristics commonly associated with HFs.
- Regarding the Principles for intermediaries, the focus has been on the provision of investment services. As a result the regime applicable to banks in the provision of asset management services has been covered in these Principles, in addition to the regime applicable to CSRC intermediaries. However the regime for banks has only been assessed under Principle 31 given that the Basel Core Principles assessment covers licensing, capital and resolution issues. The regime applicable to trust companies was outside of the scope of the assessment given that the bulk of their activities comprises the management and distribution of private funds that do not meet the characteristics commonly associated with HFs.
- Regarding the Principles for secondary markets, the focus has been on regulated markets and in particular on the exchange markets. However, the assessors recognize the “hybrid” nature of the NEEQ market; and as a result details regarding its regulation and supervision have been included in the assessment; although not considered for grading purposes. The regional trading platforms were outside of the scope of the assessment given their relative importance at the time of the assessment, the fact that companies on them cannot do a public offering of securities, that secondary market trading is restricted to qualified investors, and the nature of trading mechanisms. On bond markets, the interbank bond market was outside of the scope of the assessment given that such platform is a wholesale OTC market. Given the above, the NEEQ and NAFMII were not covered in the Principles for SROs.

47. That said, it is critical that the authorities keep a holistic view of the markets. In this regard, the assessors note the growing importance in China of the private offering regime for

capital raising including through the use of electronic platforms, and of OTC markets for the trading of equities and bonds as part of a multilayer strategy for capital markets development. Further, many of the activities and markets mentioned above are developing rapidly and their nature evolving. Thus it is key that their supervisory efforts extend beyond the products and markets covered in detail by this assessment.

MAIN FINDINGS

General Considerations

48. The authorities have a clear vision of the key role that the capital markets can play in transforming the Chinese economy to a more market oriented economy. Over the years this has led to the adoption of policies to develop different segments of the market, so that they can better serve the real economy.

49. While the markets are developing rapidly and are already large by global standards, as yet they do not have some of the features of fully developed markets. First, unlike many other jurisdictions, there is a strong direct participation of retail investors in the markets in terms of number of accounts but also more importantly in terms of trading volumes. In contrast, institutional investors do not play as significant a role in secondary market trading as in other large jurisdictions and the market discipline that investors of this kind might bring to the markets—such as monitoring the effectiveness of the corporate governance of listed entities—is not present to a significant degree. By the same token, the presence of end-users (hedgers) in the futures markets is still very limited. In addition, investors are widely dispersed and not accustomed to asserting their legal rights, and consequently the courts have not had the opportunity to develop the jurisprudence necessary for the effective exercise of these rights. Finally, intermediaries are not yet providing the full suite of services necessary to implement the authorities' vision of capital markets.

50. In practice, in some areas these special characteristics of market structure, combined with the vision of capital markets development, have prompted the CSRC as the main regulator of the securities markets to adopt different approaches to the regulation and supervision of the market than those adopted by other large markets. For example, the CSRC has considered necessary to take a stronger role in the establishment of markets, in ensuring the quality of companies that come to the market, and in pacing market development and innovation, by determining the timing of new issuers, new products and new services in the market. At times, such an approach has encountered challenges and the balance between development and stability has been difficult to strike. Some of the challenges have stemmed from the more volatile nature of the markets. Addressing them has not been easy not just because traditional tools have sometimes proved ineffective in such market structure but also because of investors' expectations about the role of the authorities and the authorities' concern to preserve social stability. But these challenges have also indicated the need to work towards more market based solutions, especially those that combine a stronger role for disclosure and transparency with enhanced public enforcement and private exercise of rights. These are key tools that should help align the incentives of different

participants with the public objectives of ensuring investor protection, fair, transparent and efficient markets and financial stability.

51. The CSRC has been taking important steps to address the structural challenges identified above. To enhance investors' ability to exercise their rights, the CSRC has taken a number of initiatives such as the pilot for the exercise of investors' rights, the authority given to the CSISC to represent investors, and the new arrangements to provide a stronger backing to mediation. The authorities are also taking steps to bring more domestic institutional investors to the market and to gradually open the doors to foreign institutional investors. The CSRC has also been addressing other market structure issues. In particular, it has been moving to develop more fully the function of market intermediaries by encouraging firms to become more capable of providing a full range of intermediary services, particularly investment banking, while redoubling efforts to monitor their internal controls and risk management. This involves a move away from business models that rely primarily on brokerage, and a tightly compartmentalized regulatory regime.

52. Over time these steps, taken together, should allow the CSRC to move towards more market-based solutions as is its intention. The assessors acknowledge that such move needs to be implemented in a gradual manner, in tandem with improvements in market structure, and complemented by the implementation of strong processes for emerging and systemic risk monitoring, a robust supervisory and enforcement program that provides confidence to investors as to the fairness of the markets, and strong educational and capacity building programs not just for investors but for all participants in the market. As will be further discussed below, there is evidence that the CSRC is seeking to move in such direction.

53. Some of the challenges identified above are not comprehensively captured in an IOSCO assessment. First, this is because an IOSCO assessment does not involve a judgment about the merits of a particular vision of development, or the role the regulator plays in that development. Second, even on issues related to regulation and supervision the focus in the Principles and Methodology is on the public markets which does not always enable a holistic account of a market as complex as that in China. Finally, use of the Methodology involves a judgment at a point in time that does not necessarily reflect the dynamic character of a market that is developing so rapidly. To the extent possible, the assessors have provided a more comprehensive and forward-looking analysis via the comments in the detailed assessment.

Findings by Sets of Principles

54. Principles for the regulator. The CSRC has a broad mandate to regulate and supervise the securities markets. It operates with a high degree of operational (day-to-day) independence, although under the strong strategic direction of the SC. Certain activities, products and markets, in particular asset management services and the bond markets, are subject to the regulation and supervision of more than one regulatory authority. However, the authorities are already working toward the implementation of harmonized regulations and to strengthen coordination and cooperation arrangements, as appropriate. During the last three years the CSRC has significantly

enhanced the tools and processes to identify and monitor systemic risk and the authorities have been working to improve cross-sectoral mechanisms for risk-identification, monitoring and management; although additional steps need to be taken. CSRC resources have not kept pace with market growth nor with its expanding mandate and the salaries it pays are not competitive with industry salaries. This poses a challenge to CSRC's ability to deliver the type of intense supervisory and enforcement program that a market structure characterized by a large presence of retail investors requires.

55. Principles for self-regulation. Market institutions such as the exchanges and industry associations have SRO functions assigned to them by the legislation. All SROs have developed their own supervisory programs; although resources seem limited, particularly in the case of the industry associations. Coordination mechanisms are being developed that seek to avoid duplication and strengthen the complementarity of the SRO programs with CSRC's own supervisory program. The CSRC exercises oversight over the exchanges and industry associations through a combination of tools that include participation in the rulemaking process, reporting obligations, and participation in the appointment of key personnel (in the case of the exchanges) and appointment of representatives in key organs (in the case of the industry associations). Increasingly inspections are also being used.

56. Principles for enforcement. The CSRC has broad supervisory powers over regulated entities. It has broad investigative powers over both regulated entities and third parties, and can impose a series of administrative measures and administrative sanctions on them. It also has the power to refer matters to the criminal authorities and an office has been established to enhance coordination on criminal matters. In practice, the CSRC has implemented a monitoring and inspection program that covers issuers, all types of intermediaries and gatekeepers; although the coverage of such programs should be kept under review. Particularly in recent years it has also taken a more vigorous approach to enforcement, including by imposing stronger penalties and bars on different types of participants. However, this more vigorous approach still needs time to take hold. Criminal enforcement is weak and is yet to have a clear deterrent role in the market, although steps have recently been taken by the criminal authorities to enhance their ability to pursue these crimes. Similarly, more severe penalties are starting to be applied. In both cases, deficiencies in the legal framework, including the low level of sanctions that can be imposed for some misconduct, pose limitations to the ability of the authorities to implement an effective enforcement program. The CSRC has implemented several initiatives aimed at empowering investors so that they can more effectively exercise their private rights of actions.

57. Principles for cooperation. The CSRC has the legal authority and capacity to share information and cooperate with other authorities domestically and internationally. At the international level, it is a signatory to many Memoranda of Understanding (MOUs), including the IOSCO Multilateral MOU (MMOU) and a number of bilateral MOUs with its international counterparts, and has a record of active cooperation. It does not require the permission of any outside authority to share or obtain information, nor does it require an independent interest in the matter to assist. At the domestic level, mechanisms have been developed for coordination and

cooperation at policy level and the CSRC has demonstrated that it cooperates with other financial authorities.

58. Principles for issuers. The current regime for the issuance of securities to the public subjects them to initial disclosure (via a prospectus) as well as periodic and ongoing disclosure obligations that are in line with international practices. Publicly offered equities must be listed on an exchange. The financial statements in all such documents must be prepared in accordance to Accounting Standards for Business Enterprises (ASBE) that have substantially converged with IFRS. The regulatory regime applicable to equity issuers provides safeguards to ensure that holders of securities are treated fairly and equitably; in particular, it requires shareholders' approval of major transactions, and information obligations exist that seek to ensure that shareholders can take informed decisions. As part of such framework, changes of control transactions are subject to full disclosure. Prompt notification of holdings by substantial shareholders and insiders is also required. The exchanges have developed programs to monitor listed issuers' compliance with their disclosure obligations. The CSRC also has a program of review of annual reports, which focuses on compliance with accounting standards. In addition, a program of on-site inspections is also in place. The programs are all risk-based. NDRC has also implemented a program of on-site inspections.

59. Principles for auditors, credit rating agencies, and other information service providers. The MoF is the competent authority for CPAs. In addition, audit firms that provide audit services for the securities and futures markets must obtain a securities services license jointly issued by the CSRC and the MoF. These firms are also subject to the CSRC's ongoing supervision, which it conducts mainly through on-site inspections. However due to limitations in resources the use of comprehensive inspections is limited. The PBoC is the lead regulator for CRAs and all firms must fulfill the record filing procedure regulated by it. In addition, they must obtain a license or recognition from the regulatory authority of the market in which the companies rated will issue securities. Pursuant to CSRC regulations CRAs are required to observe governance rules that address the quality and integrity of the rating process, independence and the avoidance of conflicts of interest. CSRC has a robust supervisory program over CRAs, which includes on-site inspections of all CRAs. Securities analysts are subject to rules aimed at mitigating potential conflict of interest, including via disclosure, and are inspected as part of the regular program of intermediaries' supervision.

60. Principles for collective investment schemes. The management of funds that are offered to the public can only be done by fund management companies and other entities authorized by the CSRC. In all cases licensing requirements are robust. Funds are subject to initial disclosure obligations (via a prospectus) and also to periodic and ongoing disclosure obligations that are in line with international practices. Fund assets must be held by a separate custodian; however it can belong to the same group as the fund manager. There are legal provisions that clearly separate the assets of the funds from the assets of the fund manager and the custodian, thus protecting the assets in the event of their insolvency. Fund assets must be valued according to ASBE. Under the condition that the NAV can fairly reflect the portfolio value of the fund, MMFs are allowed to use amortized cost and keep a stable NAV. In extreme market conditions, liquidity risks may arise when investors redeem a large amount of MMF in a short time. The CSRC has a supervisory program in

place that includes both off-site monitoring and on-site inspections that are carried under a risk-based approach. Private securities investment funds (including HFs) must register with AMAC. They are subject to reporting and an on-site inspection program that appears to be commensurate to the risk they currently pose. Some WMPs offered by banks are retail CIS. Banks offering these WMPs are subject to organizational requirements and reporting obligations. Assets of these WMPs must be held by a custodian but self-custody is permitted, and there is legal uncertainty about bankruptcy protection. WMPs must be issued under a prospectus but the requirements are at a high level of generality, and banks are allowed to quote expected returns in the prospectus and marketing material. Assets of a WMP must be valued according to ASBE and thus at fair value. The current regulatory framework for these products does not contain specific provisions setting out minimum standards for subscription and redemption pricing, pricing errors or suspension or deferral of redemption.

61. Principles for market intermediaries. Securities companies, fund management companies and futures companies are subject to licensing by the CSRC. Licensing requirements are robust. Capital requirements need to be adjusted based on the activities and risks undertaken on an on-going basis; and an early warning system is in place, where reporting takes place within 3 days. There are robust requirements for the protection of investors' assets both in the securities and futures markets and investor compensation schemes come into play in the event of the insolvency of an intermediary. Conduct obligations apply, including information and suitability requirements towards clients. All intermediaries are required to conduct annual evaluations of their internal controls, and an external auditor must also issue an opinion about the adequacy of such controls. The CSRC monitors compliance with all such obligations via a supervisory program of off-site monitoring and on-site inspections that are carried under a risk-based approach. In recent years particular attention is being paid to issues related to internal controls, as well as suitability and information obligations. A framework to deal with the failure of firms is in place, which has been tested particularly after the failures that took place in the early 2000s. Banks providing asset management services and products are required to have internal control and supervision systems, and strong suitability rules apply. The CBRC carries out inspections of banks that provide these services, under a risk-based approach.

62. Principles for secondary markets. The constitution of equity and futures exchanges is subject to the approval of the SC, upon recommendation of the CSRC, in the case of equity exchanges and approval of the CSRC in the case of futures exchanges. Robust requirements exist aimed at ensuring fair access and reliability of the systems, including on the latter the requirement of annual IT evaluations. Exchanges are the frontline supervisors for purposes of real time surveillance. They also have a critical role in ex-post monitoring supporting the CSRC in the identification of unfair trading practices. To this end all exchanges have developed automated systems, with alert triggers and a reasonable level of resources has been dedicated to the investigation of such alerts. In addition, mechanisms for cross-market surveillance (between the equities and the futures markets) have been established as well as cross-border with Stock Connect. Pre and post-trade transparency obligations apply to all exchanges, although for one exchange fewer bid/offer details are provided pre-trade than in the other markets. Current mechanisms to address volatility involve price limits; and in the futures markets they involve also the use of

margins, transactions fees and position limits. In addition, as appropriate the exchanges can suspend trading. However, the current market structure, and in particularly the large and active presence of retail investors, poses challenges to the management of volatility. Clearing and settlement in both the securities and futures markets is conducted via central counterparties (CCPs), which have developed mechanisms to manage clearing and settlement risks, and the level of settlement failures is very low. All exchanges have mechanisms in place to deal with the default of an intermediary, including clear procedures and a default waterfall. Only covered short-selling is allowed and disclosure obligations apply.

Table 7. China: Summary Implementation of the IOSCO Principles—Detailed Assessment

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	PI	The CSRC is the main regulator of the securities and futures markets. Its mandate derives mainly from the Securities Law, the Fund Law and the Regulations for the Administration of Futures Trading. Other authorities have specific competencies over certain sub-segments of the markets, and as a result in some cases a plurality of regulatory authorities have jurisdiction over an activity, a market or a product. In particular that is the case for the provision of asset management services, and the bond markets including asset backed securities and the provision of credit rating services which are subject to the regulation and supervision of more than one authority. On the former, CSRC, CBRC and CIRC have regulatory responsibilities depending on the entity involved in the provision of the services. On the latter, under the authorization of the Law on the People's Bank of China, the PBoC is the regulatory authority in the interbank bond market, while the CSRC regulates and supervises the exchange market and the NDRC has authority over the enterprise bond market. In some cases the differences in the regimes could have an impact on investor protection, market liquidity and/or financial stability. Particularly regarding asset management services and bond markets the authorities have reached agreements to work towards the harmonization of regulations, and there is already a unified draft regulation for the provision of credit rating services. In addition, the authorities have been working to strengthen coordination and cooperation arrangements. Recent improvements have also been made to the regulatory framework for the regional equity trading platforms, which are subject to day to day regulation and supervision by the provincial authorities, with a stronger role being provided to the CSRC. Mechanisms exist for coordination and cooperation among the financial regulatory authorities, including the Financial Crisis Response Group (FCRG) at the systemic risk level, and the JMC and the JMC for Bonds led by the PBoC under

		authorization of the SC both of which are aimed at improving regulatory coordination of cross-sectoral issues.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	PI	CSRC's strategic priorities are driven by the NPC and SC to which it is accountable. In its day-to-day operations the CSRC operates without the need for approval from any authority and the legal framework provides adequate protection to staff against legal suits resulting from the discharge of their functions. However certain features of the legal framework might pose challenges to its operational independence. In particular, the budget has not kept pace with market growth, regulatory demands or mandate changes and thus is no longer adequate. Other issues that might give rise to concerns are the review of decisions of the CSRC by the SC and the framework for the dismissal of the executive team; however, in both cases other provisions in the legal framework help to mitigate such concerns. The CSRC is subject to high standards of transparency and procedural fairness, including the need to provide reasons for its decisions and to provide an opportunity to the parties affected by a decision to be heard. Its decisions are subject to judicial review. Strong confidentiality provisions apply to commercially sensitive information.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	PI	In general the CSRC has broad powers to regulate and supervise the securities and futures markets. Such powers include rulemaking, licensing, supervision including carrying on-site inspections, investigations and enforcement. However, the legal and regulatory framework for administrative sanctions has deficiencies; the main one being the low level of fines that can be imposed for some misconduct. The CSRC has taken steps to provide more facilities for smaller investors so that they can exercise more actively their private rights including strengthening of alternative resolution schemes and the creation of the CSISC that can represent investors in civil suits. CSRC budget has not kept up with market growth, or with its expanding mandate. In addition, the salaries that it can pay are not competitive with the industry and this has affected its ability to hire and retain staff. Altogether these factors can affect CSRC's ability to deliver its supervisory and enforcement program in a rapidly growing market. The CSRC places a high priority on investor protection initiatives, including those related to investor education, where several innovative initiatives have been implemented.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	FI	The CSRC has adopted a transparent process for rulemaking, which includes consultation with the market and the public; the latter mainly via simultaneous publication of rulemaking proposals on the website for the Legislative Affairs Office of the SC in addition to the CSRC website. The criteria to decide

		<p>on licenses and to impose sanctions are established by law and regulations which are all publicly available through the CSRC website. There are robust requirements aimed at ensuring procedural fairness. There is a tradition of use of pilots for the implementation of regulations that could have significant impact in the market. Starting in 2015, pilots have been undertaken under a set of rules or self-regulatory standards which provides certainty to the market regarding the scope and conditions of the pilot; thus mitigating concerns of their potential to give rise to unlevelled playing field.</p>
<p>Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.</p>	BI	<p>CSRC staff is subject to high ethical standards, including the prohibition on occupying positions in regulated entities; the obligation to recuse in cases of conflict, the prohibition on accepting gains; and cooling-off periods. Staff is prohibited from holding shares and futures; but they can hold and own bonds and mutual funds. For midlevel staff and up, annual disclosure of holdings is required. Staff is also subject to confidentiality provisions. Breaches of these obligations carry disciplinary consequences and, depending on the case, administrative penalties and even criminal penalties (in the case of disclosure of inside information). There is evidence that the CSRC has actively acted against corruption.</p>
<p>Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.</p>	BI	<p>The CSRC has developed a series of tools to identify and manage systemic risk including (i) a set of indicators for intermediaries, for market infrastructure, for the market and macroeconomic indicators; (ii) a contingency response mechanism for the stock market; and (iii) stress testing, all of which complement the regular mechanisms to monitor the markets, market infrastructure and intermediaries. A steering group on stock market risk monitoring and response was set up, which meets on a quarterly basis to assess the risk profile of the market, identify potential risk and make corresponding recommendations. In tandem, the CSRC is stepping up its ability to collect and use data to monitor risks, mainly via (i) the creation of the Capital Markets Statistics and Monitoring Center (CMSMC) in charge of data collection, analysis and risk identification and, (ii) the development of the Central Regulatory Information Platform, which is an integrated system for the aggregation and sharing of information. The platform will significantly increase the level of digital monitoring and smart monitoring of risks. The authorities have been strengthening cross-sectoral mechanisms to share information, identify and monitor systemic risk. In particular, they are working to enhance data sharing on asset management and standardizing data. They are also working towards enhanced data sharing regarding bond markets.</p>

<p>Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.</p>	FI	<p>There are several sources of emerging risk identification, from referrals by the SC to the regular processes in place to supervise regulated entities. The steering group on stock market risks serves also as a regular forum for discussion of major potential risks. When issues identified are within the jurisdiction of the CSRC, they are tackled through rulemaking, supervision and/or enforcement actions. There is evidence of continuous enhancements to the rules and regulations, triggered by findings from such supervisory activities and/or referrals; as well as of changes in the organizational structure to give appropriate response to new challenges. In the case of new issues or issues involving a plurality of authorities, they are brought for discussion at JMC level and then reported to the SC. There is also evidence that such mechanism has been used. The CSRC has participated actively in the review of the Securities Law and the development of a Futures Law; in both cases drafts are currently under consideration.</p>
<p>Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.</p>	FI	<p>There are rules in place that require intermediaries to establish controls to address conflict of interest. In addition, specific prohibitions apply for particular sets of intermediaries aimed at prohibiting specific activities that might pose substantial risk of conflict. Compliance with these rules is monitored through the regular supervisory programs of the CSRC. In the case of issuers, misalignment of incentives is mainly managed through disclosure obligations, which are monitored by both the exchanges and the CSRC through their off-site monitoring programs. In addition, the CSRC has an on-site inspection program for issuers. In the case of securitization, the current regulatory regimes by PBoC, CSRC and CBRC only allow their placement to qualified investors, and general disclosure obligations apply.</p>
<p>Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.</p>	BI	<p>Market institutions such as the exchanges and industry associations for securities companies, futures companies and asset managers have SRO functions assigned to them by the legislation. Exchanges are responsible for the supervision of their markets, market participants, and listed companies – the last only for equity exchanges. Membership in an industry association is mandatory for all relevant intermediaries, and associations make rules that are binding on their members. In practice all SROs have developed off-site and onsite inspections programs to carry out their supervision responsibilities, although the resources assigned appear limited, particularly at industry associations. The programs are run independently from the CSRC programs; however mechanisms for coordination are being developed. The CSRC exercises oversight over the exchanges and industry associations through a combination of tools that</p>

		include participation in the rulemaking process, reporting obligations, participation in the appointment of key personnel (in the case of the exchanges) and appointment of representatives in key organs (in the case of the industry associations). Increasingly inspections are also being used.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	FI	The CSRC has the authority to inspect regulated entities and to require from them any information that it needs concerning their operations. Recordkeeping obligations exist for all intermediaries, which in general extend for 20 years.
Principle 11. The Regulator should have comprehensive enforcement powers.	BI	The CSRC has the authority to investigate violations of the laws and regulations under its jurisdiction. To this end, it can request explanations and information from any entity or person involved in the event under investigation. There are specific provisions that require banks to cooperate with the CSRC and provide it with information concerning banking records. The CSRC has the obligation to report violations that may constitute a crime to the criminal authorities. This is done through the Enforcement Bureau. The CSRC has the authority to impose regulatory measures on regulated entities; and administrative sanctions on regulated entities and third parties that violate the laws and regulations for the securities and futures markets. Administrative sanctions include confiscation of illegal gains, money penalties and market bans. However, the legal framework for administrative sanctions has deficiencies; the main one being the low levels of fines that can be imposed for some misconduct.
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	PI	The CSRC has implemented a supervisory program that reasonably covers all intermediaries under its remit, gatekeepers and other regulated entities, through off-site monitoring and on-site inspections; however the coverage of the programs should be kept under review. The CSRC is moving towards using administrative measures and sanctions in a more vigorous way, including through the imposition of larger monetary penalties and bans on a full range of market participants. However, this more vigorous approach towards enforcement still needs time to take hold. More importantly, the use of criminal enforcement and in particular actual imprisonment has been limited. This can significantly limit the deterrence effect that enforcement is intended to achieve. The criminal authorities have taken recent steps to strengthen their ability to pursue these types of cases via the creation of centralized teams and larger prison sentences are starting to be applied.
Principle 13. The Regulator should have authority to share both public and nonpublic information	FI	The CSRC has the obligation to establish mechanisms for sharing regulatory and supervisory information with other domestic financial regulatory authorities. It also has the

with domestic and foreign counterparts.		power to establish arrangements with foreign securities and futures regulators for supervisory cooperation in relation to cross-border matters. The CSRC is not required to obtain any external approval to establish such mechanisms or arrangements nor is it limited in the type of information that it can share. The CSRC is able to share both public and non-public information on all the areas mentioned in the IOSCO methodology and it is not required to have an independent interest in the matter to provide cooperation.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.	FI	There are mechanisms in place for cooperation at both the domestic and international level. At the domestic level, coordination and cooperation on systemic issues takes place via the FCRG, and on policy issues via the JMC and the JMC for bonds. There is also a MoU between the CBRC, CIRC and CSRC that establish principles for cooperation and exchange of information among the Commissions. At the international level the CSRC is signatory to the IOSCO MMoU, as well as a significant number of bilateral MoUs with foreign securities and futures regulators. The CSRC actively responds to and increasingly makes requests for information and assistance from foreign regulators.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	FI	The CSRC is able to collect information that is not already in its files on behalf of foreign regulators as required by the IOSCO Principles and the IOSCO MMoU. It can use all its investigative powers to this end. There is evidence that the CSRC has used its powers to cooperate with foreign regulators.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	BI	Companies can issue securities to the public either via the regulatory regime of the CSRC or, in the case of enterprise bonds, the regulatory regime of the NDRC. In both cases a merit approval system is in place and issuers must submit a prospectus for the review of the respective authority. Companies can also issue securities in the interbank bond market, but in such case their offering is restricted to qualified investors. Companies that offer securities to the public are subject to periodic and ongoing obligations including publication of annual and semi-annual reports, and the prompt disclosure of material events. Equity issuers also have to issue quarterly reports. Companies that issue securities to the public under the CSRC framework are required to be listed. Enterprise bond issuers can choose whether to list on the exchanges or trade in the interbank bond market, and the requirements of the respective trading venue apply to them. In the case of listed issuers, monitoring of ongoing obligations is conducted mainly via off-site monitoring by the exchanges. In addition, the CSRC has a program of review of annual reports aimed at assessing

		compliance with accounting standards and some regional offices conduct their own reviews of annual reports. A program of on-site inspections is also in place at both the CSRC and NDRC.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	FI	The regulatory regime provides safeguards to ensure that holders of securities are treated fairly and equitably. In particular the legal and regulatory framework requires shareholders' approval of major transactions and information obligations are in place to ensure that shareholders can take informed decisions. The Takeover Measures provide a framework for changes in control transactions to be conducted fairly and with full disclosure. To this end, a tender offer report must be submitted to the CSRC and published. In case of partial offers, a pro-rata principle applies. Prompt notification of holdings by substantial shareholders and insiders is required. Compliance with these requirements is mainly monitored by the exchanges.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	FI	Financial statements required to be included in prospectuses and in the periodic reports of public issuers must be prepared according to the ASBE. ASBE have substantially converged with the IFRS. Current mechanisms to supervise compliance with accounting standards include the review of financial statements by the CSRC and the complementary review of periodic reports by the exchanges.
Principle 19. Auditors should be subject to adequate levels of oversight.	BI	The MoF is the competent authority for CPAs. In addition, audit firms that provide audit services for the securities and futures market must obtain a securities services license jointly issued by the CSRC and the MoF, met licensing requirements on an ongoing basis and remain subject to the CSRC's ongoing supervision, which it exercises primarily through on-site inspections. On-site inspections include comprehensive and targeted inspections. Comprehensive inspections are limited. Targeted inspections are used by the CSRC to ensure that the majority of audit firms are subject to some level of inspection once every three years.
Principle 20. Auditors should be independent of the issuing entity that they audit.	FI	Independence requirements for audit firms have converged with the international standards. Supervision of auditors' compliance with such requirements involves monitoring by the firm itself, the audit committees of listed companies and the supervisory program of the CSRC. In addition, the MoF performs the supervisory function on the industry while the Chinese Institute of Certified Public Accountants (CICPA) is the industry SRO.
Principle 21. Audit standards should be of a high and	FI	The Chinese standards of auditing have fully converged with the International Standards of Auditing (ISA). Supervision of

internationally acceptable quality.		audit firm's compliance with the standards of auditing involves monitoring by the firm itself and the CSRC's program of on-site inspection of the audit firms licensed to provide securities services. In addition, the MoF performs the supervisory function on the auditing industry while the CICPA is the industry SRO.
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	FI	The PBoC is the lead regulatory agency for the provision of credit rating services. All firms that want to provide this type of service must fulfill the record filing procedures regulated by the PBoC. In addition, a firm must obtain a license or recognition from the regulatory authority of the market in which the companies rated will issue the securities. In practice there is significant overlap in the CRAs authorized by the different regulators to provide services for these markets. CRAs that want to obtain a CSRC license are subject to governance requirements that address the quality and integrity of the rating process, independence and the avoidance of conflicts of interest, and responsibilities to the investing public and rated entities. Ongoing supervision includes off-site monitoring through periodic reporting requirements and on-site inspections. In practice the CSRC has conducted on-site inspections on all CRAs.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	FI	The provision of securities and futures research reports falls under the definition of engaging in the business of providing securities and futures investment consultancy and therefore is subject to license. Securities and futures companies and their staff who provide research reports are also required to obtain CSRC's approval. Securities analysts are subject to specific requirements mainly aimed at addressing potential conflicts of interest, including by requiring disclosure by the firms of their holdings and other type of conflicts, and by establishing rules applicable to the analysts themselves. As most firms providing securities research are securities companies, ongoing supervision of compliance is conducted as part of the supervisory program for securities companies.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a CIS.	BI	Pursuant to the Funds Law, the management of funds that are offered to the public can only be done by fund management companies and other entities authorized by the CSRC. In all cases licensing requirements include capital requirements, and organizational requirements. An on-site inspection is conducted as part of the licensing process. Fund management companies are subject to reporting requirements that include quarterly, semi-annual and annual reports. In addition, the CSRC conducts onsite inspections to verify compliance with their obligations, under a risk-based approach. Inspections are mainly carried out by the CSRC regional offices, with an active role from CSRC central office

		<p>via the definition of themes for annual inspections. In practice during the last years, all fund managers have been subject to some level of annual on-site inspection. Distributors of funds are also subject to licensing by the CSRC, periodic reporting and on-site inspections. Fund managers are subject to record keeping obligations. They are required to place the interest of investors first. There are rules in place to manage conflict of interest, including those arisen from the possibility given to fund managers to do some of the trading for the funds they manage (rent seats). Delegation is permitted, but the manager retains responsibility.</p> <p>Banks can offer WMPs to retail investors, some of which products substantively are CIS. In the provision of such activity, banks are subject to strong organizational requirements. They are also subject to reporting obligations that include monthly, quarterly and annual reports. The CBRC conducts on-site inspection of banks' compliance with obligations relating to the provision of WMPs, under a risk-based approach. Banks are also subject to record keeping obligations. They are subject to rules on conflict of interest. Delegation is also permitted, but the banks retains responsibility.</p>
<p>Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	<p>PI</p>	<p>Pursuant to the Funds Law, funds under the CSRC are established via a contract, and do not have separate legal personality. Funds must have a custodian, which is in charge of the safekeeping of assets as well as of monitoring fund managers' compliance with their obligations. Custodians need to be separate entities, but can be associated with the fund management company. There are explicit provisions in the Fund Law that establish a strict separation of the assets of the fund from the assets of the fund management company and the custodian, and thus protect investors in the event of a bankruptcy of the fund management company and the custodian.</p> <p>Pursuant to CBRC regulations, WMPs under the CBRC are also established via a contract and do not have legal personality. Regulations of the CBRC and the MoF require strict segregation and separate accounting for each WMP. WMPs assets must be held by a custodian bank, but a bank that is a licensed custodian can hold assets of that bank's WMPs. There have not been cases of banks' insolvencies leading to questions concerning WMPs' protection; as a result there is legal uncertainty regarding the treatment of WMP assets in the event of insolvency of the bank.</p>
<p>Principle 26. Regulation should require disclosure, as set forth under the principles for issuers,</p>	<p>BI</p>	<p>Funds under the jurisdiction of the CSRC are required to submit a prospectus for the approval of the CSRC ahead of the offering. Specific legal and regulatory provisions govern</p>

<p>which is necessary to evaluate the suitability of a CIS for a particular investor and the value of the investor's interest in the scheme.</p>		<p>the content of the prospectus, which is in line with international standards. In addition, funds are required to provide prompt quarterly, semi-annual and annual reports to investors. They are also subject to prompt material events disclosure. Changes must be notified to investors, and some require their approval. There are specific rules concerning advertisements that prohibit funds from promising returns, misleading investors or using expected returns in their prospectus and their advertisement material.</p> <p>Banks must submit a series of disclosure and sales information to the CBRC 10 days before starting to offer a WMP. For new types of products prior approval is required. A prospectus is part of the documentation to be submitted, along with a risk statement. However the regulatory requirements for the content of this disclosure are high level. WMPs are required to provide monthly reports to investors, and a report upon liquidation. Changes in the scope of investment and in fees must be disclosed to investors before they are implemented. There are rules concerning advertisements that prohibit banks from promising returns and, more generally, from misleading investors; however, banks can include expected returns in their prospectuses and market material.</p>
<p>Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a CIS.</p>	<p>PI</p>	<p>Funds under CSRC jurisdiction are required to prepare their financial statements in accordance with ASBE. There is specific guidance for the valuation of assets where market price is not available. Open-end funds must disclose the NAV per unit daily, while closed end funds must disclose it at least weekly. There are specific rules regarding pricing errors and the fund unit holders can ask for compensation from fund manager and fund custodian for losses caused by such errors. The regulatory regime prescribes specific circumstances under which redemptions can be suspended; in all such cases the fund manager is required to report the suspension to the CSRC. Money market funds are authorized to value their assets at amortized cost and keep a stable NAV, although specific conditions must be met. However, current regulations still allow for significant credit and market risks at these funds that could also impact a fund's ability to meet redemption obligations. The CSRC recently released a new rule for the liquidity risk management of open-ended securities investment funds. The rule, effective October 1, proposes revisions to the valuation methods of MMFs and liquidity management tools under circumstances of substantial redemptions.</p> <p>WMPs are required to prepare their financial statements according to ASBE. All WMPs, including those that operate like MMFs, must value their assets and participations at fair value. The current regulations do not contain specific</p>

		provisions on minimum standards for subscription and redemption pricing, pricing errors, or on the possibility of suspensions or deferrals of redemption. However, banks are required to establish internal rules and controls for their WMPs; these issues need to be covered by the rules and the corresponding disclosures made to investors via the sales documents.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	FI	There is currently no definition of HF in the jurisdiction. At the time of the assessment, the number of private funds that might be considered a HF was not significant. Such funds are covered by the regulations on private funds. Pursuant to this regime fund managers that manage private securities investment funds, and the private funds themselves, are subject to registration with AMAC. AMAC's rules require fund managers to comply with internal control requirements and as part of the registration process, it requires a legal opinion on the company meeting such requirements. Private funds report every quarter. AMAC has also promulgated rules on leverage. The CSRC and AMAC conduct on-site inspections on HF managers. While the program is limited, at present it appears to be commensurate to the risks that HFs seem to pose to the system.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	FI	Securities companies, futures companies, fund management companies and investment consultancy firms are all subject to licensing by the CSRC. For all but investment consultancy firms that only provide advice, the requirements include minimum and ongoing capital requirements, as well as robust organizational requirements. On-site inspections are conducted as part of the licensing process. Major changes need to be approved by the CSRC. The CSRC keeps a registry of licensed entities, which is also available to the public.
Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	FI	Securities companies, fund management companies and futures companies are subject to minimum and ongoing capital requirements. The main requirement is a net capital rule, which has an imbedded leverage ratio. In addition, securities companies are subject to two liquidity ratios. All firms must report their capital on a monthly basis (and securities companies must calculate it on a daily basis). They must also provide early warning reports when capital or certain risk indicators fall below trigger points. For securities companies these reports are due within three days, while for futures companies they are due within the same day of reaching the threshold. Equity in subsidiaries is fully deducted. A more comprehensive framework to address risks from outside the regulated entity is being piloted in a selected number of securities companies.

<p>Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.</p>	BI	<p>Securities companies, fund management companies and futures companies are required to have in place robust internal controls and risk management requirements. In addition, they are required to have a compliance function. All intermediaries are required to prepare and submit to the CSRC an annual report on internal controls, which needs to be assessed by the external auditing firm. All intermediaries are subject to a unified system of suitability requirements in the offering and distribution of products and information obligations towards their clients. They are also required to set up mechanisms to deal with complaints. All these obligations are mainly monitored through a program of on-site inspections, which is risk-based. Inspections are carried out primarily by the CSRC regional offices, with an active role from CSRC central office via the definition of themes for annual inspections.</p> <p>Banks providing wealth management services that involve securities are required to have strong internal controls and risk management systems. There are detailed rules for internal supervision (compliance) and the board and senior management must directly oversee these arrangements. There are strong suitability requirements for banks distributing WMPs to their clients, and clients must be given statements of account and quarterly financial reports. Banks must also establish procedures for dealing with client complaints. Compliance with these obligations is monitored by on-site inspections carried out by the CBRC, which are risk-based.</p>
<p>Principle 32. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</p>	FI	<p>An early warning system is in place to monitor the capital of securities intermediaries. The CSRC has plans in place and sufficient tools at its disposal to deal with distressed firms. There are specific rules to deal with the failure of a securities intermediary, which have been tested. There are mechanisms in place in both the securities and futures markets to protect clients' assets in the event of the failure of an intermediary. For securities markets, ownership of securities is registered directly at the investors' level in the CSDC, while cash must be kept in individualized accounts on the name of the investor at deposit banks. In case of losses, the Securities Investor Protection Fund (SIPF) has rules that protect the cash of investors. For futures markets, margins are deposited in individualized accounts in the name of the investor, thus ensuring full portability and the Futures Investor Protection Fund (FIPF) is available to meet client margin losses.</p>
<p>Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization</p>	FI	<p>The constitution of equity and futures markets is subject to the approval of the SC, upon a recommendation of the CSRC, in the case of equity markets and the CSRC in the case of futures markets. In all cases the authorization is</p>

and oversight.		conditioned on meeting a set of organizational, risk management and technological requirements. Exchanges are required to submit annual independent evaluations of their IT systems. There are no circuit breakers, but other measures are in place to deal with volatility such as price limits and, for futures markets, also the possibility of increasing margins, as well as position limits. In addition, exchanges can suspend trading.
Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	FI	The exchanges are the frontline supervisors of the markets. They have automated surveillance systems that allow them to conduct real time surveillance for purpose of ensuring orderly trading. They also conduct ex-post monitoring to support CSRC in the identification of unfair trading practices. To this end all the exchanges have established market surveillance teams to follow up on leads. The CSRC has established a program for the supervision of the exchanges that includes the approval of their rules and new products, reporting requirements, on-site inspections and approval of the appointment of key personnel.
Principle 35. Regulation should promote transparency of trading.	BI	Exchanges are subject to pre-and post-trade transparency requirements. As for pre-trade transparency, most –but not all–exchanges display at least the five best bids and offers. Neither iceberg orders nor dark orders are permitted. Under the current framework, all transactions must be conducted on the exchanges. Block trades can be negotiated off the market, but must be reported to and confirmed by the exchanges.
Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	FI	The exchanges have automated surveillance systems designed to identify unfair trading practices. In general they have assigned sufficient resources to the investigation of such practices. If cases are complex, and/or involve the violation of laws then they are transmitted to the CSRC for their follow up. Mechanisms have been established for cross-market supervision, in particular there is a dedicated data feed to share information. Mechanisms have also been established for cross-market surveillance with Stock Connect. There is evidence that the CSRC is taking a stronger stance in connection with enforcement cases including those related to unfair trading practices such as insider trading and market abuse. In addition, it is also referring a significant amount of clues to the criminal authorities. While criminal judgments exist, in general criminal enforcement is still weak, although the criminal authorities have taken recent steps to strengthen their ability to pursue these types of cases via the creation of centralized teams and larger prison sentences are starting to be applied. These actions require time to take hold. These latter type of issues have been considered for the grade of Principle 12.

<p>Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.</p>	<p>FI</p>	<p>All exchanges have CCPs. The CSDC is the CCP for all the equity exchanges, while the futures exchanges themselves act as the CCPs for their markets. All exchanges have established mechanisms to address clearing and settlement risks, and the risks of large exposures. In the case of the equity markets, the main requirements are access criteria for clearing members, settlement margins, collateral requirements, a guarantee fund and a risk reserve fund. Large holdings can be directly monitored by the exchanges and the CSRC as each client is required to have a single identification number. In the case of futures markets, the main requirements also include access criteria for clearing members, margin requirements, mark to market of positions on a daily basis, positions limits, a guarantee fund and a risk reserve fund. A large positions report has also been implemented. There are clear mechanisms to deal with the default of a clearing member. Only covered short selling is allowed, and is subject to disclosure obligations.</p>
<p>Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA).</p>		

Table 8. China: Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
<p>Principle 1 (with cross linkages to Principles 8, 16, 24-27, 28, 31 and 33)</p>	<p>The authorities should implement the agreements reached in the JMC aimed at developing harmonized regulations for asset management services, while allowing for differentiation based on the type of products, the type of investors to which they are offered and the systemic importance of the products. In this context, there could potentially be three different “sets” of regulations: (i) one for CIS offered to retail investors, which should be developed based on the requirements imposed by the IOSCO Principles and Methodology. In this context, the authorities are encouraged to consider the application of disclosure and conduct obligations of CIS to insurance products that have an investment component such as unit-linked products, (ii) one for CIS offered to non-retail; in this case the regulations should be flexible enough to allow different investment strategies and structures, while ensuring that the authorities are able to monitor their potential systemic implications and impose prudential requirements if and when necessary for purposes of ensuring financial stability, including in the case of HFs as required by the IOSCO Principles and Methodology; and (iii) finally a set of regulations for other asset management services (individual and portfolio management and advisory services).</p> <p>In tandem, coordination and cooperation arrangements should continue to be strengthened to ensure consistent administration of these regulations.</p> <p>The authorities should continue to actively implement the agreements reached in the JMC for Bonds aimed at (i) unifying the issuance criteria and disclosure requirements gradually in accordance with the principle that like products should be subject to unified regulatory rules; (ii) establishing appropriate mechanisms for coordination, (iii) promoting cross-market issuance and (iv) engaging the CSRC in cross-market enforcement.</p> <p>The authorities should continue working towards the implementation of a single regulatory regime for CRAs, via the draft regulation currently under consultation. The authorities should ensure that such draft meets the requirements set forth in the IOSCO Principles and Methodology.</p> <p>In the medium term, the authorities should work toward the development of harmonized regulations for ABS. In this context, and in anticipation of the expected changes to the IOSCO Methodology, the authorities are encouraged to consider the following issues: (i) the need for strong disclosure obligations, not just at the moment of issuance but over the life cycle of the underlying assets, potentially supported by the development of standardized disclosure templates, and (ii) the need for retention requirements.</p> <p>The CSRC along with relevant authorities should continue working towards the implementation of a stronger framework for the regulation and supervision of the regional equity trading platforms. The CSRC should give priority to the development and implementation of the corresponding code of conduct and to the establishment of adequate mechanism for the oversight of these platforms, supported by strong reporting requirements by the trading platforms to the CSRC.</p> <p>In the long run, the authorities are encouraged to consider the development of a</p>

	<p>unified regulatory framework for all non-exchange trading platforms. Such a framework would establish operational criteria applicable to all platforms, while allowing for differentiation between types of platforms and the role of the CSRC in their supervision based on criteria including their size and importance as well as the type of investors that have access to them.</p> <p>The CSRC should develop regulations for equity crowdfunding. More generally, the authorities are encouraged to review whether any gaps in the regulation of online financing remain.</p> <p>In anticipation of changes to the Methodology, the authorities are encouraged to consider whether there is a need to further strengthen the framework for OTC derivatives transactions.</p> <p>The authorities are encouraged to finalize the drafts for a new Securities Law and a Futures Law.</p> <p>The CSRC and CBRC are encouraged to consider whether current rules and regulations could be consolidated into fewer number of normative documents thus enhancing clarity and certainty of the framework that applies to specific activities.</p>
Principle 2-3	<p>The authorities should consider providing the CSRC with greater autonomy to decide on the number of staff and to have a separate salary scale to allow is to hire and retain qualified personnel.</p> <p>The authorities should consider transferring the responsibility for approval of equity exchanges and markets more generally to the CSRC.</p>
Principle 3, 11, 36	<p>The authorities should prioritize the review of the legal and regulatory regime for administrative sanctions to increase the level of penalties that can be applied where the current levels are too low and to ensure that the same misconduct across the securities and futures market is subject to the same level of penalties.</p> <p>The CSRC is encouraged to work actively with the criminal authorities to ensure that the sanctions that can be applied in criminal cases (including terms of imprisonment) provide sufficient deterrent effect.</p>
Principle 4	<p>The CSRC is encouraged to monitor the implementation of pilot programs with a view to ensuring that the potential for unlevelled playing field does not arise in practice. In addition the CSRC is encouraged to consider whether additional transparency can be brought to the selection process.</p>
Principle 5	<p>The CSRC should implement a system of prompt notification of any change in holdings of securities by its staff.</p>
Principle 6	<p>The CSRC should continue to enhance the tools used to monitor all the markets under its supervision.</p> <p>In addition, the CSRC is encouraged to consider expanding the mandate of the stock market crisis group so that it becomes the regular venue to discuss all emerging and systemic risks on a periodic basis.</p> <p>If it has not done so, the CSRC should incorporate market intelligence meetings to the tools available for systemic risk identification.</p> <p>The authorities should continue to strengthen current cross-sectoral mechanisms</p>

	<p>to share information, and monitor risks. In particular, data sharing on asset management should continue to be expanded, and efforts to standardize data be given full priority. The authorities should also explore the implementation of improvements in the mechanisms to jointly monitor risks stemming from the bond markets.</p> <p>More generally, the authorities are encouraged to consider further strengthening of the institutional framework for systemic risk identification.</p>
Principle 7	<p>The CSRC is encouraged to consider the development of a more structured framework for the identification of emerging risks that considers their impact and probability as first step to determine the actions to take. In tandem, a risk registry could be implemented.</p>
Principle 8	<p>The CSRC is encouraged to continue paying attention to governance practices in listed companies as they are key to the protection of minority shareholders.</p> <p>The CSRC is encouraged to intensify the monitoring of the OTC equity markets.</p> <p>The CSRC is encouraged to monitor compensation arrangements for intermediaries and how they may affect the products offered to clients, including in the context of MFs.</p> <p>In anticipation of the changes to the Methodology, the authorities are encouraged to review the framework for securitization and consider the need for consistent regulations that impose (i) stronger disclosure obligations, not just at the moment of issuance but over the life cycle of the security and its underlying assets, potentially supported by the development of standardized disclosure templates, and (ii) retention requirements on the issuer/promoter.</p>
Principle 9	<p>The CSRC should keep the resources of SROs under review to ensure that sufficient resources are devoted to their regulatory functions, including on-site inspections.</p> <p>The CSRC should review whether comprehensive inspections of SROs are needed.</p> <p>The CSRC is encouraged to require the SROs to appoint independent members in their decision-making bodies, including their disciplinary bodies.</p>
Principle 10	<p>The authorities are encouraged to eliminate the legal authority of corporations to issue unregistered stock.</p>
Principle 11	<p>The authorities are encouraged to (i) consider changes to the legal framework in order to explicitly provide the CSRC with stronger legal backing to request testimony from third parties, and to request telephone and internet service provider (ISP) records, along with the tools to make this power effective, (ii) to review whether there is a need to strengthen the powers to freeze assets and (iii) to ensure that all these powers can be used to assist foreign regulators.</p> <p>The CSRC is encouraged to continue working with other authorities to address any remaining challenges that might prevent investors from effectively exercising their rights in courts if they choose to do so. In this context, a class action system could be explored, along with a change in the burden of proof.</p> <p>The CSRC is encouraged to continue working with other authorities to implement the multilayer system of mediation.</p>

Principles 12	<p>ould give priority to securities markets offenses to ensure that criminal enforcement is efficient.</p> <p>The CSRC should keep its enforcement strategy under monitoring to ensure that it is making appropriate use of its powers to impose administrative sanctions (monetary penalties and bans), including for breaches of business conduct obligations such as suitability rules.</p>
Principles 12, 16, 24, 31	<p>The CSRC should keep the intensity of its programs for issuer monitoring and intermediary supervision under review and calibrate their intensity as needed.</p> <p>The CSRC should continue to enhance its theme identification framework potentially by linking it to a more structured framework for emerging risk identification as well as its current risk monitoring framework for securities companies, and to develop a similar type of framework for futures companies and fund management companies.</p>
Principles 14-15	<p>The CSRC is encouraged to shorten the time required to answer requests for foreign assistance, particularly in cases where collection of information is required.</p>
Principles 16	<p>The CSRC is encouraged to shorten the deadlines for submission of annual financial statements at least in connection with larger companies.</p> <p>The CSRC is encouraged to consider a package of measures aimed at further strengthening the role of disclosure on investment decisions including initiatives to (i) strengthen corporate governance of issuers as a key step to improve the quality of their financial disclosure, (ii) ensure that gatekeepers comply with their responsibilities, (iii) enhance investors' ability to exercise their rights and (v) foster additional participation of institutional investors into the market.</p>
Principle 17	<p>The CSRC is encouraged to consider requiring issuers to provide a longer period of notice of shareholder meetings for important matters requiring a two third's majority.</p>
Principle 19	<p>The CSRC should expand the use of comprehensive inspections for the supervision of auditors.</p> <p>The authorities could explore the creation of an independent body for the oversight of auditors in the financial sector.</p>
Principle 23	<p>The CSRC is encouraged to review whether adjustments are needed to the current rules for futures analysts.</p> <p>The CSRC is encouraged to review the current guidelines for securities analysis in order to provide more guidance on specific conflict situations where public disclosure should be made; this would promote consistency in firms' disclosure practices.</p>
Principle 24	<p>Both CSRC and CBRC should keep the intensity of their supervision of CIS under review and ensure appropriate use of the full range of enforcement actions.</p>
Principle 25	<p>The CSRC and the CBRC should consider requiring fully independent custodians. Alternatively, at a minimum, they should introduce additional measures to protect</p>

	<p>investors and their assets when self-custody or related party custodians are used, including but not limited to, enhanced reporting and supervision.</p> <p>The CBRC and relevant authorities should consider introducing specific provisions to ensure that WMP assets are protected if the bank that issues the WMP becomes insolvent.</p>
Principle 26	<p>The CSRC should require an updated or replacement prospectus if there are significant changes in a fund's circumstances.</p> <p>The CSRC is encouraged to consider requiring funds to provide investors with a simplified information document in addition to the detailed prospectus.</p> <p>The CBRC should prohibit the use of expected return information in non-guaranteed collective WMPs offered to retail investors.</p> <p>The CBRC should require WMP offer documents to contain disclosure about the methodology for valuing assets, redemption and pricing of interests, custodial arrangements and financial information about the WMP. More generally the CBRC should review whether more comprehensive guidance should be given in relation to the content of the prospectus and how to keep it up-to-date. Finally, the CBRC should review whether a more comprehensive regime for material events disclosure is needed.</p>
Principle 27	<p>The CSRC should monitor the implementation of the new framework for MMFs to assess sufficiency of changes.</p> <p>The CBRC should establish minimum standards for subscription and redemption pricing, pricing errors, a WMP's right to suspend or defer redemptions, and obligations to report suspensions or deferrals of redemptions to the CBRC.</p>
Principle 28	<p>The CSRC, in coordination with AMAC should continue to monitor the HF industry to ensure that it develops in a healthy manner. If large, potentially systemically important, funds emerge, it may be necessary to take a differentiated approach to the regulation of such funds. In such an approach, the CSRC along with relevant authorities might consider a transfer of the registration of such managers and funds to the CSRC, as well as additional reporting obligations and more intense on-site supervision.</p> <p>Other authorities should continue to monitor non-retail asset management activity to ensure that the potential for systemic risk is identified and managed.</p>
Principle 30, 31	<p>The CSRC is encouraged to consider implementing a more prompt notification requirement for deficiencies in capital in securities companies.</p>
Principle 31	<p>Both CSRC and CBRC should keep the intensity of their supervision of intermediaries under review and ensure appropriate use of the full range of enforcement actions.</p>
Principle 33	<p>The CSRC is encouraged to enhance the monitoring of the NEEQ market.</p>
Principle 33, 37	<p>As part of PFMI assessment on the CCPs, the CSRC is encouraged to review whether intraday margin is needed for clearing members and if so, whether a recalibration of initial margins is warranted.</p>

Principle 35	The CSRC should review current transparency requirements for the exchanges and ensure that an appropriate level of pre-trade transparency applies to all of them.
--------------	---

A. Authorities' Response to the Assessment

63. The CSRC is highly committed to the FSAP exercise and views the IOSCO Principles assessment as an opportunity to fully examine and strengthen the regulation of China's capital markets in line with international standards. We appreciate the comprehensive and thorough review of the regulatory framework and practices in China's securities and futures markets by the assessment team, and applauds their professionalism and dedication shown throughout the process.

64. Since China's first FSAP in 2009, the CSRC has placed high importance and taken real actions on the recommendations made in the assessment reports, achieving significant progress in many areas identified for action. Specifically, the CSRC has continued to develop China's multi-tiered capital markets to support national development strategies and the real economy; enhanced communication and coordination on financial regulatory policies under the Joint-Ministerial Conference (JMC) spearheaded by the PBoC; strengthened the regulation of listed companies and intermediaries by raising quality standards for listed companies and requirements for intermediaries in regard to risk management and internal control; improved the mechanism for risk monitoring, surveillance and contingency response in capital markets; fought forcefully against violations and misconduct to provide effective protection for investors' legitimate rights and interests; steadily expanded two-way opening-up of China's capital markets; and established a database on the integrity record of market participants and promoted the use of information technology in regulation.

65. This year's assessment report objectively depicts the current stage of development of China's securities and futures markets, acknowledges that the regulatory framework is largely compliant with the IOSCO Principles, and recognizes the authorities' efforts to mitigate risks, deepen reforms, and promote development in the context of China's capital markets since the first FSAP. In particular, the report points out that China's innovative approaches to investor protection and market surveillance could serve as a reference for other jurisdictions. In the meantime, the report also notes some specific challenges faced by China's capital markets at the current stage.

66. The report gives recommendations to increase regulatory resources, strengthen regulatory coordination and information sharing, improve governance practices of listed companies, strengthen regulators' investigation and enforcement powers, increase the intensity of supervision on capital market gatekeepers, consider creating an independent authority for audit oversight, bolster the risk management function of the futures market, explore differentiated regulation of hedge funds. Such recommendations are very much in line with the authorities' philosophy of pursuing law-based, comprehensive, and strict regulation, and will be of great value to the authorities when strengthening the legal and regulatory framework of China's capital markets.

67. The continued deepening of financial markets in recent years and the wide use of cross-sector and cross-market financial instruments have given rise to a higher likelihood of intertwined and magnified financial risks, presenting new challenges to and higher requirements for the regulators. Regarding some specific issues discussed in the assessment report, the CSRC would like to further clarify its

views. **With respect to harmonized regulation of like products**, under the leadership of the PBoC, financial regulators have reached important consensus on harmonizing regulation of asset management products and services and are developing unified regulatory rules. The CSRC will, under the guidance of the Financial Stability and Development Commission (FSDC) of the State Council, continue to enhance regulatory coordination with other regulators in order to eliminate supervisory shortfalls, prevent financial risks, and safeguard national financial security and the sound development of the capital markets. **With respect to the use of criminal enforcement**, over the past few years, the CSRC has strengthened cooperation with judicial authorities to impose stricter criminal sanctions against securities crimes. Synergies are created through coordinated administrative and criminal investigations to ensure timely information sharing between securities regulators and public security authorities. Moreover, the police force has established specialized offices targeted on criminal offenses in the securities and futures markets. The CSRC will act upon recommendations in the report and continue to assist China's legislature to expand the scope of applicability and increase the level of sanctions of the *Criminal Law* with regard to securities crimes. **With respect to information disclosure by listed companies**, the CSRC has employed a disclosure-focused supervisory regime and steadily raised the transparency of listed companies. As the next step, the CSRC will analyze the specific recommendations in the report on expanding the coverage of periodic report review, shortening deadlines for submitting annual reports and extending the notice period for *ad hoc* shareholder meetings in light of China's situation. **With respect to preventing conflicts of interest**, the *Securities Law* prohibits the CSRC staff from holding or trading stocks. In practice, the CSRC has set out even more stringent requirements, e.g., disallowing the staff to open securities accounts, thus eliminating the possibility for them to hold, let alone trade bonds on the stock exchanges. In addition, the CSRC has issued specific rules to regulate the trading of securities investment funds by its staff. Such rules have proved effective in maintaining high standards of integrity and preventing conflicts of interest for the staff.

68. The CSRC believes that recommendations and action points proposed in the report will not only facilitate future plans of the regulators, but also foster consensus among regulators, legislators and other stakeholders to create a positive environment for the reform and development of the capital markets. Pressing ahead with reforms would require efforts of the CSRC as well as support from many external authorities. Going forward, the CSRC will pay special attention to drawing on the comments and recommendations and apply international standards to the particular circumstances in China and its capital markets. The CSRC will, sticking to the market-oriented and law-based reform path with a global vision, accelerate the formation of multi-tiered capital markets that feature full range of financing functions, sound underlying structures, effective regulatory regime and adequate investor protection, thereby enabling the markets to better support China's real economy and become more resilient to financial risks.

DETAILED ASSESSMENT

69. The purpose of the assessment is primarily to ascertain whether the legal and regulatory securities markets requirements of the country and the operations of the securities regulatory authorities in implementing and enforcing these requirements in practice meet the standards set out in the IOSCO Principles. The assessment is to be a means of identifying potential gaps, inconsistencies, weaknesses and areas where further powers and/or better implementation of the existing framework may be necessary and used as a basis for establishing priorities for improvements to the current regulatory scheme.

70. The assessment of the country's observance of each individual Principle is made by assigning to it one of the following assessment categories: fully implemented, broadly implemented, partly implemented, not implemented and not applicable. The IOSCO assessment methodology provides a set of assessment criteria to be met in respect of each Principle to achieve the designated benchmarks. The methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the Principles in many different ways.

- A Principle is considered **fully implemented** when all assessment criteria specified for that Principle are generally met without any significant deficiencies.
- A Principle is considered **broadly implemented** when the exceptions to meeting the assessment criteria specified for that Principle are limited to those specified under the broadly implemented benchmark for that Principle and do not substantially affect the overall adequacy of the regulation that the Principle is intended to address.
- A Principle is considered **partly implemented** when the assessment criteria specified under the partly implemented benchmark for that Principle are generally met without any significant deficiencies.
- A Principle is considered **not implemented** when major shortcomings (as specified in the not implemented benchmark for that Principle) are found in adhering to the assessment criteria specified for that Principle.
- A Principle is considered **not applicable** when it does not apply because of the nature of the country's securities market and relevant structural, legal and institutional considerations.

Table 9. China: Detailed Assessment of Implementation of the IOSCO Principles

Principles for the Regulator	
Principle 1	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>Mandate</p> <p>The regulation and supervision of the financial sector in China is set broadly along sectoral lines, whereby the securities industry is regulated by the China Securities Regulatory Commission (CSRC); the banking industry and the trust company industry by the China Banking Regulatory Commission (CBRC) and the insurance industry by the China Insurance Regulatory Commission (CIRC).</p> <p>In general, the mandate of the CSRC covers the regulation and supervision of the cash and futures markets, as well as a developmental role. Such responsibilities are clearly established by law and complementary by regulations and decisions of the State Council (SC). CSRC's responsibilities over the cash markets derive mainly from the Securities Law and the Securities Investment Fund Law (the latter referred to as the Fund Law); and over the futures markets mainly from the Regulations on the Administration of Futures Trading. Such Regulations were issued by the SC pursuant to article 2 of the Securities Law, which specifically provides that "the measures for the administration of issuance and trading of securities derivatives shall be prescribed by the SC according to the principles of the Present Law".</p> <p>From a regulatory and supervisory perspective, pursuant to such legal and regulatory framework the CSRC (i) authorizes the public offering of securities and funds, (ii) licenses all categories of intermediaries with the exception of private fund managers (which are only subject to registration with AMAC), (iii) licenses futures markets and other market infrastructure providers, while the licensing of equity markets falls to the SC – on the recommendation of the CSRC, and (iv) licenses information service providers, including credit rating agencies and auditors that provide services in the securities and futures markets. It has rulemaking authority over all such categories of participants including private fund managers, and exercises day-to-day supervision of their operations. It also has investigative and administrative enforcement authority in connection with the laws and regulations that it administers and can impose administrative measures on regulated entities and administrative sanctions, including money penalties, on anyone who is in breach of such laws and regulations. Criminal enforcement is a responsibility of the criminal authorities, although the CSRC and the Criminal Enforcement Bureau of the Ministry of Public Security play a key role in assisting the investigation of criminal offenses.</p> <p>The CSRC is supported by self-regulatory organizations (SROs), including the exchanges and three industry associations (SAC, CFA, and AMAC). The exchanges have listing authority and thus have a key role in monitoring listed companies' compliance with their listing obligations, including disclosure obligations. They also exercise member regulation functions and conduct market surveillance with the objective of ensuring orderly trading and supporting the identification of unfair trading practices. Membership in the industry associations is mandatory for specific categories of intermediaries: securities companies must be members of SAC; futures companies of the CFA; and managers of private securities investment funds must register with AMAC. The industry associations have two main roles: the development and administration of a system for the qualification of practitioners (individual persons who</p>

exercise specific functions in the securities and futures industry) and the development and monitoring of rules for the industry, which provide additional granularity to CSRC regulations. Notwithstanding the existence of SROs, the CSRC has the licensing authority over all intermediaries, and has developed supervisory programs for all categories of intermediaries; thus the programs of the industry associations complement CSRC programs. The only case where there is a difference in approach relates to the managers of private securities investment funds and the funds themselves that are subject to registration with AMAC. The CSRC still has regulatory powers over them and in practice it has its own supervisory program for their oversight. As will be further explained in Principle 9 there are different mechanisms through which the CSRC seeks to coordinate its supervisory plan with that of the SROs and exercises oversight over them.

Capacity to interpret laws and regulations

The CSRC has the power to develop rules and regulations within the authority granted to it by the Securities Law, the Fund Law and the Legislation Law for the purpose of performing its functions. The CSRC's Regulations on the Procedures for Formulation of Securities and Futures Laws set out specific procedures for the development of rules and normative documents issued by the CSRC as further described in Principle 4.

In addition, the CSRC has developed a system of opinions on the application of the securities laws, through which it provides guidance on its expectations concerning the way market participants are to comply with relevant rules and regulations. Opinions are mainly issued in the form of Q&A. They can be found in the CSRC website. The interpretation of provisions of the administrative regulations is a responsibility of the Legal Affairs Office of the SC.

Securities markets activities or products subject to more than one regulator

As indicated above, the CSRC is the main regulator of the securities markets pursuant to the Securities Law, the Fund Law and the Regulations on the Administration of Futures Trading. In practice, the CSRC mandate covers most parts of the securities and futures markets; however other statutes provide other authorities with competencies over certain sub-segments of the securities market, or over certain activities or products that share similar characteristics than those undertaken or offered by securities intermediaries. As a result, in some cases the regulations applicable to similar activities or products have important differences

There are four main cases:

The provision of asset management services: there are three regimes

- (i) The regime for the provision of individual and collective portfolio management and advisory services by intermediaries under the CSRC;
- (ii) The regime for the provision of such type of services by banks and trust companies, which is administered by the CBRC and under which banks can offer asset management services to retail investors; and
- (iii) The regime for the provision of asset management plans by insurance asset management companies, which is administered by the CIRC. Pursuant to such regime the plans can only be offered to institutional investors. In practice they are mainly used by insurance companies to manage their insurance funds.

The authorities indicated that the existence of differences in the regimes has been subject of analysis by the JMC. In 2014 the JMC conducted a thematic research project on the issue and consensus was reached to improve the regulation of the products. In May 2016 the CBRC and the CSRC reached an agreement for data sharing and other data sharing agreements are

in the process of being finalized. In June 2016 consensus was reached that all financial regulatory authorities should follow the principle of gradual convergence. Based on such consensus the financial regulators have been reviewing their own rules. More recently it was decided that the PBoC would lead an effort to unify the regulations in the area of asset management.

The offering, placement and trading of bonds: there are three regimes:

(i) The regime applicable to corporate bonds that are issued to the public and which must be listed on the exchanges. Such issuances are subject to the regulation and supervision of the CSRC and the listing rules of the exchanges. The exchanges are the front line supervisors of their markets, supporting CSRC's supervision of the markets;

(ii) The regime applicable to bonds and debt instruments issued by financial and non-financial corporations strictly to institutional investors in the interbank bond market. Pursuant to the Law on the People's bank of China, the PBoC is the competent authority of the interbank bond market. Accordingly, issuances in it are subject to the regulation and supervision of the PBoC, and the debt instruments issued by non-financial corporations to institutional investors subject to self-regulation by NAFMII, which in turn is subject to oversight by the PBoC. The market infrastructure providers and NAFMII perform first-line monitoring and self-regulation that assist the PBoC in the monitoring of the interbank bond market. The CSRC could make investigations and sanctions to violations of the Securities Law such as fraudulent information disclosure, insider trading and price manipulation in the bond market.

(iii) the regime applicable to enterprise bonds which are bonds issued for specific projects. The issuance of these bonds is subject to the regulation and supervision of NDRC. In addition, such bonds can be traded on the exchanges or circulated and transferred in the interbank bond markets and as a result are subject to supervision by the applicable market.

The authorities indicated that during the November meeting of the JMC for bonds consensus was reached on key points, including: the need to (i) unify the issuance criteria and disclosure requirements gradually in accordance with the principle that like products should be subject to unified regulatory rules; (ii) coordinate various procedures on the basis of the above principle to achieve information sharing and establish a Bond Issuance Coordination Working Group to conduct periodic review; (iii) promote the cross-market issuance; and (iv) engage CSRC in cross-market enforcement for the bond market. In addition, data sharing arrangements have been established whereby the PBoC collects information from all regulators on bond issuances, trading and defaults on a monthly basis with a view to facilitating the oversight of the bond market.

Offering of ABS: Currently PBoC and CBRC share the regulating responsibilities of credit asset securitization, and CSRC takes the responsibilities of regulating enterprise asset securitization. In addition, asset backed notes are registered and issued through NAFMII and subject to self-regulation by NAFMII's.

Provision of credit rating services: The PBoC is the lead regulatory agency for the provision of credit rating services. All firms that want to provide these services must fulfill record filing procedures regulated by PBoC. In addition, a firm must obtain a license or recognition from the regulatory authority of the market in which the companies rated would issue securities. The authorities indicated that coordination in this area takes place in the JMC for Bonds. Furthermore, recently the relevant authorities reached agreements aimed at unifying the regulation and strengthening the supervision of CRAs. In this context, in 2016 the PBoC, the CSRC and the NDRC jointly drafted the *Provisional Regulation for the Credit Rating Industry* in order to promote the regulation and supervision for credit rating industry and

implement unified access standards. The draft has been sent to the public for comments.

In addition, it is important to mention the situation of the regional equity trading platforms. Under the Circulars of the SC such platforms are under the direct regulation and supervision of the local authorities, although the CSRC has been empowered to provide further guidance. In practice, their regulation and supervision was considered not to be in line with the risks they posed. As a result, the General Office of the SC issued the Notice on Supervising and Developing Regional Equity Markets in January 2017 which has further standardized key aspects of the regulation of these platforms and provided the CSRC with a larger role concerning their supervision. The provincial authorities remain in charge of day to day supervision, while the CSRC and its regional offices are in charge of (i) formulating a set of uniform business and supervision rules, (ii) providing guidance and coordinating supervision for the provincial governments in their day-to-day oversight, and (iii) overseeing and inspecting the platforms and providing warnings as appropriate and monitoring risk disposal. In line with the above, the CSRC issued the Trial Measures for the Supervision and Administration of Regional Equity Markets in May 2017. As such regime was implemented after the mission took place, the assessors did not evaluate it.

Perimeter of regulation issues

In 2015, ten regulatory authorities issued a joint Guideline on Promoting the Healthy Development of Internet Finance. The guideline allocated responsibilities for the regulation of peer-to-peer lending to the CBRC and of equity crowdfunding to the CSRC. (Yin Fa [2015] No. 221) The framework for peer-to-peer lending has already been developed by the CBRC. There are concerns in the market that certain types of internet financing activities do not fit neatly into the definition of peer-to-peer peer lending and that there is a need for further regulation. In addition, market participants highlighted the importance of bringing regulatory certainty to equity crowdfunding. CSRC staff informed the assessors that a working group has been created to review the issue and that equity crowdfunding has to be regulated according to laws and regulations due to concerns over public interests and national financial safety. So far, pilot programs of equity crowdfunding within CSRC's scope of regulation have not started.

Coordination and cooperation

The authorities have developed several avenues for coordination and cooperation.

FCRG: At the highest level, the authorities established the FCRG in 2008. The FCRG is chaired by the Vice Premier of the SC in charge of the financial sector and it includes representatives from the PBoC, the State Administration of Foreign Exchange (SAFE), the NDRC, the MoF, and the three Commissions (CSRC, CBRC, and CIRC). The topics for discussion are chosen based on recent financial system developments and concerns, while the briefing materials are prepared by the relevant agencies in advance of the meeting. For financial stability topics, the PBoC, together with the three Commissions and with feedback from MoF and NDRC, as necessary, prepares and submits a report that analyses the current financial risks. The meetings have included a discussion of a number of financial stability topics, including the regulation and supervision of shadow banking activities (which led to the issuance of SC guidance in January 2014). In 2015 the group convened 10 times; and as of the time of this assessment it had met 7 times in 2016.

Financial Regulatory Coordination Joint Ministerial Conference: At the level of the financial regulators, the SC approved the Financial Regulatory Coordination Joint Ministerial Conference for coordination of financial regulation (JMC) in 2013, to further strengthen the coordination of regulatory efforts in the financial industry. The JMC comprises the PBoC, the three Commissions and the SAFE, and as necessary, the ministers of the NDRC and Finance.

The functions and duties of the JMC include: (i) harmonization of monetary policies and financial regulatory policies; (ii) coordination between financial regulatory policies and legislation; (iii) maintenance of financial stability and prevention and mitigation of regional and systematic financial risks; (iv) coordination with respect to cross-sectoral financial products and cross-market financial innovations; (v) coordination with respect to financial information sharing and comprehensive statistical system for the financial industry; and (vi) other matters delegated by the SC. The JMC's Rules of Procedure state that it is a coordinating body and that it does not alter the configuration of regulatory decision-making responsibilities among its member agencies, nor does it substitute for the decision making of the SC. The JMC is chaired by the governor of PBoC, and attended by the chairs of the three Commissions and the head of SAFE. The PBoC holds the secretariat. Preparation of the agenda is led by the PBoC, but all members can submit topics for discussion. Issues discussed tend to vary across meetings; there are no standing agenda items. In practice, the JMC has focused most of its discussions on cross-sectoral issues. Current financial stability conditions and potential vulnerabilities are not a standing agenda item of JMC discussions, but have been considered by the JMC on occasion when explicitly included as a discussion item. JMC decisions are made by consensus, with any proposals or views on major cross-sectoral financial regulatory issues being sent to the SC for approval. Significant differences of view among members are also reported to the SC. The JMC considers issues of importance to multiple agencies, but issues may also be sent directly to the SC from individual agencies based on their respective mandates and with input from other agencies as needed. Since its establishment the JMC has convened eight times and dealt with over 20 topics. Authorities were broadly of the view that the JMC has improved coordination in cross-sector issues in important topics such as internet finance and more recently on asset management – as discussed above.

CSRC has been supporting PBoC efforts as the lead agency of the JMC, to strengthen information sharing and standardization of statistical information. First, the CSRC has provided the PBoC with data on financing activities in the capital markets on a monthly basis and supported it also in collecting statistical data on Total Social Financing.. Second, the CSRC has worked with the PBoC to promote the establishment and improvement of the Statistical Framework for Bonds; to this end it has worked on the development of the statistical system for bonds and the submission of data on exchange-traded bonds. Third, the CSRC, jointly with the CBRC and the CIRC, is supporting the implementation of pilot program of integrated statistics for the financial sector. Fourth, the CSRC has assisted the PBoC in the sharing of credit information by providing it with credit information and credit product information arising from the regulation and supervision of the securities and futures markets. Fifth, the CSRC has set up a transmission line dedicated for the sharing of data between the PBoC and the CSRC, laying the technical foundations for the development of an information sharing platform.

JMC for Bonds: There is also an Inter-ministerial forum for corporate bonds regulation, the JMC for Bonds, which was established in 2012 upon approval of the SC. It comprises the PBoC, the NDRC, and the CSRC, as regulators of the bond markets. It is led by the PBoC, and attended by the Chairs of each Commission and the deputy of each agency as assistant.

The duties of the JMC for Bonds are as follows: (i) promoting the reform and development of corporate credit bond market, further expanding the direct financing channels, optimizing the structure of social financing, maintaining financial stability and making full use of the function of market in resource allocation to support the sound and rapid development of economy; (ii) harmonizing and improving the rules on issuance, trading and information disclosure of the corporate credit bonds. Based on consensus on relevant rules, the regulatory standards developed by different authorities are mutually recognized by members

	<p>of the mechanism. Furthermore, the mechanism is responsible for drafting the development strategy, planning and policies of the corporate credit bond market, and forming guidance to promote the reform and development of corporate credit bonds; (iii) all members coordinate and perform their own responsibilities to display their respective advantage. The mechanism calls for strengthening the supervision coordination in product innovation, infrastructure construction, investor management, investigation and sanction of illegal activities in corporate credit bond market. Establishment and improvement of the information sharing mechanism is required to achieve comprehensive monitoring of risks in the market.</p> <p>The JMC for Bonds holds meetings on a "need" basis to discuss important problems in corporate bonds. So far it has met five times. As stated above, in the November meeting important decisions were made concerning the need to harmonize the framework for bonds.</p> <p><u>MoUs:</u> The three Commissions signed the <i>Memorandum of Understanding among CBRC, CSRC and CIRC on Division of Responsibilities and Cooperation in Financial Regulation ("CBRC-CSRC-CIRC MOU")</i> in 2004. The Memorandum establishes five guiding principles for the working of the Commissions, regarding their obligations to: (i) conduct supervision in a separate manner; (ii) understand their mandates well, (iii) collaborate and coordinate with each other, (iv) make public their operating rules and procedures, and (v) be efficient and avoid corruption. The MoU also commits them to cooperate closely with the MoF and the PBoC to jointly maintain financial stability and public confidence in the financial market.</p> <p>There is also a bilateral MoU between the CBRC and the CSRC whereby the CSRC and CBRC share data on stock dominant securities investment trust products and equity pledge financing as further described in Principle 6.</p>
Assessment	Partly Implemented
Comments	<p>There are challenges related to KQ 2(a), 2(b) and 2(d) in relation to both activities subject to more than one regulator and perimeter of regulation issues, which have all been factored in the grade.</p> <p>Activities subject to the regulation and supervision of more than one regulatory authority</p> <p>As indicated in the description, there are currently important products and activities that are subject to different regulatory and supervisory regimes. In the opinion of the assessors in some of these cases the differences in the regimes can have an impact on investor protection, liquid markets or affect the ability of the authorities to monitor the markets. Thus, as already agreed and planned by them, it is critical that the authorities continue to work towards the development and implementation of harmonized regimes and to strengthen current coordination and cooperation arrangements. A more detailed explanation is provided below for each of the cases mentioned in the description.</p> <p>First, in the area of asset management services, as covered in the assessment, the assessors found that the current regimes and supervisory programs are broadly compliant with the Principles, although a few material gaps were identified. However in particular in regard to CIS offered to retail investors, differences in key operational aspects create opportunities for regulatory arbitrage and can negatively impact investor protection and potentially also affect the ability of the authorities to monitor systemic risk. That is why they recommend that the authorities prioritize the implementation of the agreements reached in the JMC to work towards a harmonized regime for asset management services. The regulations could allow for differentiation based on the nature of the product, the type of investor, and the importance of the products. In such context, potentially three "sets" of regulations could be</p>

envisioned: (i) one for CIS offered to retail investors, (ii) one for CIS offered to non-retail investors –which should allow further distinction based on the potential systemic relevance of the products, and (iii) one for other asset management activities (individual portfolio management and advisory services).

Regarding bonds, as indicated elsewhere the assessment focused in the regime for the public markets, which the assessors found to be compliant with the Principles. However, also in this area the assessors believe that working on a harmonized regulatory regime (which should allow differentiation based on the type of investors involved) and on strengthening coordination including in the context of enforcement, should further the objectives of investor protection, efficient markets and the ability of the authorities to monitor the bond markets.

In the case of CRAs, the assessors reviewed the framework of the CSRC, which they found to be compliant with the Principles. Other regulations appear to be more high-level. In this context, and understanding the role that CRAs would continue to play in the development of the Chinese markets, it is also critical that the authorities work to ensure that their regulation and supervision is strong. Further, given that many CRAs provide services in more than one market, coordination and cooperation should continue to be strengthened, to foster investor protection and potentially also financial stability. Thus, in line with the work already underway, the authorities should continue to work towards the implementation of unified regulations for CRAs, and leveraging the JMC for bonds for coordination.

Finally, the assessors note that the ABS markets are still at an early stage. That said, their potential systemic importance is one of the lessons from the crisis. Thus, it is important to ensure that these markets develop in a way that fosters alignment of incentives between originators and investors, and where the potential for regulatory arbitrage is being minimized. In such context, in the medium term the authorities should consider the development of harmonized regulations for these products that provide strong disclosure obligations and retention requirements, and that foster standardization, with the aim of ensuring that such markets develop in a healthy way.

Other issues not affecting the grade

Perimeter of regulation

The regional equity trading platforms could offer opportunities to further expand the ability of the capital markets to serve small companies through a system of “local financing for local companies”. At the same time, if they are not properly set up they could pose challenges to investor protection and undermine confidence of investors in the capital markets. The assessors acknowledge that there is already work underway to implement a sound framework for the regulation and supervision of these platforms. One aspect that will remain critical is enforcement, and the need to ensure that cases of fraud are tackled swiftly.

In the long run the authorities might wish to consider the development of a single regulatory regime for all non-exchange trading platforms. The regulations would establish operational criteria applicable to all trading venues, while allowing for differentiation between types of platforms and the role of the CSRC in their supervision based on different criteria including their size and importance as well as the type of investors that have access to them.

In addition, it is important that there be clarity in the market about different forms of Internet financing and the regulatory framework applicable to them. In this context, the CSRC should prioritize work on equity crowdfunding. More generally, the assessors encourage the financial authorities to review the regulation for online financing to determine whether there are gaps that need to be addressed.

	<p><i>The need to update the legal and regulatory framework</i></p> <p>The assessors recognize that the Securities Law expressly provides the foundation for the regulation of futures trading. That said, it is important that a more detailed legal framework for futures be enacted. In addition, updates are needed to the Securities Law to account for new developments such as crowdfunding. Finally, as further discussed in Principles 3 and 11 it is important that the legal framework related to administrative and criminal enforcement be strengthened. The assessors are aware of the work being done to update the Securities Law and to develop a Futures Law and encourages the authorities to finalize such work, and to consider prioritizing an update of the administrative and criminal framework for enforcement of securities and futures markets.</p> <p>In anticipation to the changes in the Methodology, the assessors encourage the authorities to review whether enhancements are needed in connection with their current regulatory approach to OTC derivatives transactions.</p> <p>Finally, the assessors note the existence of a significant number of rules and regulations pertaining each activity that a participant may want to undertake in the securities and futures markets, in addition to self-regulatory rules. In the interest of clarity, the authorities might wish to consider whether a consolidation of such rules and regulations is possible.</p> <p><i>The developmental role of the CSRC</i></p> <p>The assessors note that the IOSCO Principles do not refer to the possibility that a developmental role be assigned to a securities regulatory agency. In practice many regulators have such role, particularly in emerging markets. Vis-a-vis the IOSCO principles what is key is that such role be exercised in a way that fosters the development of markets where investors are protected, markets are fair, efficient and transparent and where the possibility of systemic risk is reduced.</p> <p>In the context of China the specific characteristics of the market and the vision of capital markets development have prompted the CSRC as the main regulator of the securities and futures markets to adopt different regulatory approaches to those used in other large markets. For example, the CSRC has considered it necessary to take a stronger role in the establishment of markets, in ensuring the quality of companies that come to the market and in pacing market development and innovation, by determining the timing of new issues, new products and new services in the market. At times, such an approach has encountered challenges and the balance between development and stability has been difficult to strike. Some of the challenges have stemmed from the more volatile nature of the markets. Addressing them has not been easy not just because traditional tools have sometimes proved ineffective in such market structure but also because of investors' expectations about the role of the authorities and the authorities' concern to preserve social stability. But these challenges have also indicated the need to work towards more market based solutions, especially those that combine a stronger role for disclosure and transparency with enhanced public enforcement and private exercise of rights. These are key tools that should help align the incentives of different participants with the public objectives of ensuring investor protection, fair and liquid markets and financial stability. The assessors understand that the intention of the authorities is to move in such direction and steps are already being taking towards that end.</p>
<p>Principle 2</p>	<p>The regulator should be operationally independent and accountable in the exercise of its functions and powers.</p>
<p>Description</p>	<p>Independence</p>

	<p><i>Governance</i></p> <p>The CSRC was established in October 1992 as a ministry-level government agency directly under the SC, to which it is accountable. In 2006, the CSRC was approved to be governed under the Civil Servant Law of the PRC. It has no administrative affiliation with other departments of the SC or organizations directly under the SC.</p> <p>The main governing body of the CSRC is the Chairman, whose position has Ministerial rank. He is currently supported by four Vice-Chairmen and two Assistant Chairmen. The Chairman has responsibilities for all matters, while each Vice-Chairman and Assistant Chairman has responsibilities to oversee day-to-day operations of specific departments.</p> <p>None of the Chairman, Vice-chairmen and Assistant Chairmen can hold any position in a regulated entity. The Civil Servants Law has general provisions applicable to all levels of civil servants. Under article 9, civil servants enjoy rights, including the right not to be removed from office, demoted, dismissed or disposed of without due cause of law, without going through legal procedures. All the staff of CSRC, including the executive management team, perform their duties as civil servants. There are separate rules governing the appointment, dismissal and tenure of senior officials - "Rules on the Selection and Appointment of Party and Government Officials" and "Provisional Rules on the Tenure of Party and Government Officials". Senior officials have 5-year terms, renewable once, and the reasons for not completing a full term include reaching retirement age, health reasons, considered unsuitable for current position, resignation (voluntary or involuntary), deposition, and special needs for reassignment. All appointments and dismissals are formalized by a corresponding letter issued by the SC and are publicly disclosed pursuant to the Civil Servants Law.</p> <p><i>Strategic priorities and day to day operations</i></p> <p>The SC exercises strategic direction on issues related to capital markets development, and by implication on the regulation and supervision of capital markets via the issuance of opinions. Opinions can cover both aspects related to the need for rules and regulations in a particular area as well as aspects related to the way laws, rules and regulations are being supervised and enforced. Key opinions in the area of securities and futures markets are the Opinion of the SC on Further Enhancing the Protection of Small Investors' Rights and Interests from 2013 and the Opinion of the SC on the Healthy Development of the Capital Markets from 2014. CSRC strategic priorities are driven by such opinions. CSRC staff highlighted that the process of developing such opinions involves consultation with several agencies, including the CSRC; further, the CSRC can comment on proposals made by other agencies.</p> <p>In addition, the SC has the power to issue administrative regulations which are issued following the general consultation procedures detailed in Principle 4. Pursuant to the relevant laws, the CSRC exercises its day-to-day operations (approval of public offerings, licensing of intermediaries, supervision including on-site inspections, and imposition of administrative measures and sanctions) without the need for external approval. The licensing of securities exchanges is a responsibility of the SC, although a recommendation of the CSRC is required. Decisions of the CSRC are subject to reconsideration by the SC as will be further explained below.</p> <p><i>Issuance of rules</i></p> <p>As indicated in Principle 1, the CSRC can issue rules, which, depending on the scope of authority provided by the law, may be subject to the review of the SC. The formulation of rules by the CSRC does not require the approval by other departments, but are subject to consultation as further described in Principle 4. Pursuant to article 81 of the Legislation Law and article 8 of the Regulations on the Procedures for Formulation of Rules, for issues for</p>
--	---

which more than one ministry or ministry-level authority under the SC is responsible, or when the formulation of administrative regulations is premature, and thus rules are needed, the relevant agencies under the SC must formulate the rules jointly.

Protection against legal suits

The legal framework provides adequate protection to staff against legal suits for the bona fide discharge of its functions. Pursuant to article 152 of the Opinions of the Supreme People's Court on Several Issues Concerning Implementation of the General Civil Law of the People's Republic of China (Tentative) and the State Compensation Law, the state must assume civil and administrative liability for damages caused by staff to the legitimate interests of any citizen and legal person when discharging their functions and powers. Pursuant to the Compensation Law, in case of illegal acts that caused damage to citizens, the corresponding state body must compensate. If staff has deliberately caused the damage, then the corresponding state body must order the person concerned to assume the compensation partly or wholly. It is the understanding of the CSRC that there have not been CSRC related cases where the state has ordered compensation by staff.

Stable budget

The CSRC is funded by the general budget of the government. All supervision fees levied by the CSRC on securities and futures market participants are paid directly into the national Treasury.

Article 32 of the Budget Law of the People's Republic of China (PRC) stipulates that the various departments must compile their annual budgets according to their responsibilities, tasks and development plans, implementation of budgets from the previous year, and factors affecting the revenues and expenditures for the current year. Pursuant to this article CSRC prepares its budget on an annual basis, and submits it to the MoF that incorporates the CSRC budget into the central government budget.

In practice the CSRC's budget is largely based on historical spending. Additional funding for specific projects for the purpose of safeguarding the stability and healthy development of capital markets is made available also by the central government. Adjustments are sometimes made to the budget sent by the CSRC. For example, for 2017 a decrease of 5% was applied to the budget of all departments and thus has affected the CSRC budget. The CSRC budget is finalized by the MoF upon its review and approval.

In addition, the CSRC has a specific quota of staff that it cannot surpass –as is the case for other entities subject to the Civil Servants Law. In its case this number has been kept relatively "frozen" for the last 7 years: from 3338 in 2009 to 3455 in 2016. As a result the number of staff has not kept in line with the growth of the market. For example, from 2009 to 2015 the number of listed companies has grown from 1,718 to 2,827, and market capitalization has increased from 3.67 trillion in 2009 to 53.15 trillion. Further, a new trading venue, the NEEQ, was created in 2013, which by 2016 had 10,163 listed companies. For the same period, assets under management by fund management companies grew from 0.4 trillion into 12.42 trillion. The number of intermediaries has also increased. For example, the number of securities companies grew from 106 to 125, with assets of 6.4177 trillion assets. In addition, a whole new category of intermediaries, private fund managers are now under the jurisdiction of the CSRC. CSRC staff has highlighted that the current level of staff has mainly affected the workload per person.

Further, as per any other entity under the Civil Servant Law, changes in CSRC structure require approval of an administrative organ of the SC.

Accountability to the government

As indicated above the CSRC is accountable to the SC through a series of mechanisms, including the review of its rules, and the reconsideration procedure. The SC is also accountable to the National People's Congress (NPC) mainly through the review and approval of the budget. In addition, it is common that during the NPC annual meetings issues concerning the development of the capital markets are raised that may drive the priorities of both the SC and the CSRC.

Pursuant to article 19 of the Audit Law and article 9 of the Securities Law, the CSRC's receipt and use of funds are subject to audit by the National Audit Office.

Transparency to the public

Under the *Regulations on Disclosure of Government Information* and the *Measures for the Disclosure of Securities and Futures Regulatory Information (Tentative)*, the organizational structure, division of responsibilities, work procedures, legislation, and issues with material impact on relevant regulated entities, such as administrative licensing, penalties, as well as other matters that need to be disclosed must be disclosed, provided that the confidentiality provisions are observed.

In practice, the CSRC discloses the following regulatory information through its website: (i) the organizational structure, responsibilities, contact details, etc. of the CSRC and its regional offices; (ii) securities and futures rules and normative documents; (iii) development plans and reports of the securities and futures markets; (iv) statistical information of the securities and futures markets incorporated into the national statistics indicator system; (v) matters concerning administrative licensing, including the legal bases, conditions, numbers, procedures, time limit, catalogs of application material documents, relevant departments responsible for licensing and results of applications; (vi) listings approved for securities and futures exchanges; (vii) approvals and record of the articles of association and self-regulatory rules of securities and futures exchanges, securities registration, custody and clearing institutions, securities and futures associations; (viii) names, addresses and contact details of securities and futures business institutions, fund management companies, and securities service providers such as investment consulting agencies, financial advisory institutions, credit rating agencies, asset appraisal agencies and accounting firms, as licensed by the CSRC; (ix) decisions on market bars, administrative penalties and administrative reconsideration; and (x) other information that must be disclosed as required by laws, administrative regulations and the CSRC rules.

Procedural fairness in individual decision making*Obligation to inform and provide reasons for its decisions*

Different provisions require the CSRC to provide reasons for the individual decisions it makes:

- Licensing: pursuant to articles 24, 25 and 40 of the Provisions of the China Securities Regulatory Commission on the Procedures for Implementation of Administrative Licensing, the CSRC must provide written decisions on approval or disapproval of applications for administrative licensing, with reasons given in the case of disapproval, as per article 38 of the Administrative Licensing Law.
- Enforcement: according to article 39 of the Administrative Penalty Law the CSRC must give written decisions on administrative penalties and regulatory measures; and the corresponding document must include relevant facts, reasons and legal

	<p>basis of the penalty.</p> <ul style="list-style-type: none"> • Inspections and investigations: article 181 of the Securities Law provides that, when conducting inspections and investigations the CSRC must present a letter of inspection or investigation to the party concerned, otherwise the latter has the right to refuse. • Compulsory measures: articles 12 and 13 of the Measures of the CSRC for the Implementation of Freeze and Seal-up and articles 8 and 11 of the Measures of the CSRC for the Implementation of Restricting of Purchases and Sales of Securities requires the CSRC to issue a letter of decision to the party concerned, and a letter of notice to the assisting entity. <p><i>Obligation to provide persons affected by its decisions with the opportunity to be heard</i></p> <p>Different provisions require the CSRC provide persons affected by its decisions with the opportunity to be heard.</p> <ul style="list-style-type: none"> • Licensing: articles 46 and 47 of the Administrative Licensing Law and article 42 of the Administrative Penalty Law provide that those affected by the licensing process or interested parties are entitled to a hearing with respect to any decision to grant, deny, or revoke an administrative license. • Administrative penalties: article 32 of the Administrative Penalty Law grants the affected persons the rights to make statements and to defend themselves. Paragraph 3 of Chapter V thereof prescribes the hearing procedures for the imposition of administrative penalties. The Rules on the Hearing of Administrative Penalty set forth the specific hearing procedures to be followed. <p><i>Checks and balances within the decision making processes</i></p> <p>In addition, checks and balances have been built into the decisions making process.</p> <ul style="list-style-type: none"> • Licensing: CSRC's General Office has set up a special office for registering, providing feedback on and servicing documents related to administrative licensing applications, while relevant CSRC departments are responsible for review of licensing applications through a double-check system to make administrative licensing process more transparent and standardized. • Decisions on securities offerings, M&A and restructuring: in these cases the process involves the participation of experts. In particular, the "Public Offering Review Committee" and the "M&A and Restructuring Committee" have been set up, whose opinions and recommendations are heavily relied upon by the CSRC in making final decisions. • Enforcement: for purposes of the imposition of administrative sanctions, the principle of separation of investigation and hearing functions was implemented in 2002 and the Administrative Sanctions Committee was established in 2007 to further improve cooperation mechanisms as well as internal checks and balances. In addition, a system of joint approval of decisions for complex cases has been established whereby all compulsory measures are subject to joint review and approval by the functional department and the legal affairs department.
--	--

	<p>Review of decisions</p> <p>Pursuant to articles 6 of the Administrative Reconsideration Law and article 12 of the Administrative Litigation Law, a citizen, legal person, or entity may file an application with the CSRC for administrative reconsideration or directly initiate administrative proceedings with a People's Court if it considers that any specific administrative action by the CSRC has infringed upon its lawful rights and interests. Administrative reconsiderations can be initiated not only for the imposition of administrative penalties and market bars, but also for other forms of administrative act including administrative licensing, regulatory measure, information disclosure, as well as handling whistleblowing and complaints.</p> <p>The CSRC has an independent department responsible for examining applications for administrative reconsideration. For important or complicated cases, the Administrative Reconsideration Committee will hold discussions and the final decision will only be made after statutory procedures have been followed and completed. A person who disagrees with a decision of administrative reconsideration by the CSRC may initiate administrative proceedings with a People's Court or apply to SC for a ruling. The SC after examining the application must make a final ruling of affirming, annulling, modifying or rejecting the administrative reconsideration decision. In such case, the reviews are conducted by the Legal Affairs Office of the SC.</p> <p>CSRC senior staff highlighted that the reconsideration procedure is a feature of the political system of China that applies to all agencies under the supervision of the SC, not just the CSRC. Further, the choice of whether to apply for it or not belongs to the individual affected by the decision of the CSRC and thus it should not be construed as an active involvement in day to day decisions by the SC; rather it operates as a remedial procedure. Finally, the SC reviews all such decisions via its Legal Affairs Office, which is a technical body comprised of expert staff.</p> <p>In general, the review by SC is not used often. For example, in 2015 the CSRC made 117 decisions of administrative reconsideration, out of which only four were brought to the SC by the entities and individuals concerned. Two of such decisions were on administrative penalties and the other two involved information disclosure. After due examination, the SC affirmed CSRC's administrative reconsideration decisions in all four cases.</p> <p>Confidentiality</p> <p>The CSRC and its staff have the obligation to safeguard state secrets and trade secrets of relevant parties pursuant to the provisions of the <i>Securities Law</i>, the <i>Fund Law</i>, the <i>Regulations on the Administration of Futures Trading</i>, the <i>State Secrets Law</i> and the <i>State Secrets Law Implementing Rules</i>, as well as the <i>Measures for the Disclosure of Securities and Futures Regulatory Information (Tentative)</i> and relevant CSRC rules on confidentiality. Other organs that receive the information provided by the CSRC also have the obligation to protect state secrets, trade secrets or individual privacy pursuant to the provisions of the <i>State Secrets Law</i>, the <i>State Secrets Law Implementing Rules</i> and Article 12 of the <i>Civil Servants Law</i>. In addition, article 12 of the <i>CBRC- CSRC- CIRC MOU</i> provides that the recipient of information must strictly follow the principle of confidentiality and guarantee that the information will only be used for supervisory purposes. The information cannot be provided to a third party unless otherwise provided by law.</p>
Assessment	Partly Implemented

Comments	<p>The reasons for the grade stem from challenges related to KQ 3 of the IOSCO Methodology; although some concerns arise in connection with KQ 2 and 5.</p> <p>The assessors acknowledge that all public agencies should be accountable to the government, that there is no single model of organizational structure that is considered as the best practice, and that in practice the line between accountability and independence is difficult to draw. The assessors understand the characteristics of the Chinese system, whereby similar to all other financial supervisory authorities, the CSRC is directly under the supervision of the SC, which exercises a strong level of strategic direction over the CSRC, balanced by the fact that the CSRC does not require approval from any authority for its day-to-day decisions. Nevertheless there are features of the legal framework that might pose challenges to full operational independence as expected by IOSCO. The most important is the budget process and staff quota limits which have not provided the CSRC with the necessary budget or staffing flexibility to meet its regulatory needs. In this context consideration should be given to providing more autonomy to the CSRC particularly in human resources issues.</p> <p>Other two aspects deserve comment. First, the review of CSRC decisions by the SC via the reconsideration process raises concerns; however such concerns are mitigated by the fact that in the way it has been formulated in the law such review does not constitute a mechanism for "active" involvement of the SC in day to day decisions as the decision to use it belongs entirely to the person affected. Furthermore in practice its use has been limited. Second, the legal framework seems to leave some discretion to the SC regarding the removal of the management team; however, such concerns are mitigated by the fact that the appointments and dismissal of CSRC's Chairman, Vice Chairmen and Assistant Chairmen are made by the SC pursuant to the Civil Servants Law and as a result due process procedures apply, and the corresponding decisions are announced by the SC in official documents and disclosed to the public.</p> <p>Finally, the assessors also note that the authority to give approval of stock exchanges and other markets such as NEEQ belongs to the SC although upon a recommendation of the CSRC. They recognize that decisions concerning the creation of regulated markets in some countries still lie at a government level because they are considered strategic decisions. In the long run, it would be important that such decisions be transferred to the CSRC as the technical body in charge of day to day supervision.</p>
Principle 3	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
	<p>Powers</p> <p>Pursuant to article 178, 179 and 180 of the Securities Law, article 112 and 113 of the Fund Law and articles 47 and 48 of the Regulations on the Administration of Futures Trading, the CSRC has broad powers to regulate, supervise and enforce the laws for the securities and futures markets. Such powers include:</p> <ul style="list-style-type: none"> • Rulemaking. • Approval of public offerings. • Approval of licenses for securities intermediaries' categories and market infrastructure providers; however the authority to approve securities exchanges belongs to the SC upon a recommendation of the CSRC.

- Supervisory authority over issuers and all entities subject to licensing, which includes the authority to request information as well as to conduct on-site inspections on them.
- Investigation and enforcement authority, including the authority to request information from regulated entities and third parties and to impose administrative measures on regulated entities and sanctions on both regulated entities and third parties who violate the securities markets laws and regulations. However, as will be further explained in Principle 11, there are deficiencies in the framework for the imposition of administrative sanctions, in particular the level of fines that the CSRC is authorized to impose for some misconduct is low. In addition, in some cases the sanctions for similar misconducts across the securities and futures markets are different.

Capacity to exercise its responsibilities

Funding and resources

CSRC staff indicated that the overall CSRC budget, provided for by fiscal appropriation, satisfies its regulatory needs –although it has had an impact on the workload assigned to each staff. Newly added projects, if any, are funded by the central fiscal budget as well.

However, the CSRC staff quota has remained relatively frozen for the last 7 years, in spite of market growth. Further, CSRC staff salaries are subject to the civil service pay scale. Within such scale, the CSRC has implemented a system that allows linking a small part of the salary to staff performance based on key performance indicators. Salaries have modestly increased over the years. However a wide gap remains between their salaries and industry salaries (of about 10 times). This has had an impact on the ability of the CSRC to hire and retain staff, particularly at higher levels. For example, in the last year 100 staff left the institution. An additional challenge to replace such staff is the existing limitation that staff can be hired only one time in the year.

Table. CSRC Staff

Staff	2013	2014	2015
HQ	797	769	730
Regional branches	2386	2398	2367
Total	3183	3,167	3097

Source: CSRC.

As of December 2015, the CSRC had 3097 staff, with an average age of 36 years. All CSRC's recruits over the past few years have been professionals specialized in such fields as law, finance and economics, accounting, and IT, most of whom have a master's degree and nearly half of them have worked in the capital markets. The CSRC provides ongoing trainings on a wide range of subjects. In 2015, the CSRC as a whole completed orientation training of 176 person-times, on-job training of 35 person-times, pre-appointment training of 80 person-times, overseas training of 61 person-times, and special business training of 2,606 person-times, aggregating to 3,386 person-times and equaling 51% of the total number of its staff.

Organization of work between the central office and regions

	<p>CSRC's central office in Beijing is complemented by its 38 regional offices. In general, the CSRC central office is responsible for (i) preparing market development plans; (ii) formulating, amending and revising regulations and rules concerning the securities and futures markets; (iii) carrying out the approval function in key matters such as public offerings and licenses of intermediaries; (iv) guiding and coordinating efforts on risk prevention and mitigation; (v) coordinating supervisory actions, (vi) organizing investigations and enforcement activities in relation to cases involving misconduct or material violations of securities and futures laws; and (vii) coordinating and planning investor protection initiatives. To carry out these functions the CSRC central office had 730 staff as of December 2015.</p> <p>The CSRC regional offices are the frontline supervisors of their respective jurisdictions, and as such are responsible for the supervision of entities and activities under their jurisdictions, along with the investigation of misconduct, and the corresponding enforcement actions, and the implementation of investor protection initiatives, including investor education. The number of staff in each region varies. For example, two of the largest offices, the Shanghai and the Shenzhen office had a total of 167 and 113 staff respectively as of December 2016.</p> <p>There are annual statewide meetings between the central office and the regional offices to discuss priorities on supervision and enforcement. In practice the supervisory programs of the regional bureaus include (i) inspections conducted at the request of the central office based on the themes identified on a yearly basis, and (ii) inspections conducted based on the regions' risk-based program. These issues will be further explained in Principles 12, 24 and 31.</p> <p><i>Coordination with the SROs</i></p> <p>CSRC is supported by 19 affiliated institutions. The affiliated institutions include the exchanges and the NEEQ, the three industry associations (SAC, CFA and AMAC) as well as other entities such as the China Securities Depository and Clearing Corporation Limited (CSDC), the China Securities Investor Protection Fund Corporation Limited (SIPF), China Securities Finance Corporation Limited (CSF), China Futures Market Monitoring Center Co., Ltd. (CFMMC), Capital Market Statistics & Monitoring Center Co., Ltd. (CMSMC), the China Institute of Finance and Capital Markets (CIFCM), China Securities Information Technology Service Co., Ltd. (CSITS), and China Securities Minority Investors Service Center Co., Ltd (CSISC).</p> <p>The exchanges and industry associations exercise a self-regulatory role supplementing the supervisory efforts of CSRC in the securities and futures markets. They all have separate supervisory programs that are run independently of the supervisory program of the CSRC. That said, coordination of such programs takes place essentially via the exchange of information concerning the topics and entities that will be subject to on-site inspections on an annual basis. In practice, for some topics the inspections are conducted jointly (in parallel), whereby the CSRC reviews compliance with its own rules, while the SROs review compliance with the SRO rules on the topic. For example, there were inspections conducted in 2016 in the bond and the NEEQ market that revealed problems with intermediaries' compliance with their suitability obligations and those as sponsors or underwriters. The findings were transferred to the corresponding department of the CSRC to take appropriate administrative measures. These issues will be further explained in Principles 24 and 31.</p> <p><i>Coordination at HQ level</i></p> <p>There are several mechanisms for internal coordination. In particular there are three categories of meetings:</p> <ul style="list-style-type: none"> • Meetings chaired by the leader of the Communist Party of China (CPC): with the
--	--

	<p>participation of the members of the party committee and the heads of functional departments.</p> <ul style="list-style-type: none"> • Chairman working conference meetings: chaired by the Chairman with the participation of the heads of departments and the executive team, and • Thematic meetings: chaired by the chairman or by a member of the executive team and the heads of the relevant functional departments. <p>There are specific rules for the organization of each of these meetings. In addition, minutes are taken of each meeting, which serve as the basis to track progress.</p> <p>Also, CSRC have set up individually or collectively with other ministries several task forces and working groups to address specific topics; for example, there is a themed working group on risks related to equity crowdfunding and a coordination working group on illegal securities markets activities. In addition, as explained under Principle 6 there is a steering committee on stock market risk, which meets quarterly. The group discusses emerging and systemic risks.</p> <p><i>Annual priorities</i></p> <p>As indicated in Principle 2, the Opinions of the SC drive CSRC mid- to long-term priorities. Thus they are the basis for the preparation of the annual plans of the institution. Every year, at the beginning of the year the CSRC takes stock of progress concerning priorities, which are then summarized into the Annual Report. Such Report in turn serves as the basis for the planning of the next calendar year.</p> <p>Investor education</p> <p>Given the structure of the Chinese securities markets, the CSRC has placed a high priority on investors' protection initiatives, including those related to investor education. In June, 2007, the CSRC created the Investor Education Office, which is mainly responsible for the implementation of initiatives related to investor education. On December 31, 2011, the CSRC established the Investor Protection Bureau that is responsible for the overall planning, organization, guidance, supervision, inspection, assessment and evaluation of investor protection efforts in the securities and futures markets. CSRC regional offices, exchanges, the SIPF, the CSISC, and securities and futures institutions have all established special bodies in charge of their own investor education efforts.</p> <p>The CSRC has implemented several investor education activities, in particular:</p> <ul style="list-style-type: none"> • It has organized various parties to conduct educational activities via traditional media channels such as newspapers, TV, and radio and new channels such as the internet, Web and WeChat, in an effort to develop a risk warning mechanism that can reach a broad range of participants. • It has supported the creation of innovative platforms for investor education. During 2016 it certified 13 national securities and futures investor education centers as part of its campaign to create a group of not-for-profit and one-stop investor education service providers to give investors access to more efficient, convenient and professional educational services. • It has been organizing special campaigns for the protection and education of private fund and bonds investors to prevent risks arising from investing in such products. During the first half of this year, CSRC compiled six study cases on private funds and
--	---

	<p>six Q&As for private fund investors, published them in major newspapers and aired three groups of risk warning tickers. CSRC also prepared FAQs on 59 questions from bond investors and published them in major newspapers as a series for 10 consecutive workdays. This series has sought to improve, in a targeted manner, the public's understanding of bond investing, relevant regulations and rules, and associated risks.</p> <ul style="list-style-type: none"> • It has promoted the development of websites for domestic investors and improved the integrated service platform for investors, with an aim to encourage more online resources that are "created by investors, for investors." • Finally, CSRC has advocated for the inclusion of investor education into the national education program so that investment lessons can be incorporated into curricula of primary schools, secondary schools and all the way to universities and colleges.
<p>Grade</p>	<p>Partly Implemented</p>
<p>Comments</p>	<p>The reasons for the grade stem mainly from challenges related to KQs 2 and 3 of the IOSCO Methodology and complementary from KQ1.</p> <p><i>Resources</i></p> <p>The assessors acknowledge the commitment of the CSRC to implement a robust supervisory and enforcement program. That said, the staff quota system and salary scale to which the CSRC –along with the other financial regulatory commissions- is bound are limiting its ability to keep up with a market that is growing in complexity and at a very fast pace. While improvements in off-site monitoring and the use of big data can help, a market with such a large presence of retail investors requires a much more intensive approach to supervision and enforcement than may be required in other large jurisdictions. It is important that the coverage of the monitoring programs for all participants be kept under review, and in particular the attention paid to auditors given their role in the system. Additional resources are needed to ensure that the CSRC can deliver a robust program of supervision and enforcement as the market grows in size and complexity. Further the size, speed of growth of the markets, and the level of interconnectedness observed, make it imperative that the CSRC continues to develop its systemic risk capabilities across all markets. This requires expert staff and so also requires the CSRC to be able to pay competitive salaries. Resources challenges were also mentioned by market participants, and in particular the high turnover of staff, as a potential challenge for the CSRC to deliver consistent supervision. Therefore, consideration should be given to providing the CSRC with greater autonomy to decide on the number of staff and to have a separate salary scale from that applicable to the rest of the civil service, as is the case in other jurisdictions.</p> <p><i>Powers</i></p> <p>As will be further explained in Principle 11, the current framework for administrative sanctions has deficiencies than can impact CSRC's ability to implement an effective enforcement program. In particular the current level of fines that can be imposed for some misconduct as per the current legal and regulatory framework is low. In addition, in some cases the sanctions for a similar misconduct across the securities and futures markets are different. The assessors acknowledge that the authorities are aware of this challenge and are seeking to address it in the reforms of key laws currently underway.</p>

Principle 4	The regulator should adopt clear and consistent regulatory processes.
	<p>Rulemaking</p> <p>Article 67 of the Legislation Law, articles 19 and 22 of the Regulations on the Procedures for Formulation of Administrative Regulations and articles 14 and 15 of the Regulations on the Procedures for Formulation of Rules require administrative entities to solicit the opinion of relevant organs, organizations and citizens as part of their rulemaking processes. Solicitation of opinions may take such forms as forums, symposia and hearings.</p> <p>In order to meet such requirement, the CSRC promulgated the Regulations on the Procedures for Formulation of Securities and Futures Rules and the Tentative Rules on Soliciting Public Comments on Drafts of Securities and Futures Regulations. As per such rules the rulemaking process includes many phases, from project initiation, drafting, review, to decision and promulgation. Related work includes a legislative evaluation and a review of domestic and international practices. As part of the preparatory work, articles 13 and 22 of the Rules on the Procedures for Formulation of Securities and Futures Rules and the Tentative Rules on Soliciting Public Comments on Drafts of Securities and Futures Regulations respectively require the CSRC to submit the draft rules for consultation. Such consultation involves key stakeholders and public consultation, The same obligation applies to changes in rules and regulations. The public is consulted on rules through the CSRC website or the website of the Legal Affairs Office of the SC. Along with the draft rules, the CSRC provides an email address to send comments. All such feedback allows the CSRC to evaluate the potential benefits and costs of the new rules. The final regulations are also published in the same websites. Pursuant to the above mentioned Regulations, the CSRC must prepare a special report that summarizes the way in which comments were taken into consideration.</p> <p>While some rules carry words such as “trial”, “pilot” or “interim” in their names, they are fully implementable and remain in force until they are repealed by a new rule. Further the name of the rule does not make difference in CSRC obligation of soliciting public opinions, and public opinions have been solicited for rules whose names include the word “trial”.</p> <p>The use of pilot programs</p> <p>In practice, significant changes to the regulatory framework, particularly those involving innovation, have been implemented via a pilot approach involving a limited number of firms. Depending on the case, there have been a few rounds of expansion of the pilot. The experience gained from the pilot has then been used to adjust and calibrate the framework that applies to all participants.</p> <p>Pilots have been used in connection with the application of new regulatory requirements, as well as in connection with the expansion of authorized activities or products for market participants. An example of the former is the current pilot aimed at testing the application of risk indicators on a consolidated basis. An example of the latter is the pilot on margin trading and securities lending launched in 2010, which had 6 firms in the initial round, 5 more in the second round and 14 more in the third round and became a routine business open to all firms in October 2011.</p> <p><i>Eligibility requirements</i></p> <p>The CSRC’s Guidelines for Business (or Product) Innovation by Securities Companies (for Trial Implementation) and other documents explicitly provide that if a securities company intends</p>

	<p>to engage in business (or product) innovation on a pilot basis, it must ensure that the risks of the pilot business (or product) are controllable, measurable and tolerable. Further, a pilot security company must at least meet the following regulatory requirements:</p> <ul style="list-style-type: none"> • It maintains sufficient capital and must have met requirements for all risk control indicators within the most recent two years; • It has in place well-developed risk management, internal control and compliance management rules; • It has not been sanctioned for major violations within the most recent two years and has not been subject to major regulatory measures within the most recent one year; • Its information system operates in a safe and stable manner and has not experienced any major incidents within the most recent year; and • other necessary prudential regulatory requirements. <p><i>Pilots and the existence of a leveled playing field</i></p> <p>Pilots can be initiated by the CSRC or be proposed by securities companies to meet their own business development needs.</p> <p>For pilots initiated by the CSRC, there would be regulations or self-regulatory guidelines issued ex-ante to establish the conditions for the pilot. As a result, any securities company which meets the applicable regulatory requirements may apply to participate in such pilot programs.</p> <p>Pilots requested by firms that involve expanding the business scope or innovating on products within the current regulatory framework are discussed with the firm only, and in such case there is no need for further regulations. In the case of requests that involve innovative businesses (products), after 2015, the CSRC has adopted a prudent approach whereby it generally requires the ex-ante formulation of relevant self-regulatory guidelines and rules -similar to what is required for pilots initiated by the CSRC. In line with this approach, CSRC staff indicated that since 2015 there have not been pilots that allowed a securities company to expand its businesses/products beyond what is authorized to other intermediaries.</p> <p><i>Transparency of decisions</i></p> <p>For pilot business programs launched by the CSRC, based on a comprehensive evaluation, the CSRC would publish a list of pilot securities companies.</p> <p>For pilot business programs applied for by securities companies at their own discretion, the CSRC would discuss matters related thereto and inform such securities companies of the results of such discussion.</p> <p>Transparency of rules</p> <p>Pursuant to the provisions of the Legislation Law, Article 184 of the Securities Law, the Regulations on the Procedures for Formulation of Administrative Regulations, the Regulations on the Procedures for Formulation of Rules, the Regulations on the Procedures for Formulation of Securities and Futures Rules and the Measures for the Disclosure of Securities and Futures Regulatory Information (Tentative) and other applicable rules and regulations, the CSRC must publish the rules and regulations relating to securities and futures business.</p>
--	---

	<p>In practice, the CSRC makes all the legal documents (including interpretative documents) related to securities and futures business available to the public on a centralized basis through the "Information Disclosure" section on the CSRC website and periodic publications such as the CSRC Announcements.</p> <p>Criteria for decisions</p> <p>Based on the provisions of the applicable laws, the CSRC has further developed the processes and requirements applicable to different administrative acts:</p> <ul style="list-style-type: none"> • Licensing: The Provisions of the CSRC on the Procedures for Implementation of Administrative Licensing govern the administrative licensing process. • Compulsory measures: the CSRC issued the Measures for the Implementation of Restrictions on the Purchase and Sales of Securities, the Measures for the Implementation of Freeze and Sequestration and other rules to ensure that investigations are rule-based. • Enforcement: the CSRC issued the Measures for the Composition of the Administrative Sanctions Committee and the Rules on the Hearing of Administrative Sanctions, ensuring the procedural fairness of administrative sanctions. • Administrative reconsideration: the CSRC issued the Measures for Administrative Reconsideration, putting in place a series of systems for reply, answer, joint response, etc. <p>Procedural fairness</p> <p>Issues related to procedural fairness have been analyzed in Principle 2. There are several checks and balances imbedded in the system aimed at ensuring that regulatory decisions are based on objective criteria that are known by all participants and are consistently applied.</p>
Assessment	Fully Implemented
Comments	<p>The assessors acknowledge the benefits of "pilots" as a way to test new rules in a controlled manner, thus addressing costs and/or stability concerns. However, particularly pilots that expand the scope of authorized activities could give rise to an unlevelled playing field depending on the way they are implemented; and some concerns were raised in this regard by market participants about some of the pilot programs implemented in the past. That said, the assessors consider that the prudent approach implemented after 2015 mitigates such concerns as the CSRC now requires the existence of regulations or self-regulations for pilots that would expand the scope of authorized activities/products, even when they originate in a request by a securities firm. This in turn, allows any firm that meets regulatory requirements to participate. Finally, as stated in the description, the publication of the list of firms selected for a pilot adds transparency to the process. Thus, the assessors encourage the authorities to continue relying on this approach. In addition, the CSRC is encouraged to consider whether additional transparency can be brought to the selection process -for example, by publishing not only the list of firms selected for a pilot, but also any negative decision and the reasons thereof.</p>
Principle 5	The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.

Description	<p>Conflict of interest</p> <p>CSRC staff must comply with the general provisions of the Civil Servants Law that address issues of potential conflict of interest. In particular, articles 53, 68, 70 and 102 of the Civil Servants Law provide that civil servants must not take bribes and must recuse themselves from conflicts of interest. In addition, article 102 of the Civil Servants Law establishes a cooling-off period, whereby staff leaving the public service are prohibited from taking a position in a company or any other for-profit organization that they were directly related to in their work and from engaging in any profit-making activity directly related to their work. The period is three years after resignation if staff held a leading position at the regulator and two years for other positions.</p> <p>In addition, CSRC staff are subject to the special provisions of securities and futures laws and regulations; in particular:</p> <ul style="list-style-type: none"> • Holding positions in regulated entities: pursuant to article 187 of the Securities Law and article 118 of the Fund Law CSRC staff may not take any position in any institution that is subject to the supervision of the CSRC. • Taking benefits from regulated entities: Articles 15, 16 and 17 the Code of Conduct for the Staff of China Securities Regulatory Commission prohibit staff from taking bribes or benefits from regulated entities that might influence the performance of their duties. • Cooling off requirements: CSRC regulations have expanded the cooling-off period to three years for mid-level positions. • Trading in securities: Pursuant to article 43 the Securities Law and article 25 the Regulation on the Administration of Futures Trading CSRC staff members and their parents, spouses, children and spouses of their children are prohibited from holding and trading stocks and futures. If they hold them prior to entering the CSRC they are required to divest of them. This prohibition does not cover bonds or mutual funds. • Declaration of assets: On an annual basis, CSRC staff from the director's level up are required to make an annual declaration of assets, where holdings of securities need to be included. Such declaration must be signed off by a person one level higher. <p>Confidentiality</p> <p>Relevant securities and futures laws and regulations contain provisions that require CSRC staff to observe confidentiality and secrecy provisions and protect personal data. In particular article 182 of the <i>Securities Law</i>, article 114 of the <i>Fund Law</i> and article 63 of the <i>Regulations on the Administration of Futures Trading</i> require staff to keep confidential trade secrets of relevant entities and individuals.</p> <p>Further, under Article 14 of the <i>Regulations on the Disclosure of Government Information</i> and Articles 10 and 12 of the <i>Measures for the Disclosure of Securities and Futures Regulatory Information (Tentative)</i>, the CSRC and its regional offices must not disclose regulatory information that involves state secrets, trade secrets or privacy. However, relevant regulatory information involving trade secrets or privacy may be disclosed if consent of the parties concerned is obtained; disclosure of such information is required by laws, administrative regulations or CSRC rules; or the CSRC is of the opinion that non-disclosure would impose a material impact on public interests.</p>
-------------	---

The *Code of Conduct for the Staff of China Securities Regulatory Commission* sets confidentiality rules for the CSRC staff. Article 19 of the *Code* stipulates that CSRC staff members must observe both State laws and CSRC provisions on confidentiality and must not inquire into confidential information that is irrelevant to the discharge of their duties or divulge any confidential information. Article 20 stipulates that CSRC staff members must not disclose inside information on securities or futures trading or trade secrets of any related entity or individual that they have gained access to at work, nor shall they fabricate or spread false or misleading information. Article 21 stipulates that CSRC staff members must not, in making public statements or public written materials, refer to undisclosed regulatory information on securities and futures; public statements or written materials that relate to the capital market shall be truthful and objective; and except as required by their work, staff members must not share with others undisclosed regulatory information on securities and futures.

Legal or administrative sanctions for failing to adhere to these standards

Specific provisions of the Securities Law and the Regulations on the Administration of Futures Trading impose administrative liability to staff that violate their obligations. In particular:

- Article 199 of the Securities Law and 69 of the Regulations on the Administration of Futures Trading apply to persons who breach the prohibition not to hold or trade in shares. The basic sanction includes confiscation of illegal gains and a fine. In the case of a civil servant this article requires also the imposition of an administrative penalty.
- Article 202 applies to persons who violate their obligation to not disclose or use inside information. The basic sanction for this violation is divestment of the illegally held securities, confiscation of illegal gains, and a fine of no less than RMB 30,000 but no more than RMB 300,000. However, as per such article a CSRC employee must receive a heavier punishment.
- Article 228 stipulates that a CSRC employee who fails to discharge his/her duties under provisions of the law, abuses his power, is derelict in his duties, seeks unlawful gains by taking advantage of his position, or discloses the commercial secrets of an entity or individual which he gets to know, must be held liable according to law.

In addition, staff who violate the ethics rules are subject to disciplinary measures that vary depending on the gravity of the offense.

Processes to investigate violations of the above obligations

Procedures for the investigation of violations of staff duties are provided in the Securities Law, the *Administrative Penalty Law*, the *Administrative Supervision Law*, the *Civil Servants Law*, the *State Council Regulations on Complaint Reporting*, the *Regulations on the Punishment of Civil Servants of Administrative Organs*, and the *Code of Conduct for the Staff of China Securities Regulatory Commission*. In addition, the *Regulation of the Communist Party of China on Disciplinary Actions* provide important basis for party discipline.

CSRC staff indicated that there have been cases where CSRC staff have been indicted on corruption charges, and have received criminal penalties in addition to the administrative sanction of being dismissed by the CSRC. Market participants also indicated that there has been a great effort in eradicating corruption.

Assessment	Broadly Implemented
Comments	The reasons from the grade stems from challenges related to KQ1b of the Methodology. The assessors acknowledge the existence of a robust framework aimed at ensuring that staff conduct their functions with high degree of integrity, and avoidance of conflict of interest and an active policy of combating corruption. However in what relates to securities transactions the current regime has limitations concerning scope (as bonds are not included) nor prompt notification by all staff. In such context the assessors recommend that the CSRC implements a prompt notification system for all CSRC staff.
Principle 6	The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.
	<p>Process and tools developed by the CSRC to identify and manage systemic risk</p> <p>In recent years the CSRC has strengthened the mechanisms in place to identify and monitor the build-up of systemic risk.</p> <p><i>Tools</i></p> <p>Of particular importance for systemic risk are (i) the development of indicators to monitor the market and its participants, (ii) the use of a heat indicator for the stock market and (iii) the use of stress testing.</p> <p>A preliminary system of capital markets systemic risk monitoring and early warning indicators have been developed at four levels:</p> <p>Indicators for systemically important institutions (SIFIs) including indicators related to credit risk, liquidity risk, general business risk, as well as operational risks. CSRC staff indicated that currently intermediaries under CSRC's regulation are still small and dispersed, with no institutions of real systemic importance. In such context, the indicators above are being used as part of the monitoring of larger/more complex institutions.</p> <p>Indicators for financial market infrastructure providers related to operational risks and for CCPs related to their settlement reserves, margins, settlement risk funds, etc;</p> <p>Market indicators (covering all markets): related to liquidity, volatility, investor behavior, investor sentiment, contagion, transparency, innovative areas, etc. Three indicators are used specifically for futures market monitoring: (i) investor structure, (ii) futures-spot correlation, and (iii) delivery risk indicators. For bond markets the CSRC uses the following types of indicators: (i) fluctuation in various bond market indices; (ii) inventory and trading data relating to spot transactions and pledged repos in the exchange-based bond market; (iii) benchmarks for cost of capital, including interbank overnight and 7-day repo rates, SSE overnight and 7-day repo rates and (iv) leverage, with a focus on the leverage ratio of exchange-traded pledged repos, and</p> <p>Macroeconomic indicators, covering both domestic and overseas issues. These indicators are monitored on daily, weekly, monthly, quarterly, semi-annual and annual basis, where feasible, by the corresponding departments and report back.</p> <p>In addition, a heat indicator for the stock market has been developed which serves as an early warning system. It synthesizes the information derived from the different markets (vulnerability, liquidity, market sentiment, etc.) into one single grade, based on a 5 degree category system consisting of too hot, hot, mild, cold and too cold. This gives the regulator a</p>

visual indicator of changes and allows the CSRC to create a tiered response plan and take measures as needed to mitigate rising risks.

Stress testing is being conducted on securities firms, fund management companies and futures companies. Since 2011 the SAC has conducted stress tests in securities firms on an annual basis. Since 2008, the China Futures Market Monitoring Center (CFMMC) has been conducting stress tests and monitoring the risk levels to futures companies brought on by hypothetical losses arising from negative margin balances. In the same vein, the fund management industry has also conducted stress tests with respect to the liquidity situation of money market funds. The CSRC carried out two rounds of stress tests of its own, one at the end of 2015 and one in early 2016, for both key players in the industry and the industry as a whole.

These tools are complemented by the regular mechanisms to monitor the markets, including cross-market tools explained mainly in Principle 34; the regular mechanisms to monitor large exposures explained mainly in Principles 37, and the regular mechanisms to supervise intermediaries explained mainly in Principles 24, 30 and 31.

Institutional arrangements

From an institutional perspective, a steering group to identify and mitigate systemic risk has been set up (the steering committee on stock market risk). It is chaired by the three members of CSRC's executive team, and includes relevant departments (General Office, market supervision, legal affairs, fund and intermediary supervision, listed companies' supervision) of the CSRC and affiliated institutions (SSE, SZSE, CMSMC, etc.). The group meets on a quarterly basis to assess the state of the market, and on an ad-hoc basis as needed. There are minutes of the meetings that allow for accountability and follow up. This group is intended to look at areas that are closely related to and may have material impact on the stock markets.

The CSRC has been increasing efforts to monitor risks in the bond market and the futures market. In addition to the system of indicators for the monitoring and early warning of systemic risks in the capital markets which covers, among others, the bond market and the futures market, the CSRC has in place more specific mechanisms to monitor and handle risk. In practice, most of the functions to implement these mechanisms may be performed by corresponding functional departments (Department of Corporate Bond Supervision and Department of Futures Supervision).

Human resources and data enhancements at CSRC level

During the last 3 years the CSRC has focused on enhancing its ability to use the data it receives for purposes of monitoring risk. In September 2012, the CSRC created a dedicated risk monitoring agency: the CMSMC. Under the direct management of CSRC, the CMSMC is in charge of collecting data and information about the financial market and macroeconomic conditions and identifying and assessing capital market risks. In addition, an integrated system for the aggregation and sharing of information from securities and futures industries, the Central Regulatory Information Platform, is being implemented. The platform will contain all information from the markets, both cash and futures markets, (covering the lifecycle of all transaction), along with information related to the regulated entities (securities companies, futures companies). This effort has involved changes to the way securities intermediaries and exchanges send information to the CSRC. For example, a pilot is currently underway with a set of securities companies aimed at overhauling the mechanisms through which they transmit information to the CSRC. Also, the CSRC recently set standards for data submission by exchanges. Once launched, the platform will increase the level of digital monitoring and smart monitoring of risks. This platform is being managed by the CMSMC. In addition, the ability to monitor markets has been enhanced with the implementation of a universal

	<p>identification number for investors across all markets (cash and futures).</p> <p>However, CSRC senior officials expressed concern about the need to ensure that the CSRC has staff with the adequate skillset to monitor systemic risk across different markets. Further, while equity markets have been the initial concern, the growth of the bond and futures markets indicates the need to strengthen resources to monitor these markets too.</p> <p>Coordination and information exchange with other financial regulators</p> <p>As explained in Principle 1 the FCRG is the key channel through which the authorities discuss financial sector developments that may pose systemic risks.</p> <p>Since last year, the financial regulators have worked on improving data sharing related to the securities markets. Currently data is being shared monthly on the stock markets, the bond markets (including data from all the regulators of the different segments of the market as explained above) and the futures markets. Data on securities intermediaries is shared on a quarterly basis.</p> <p>For asset management, the assessors understand that the CSRC and the CBRC have created a mechanism for the regular (monthly) sharing of data on stock dominant securities investment trust products, covering the scale, quantity, investment portfolio composition of these trust products as a whole, single-account structured products and umbrella-structured products, as well as average leverage ratio of single account structured products and umbrella-structured products. Data on asset management products of insurance companies is currently not shared on a regular basis. In the meantime, a working group of the JMC is exploring ways to harmonize data on asset management, including the creation of a unified identification code of all asset management products in China.</p> <p>A similar effort is being made in connection with the bond markets, whereby the PBoC collects data from all the regulatory authorities on bond issuances, trading and defaults.</p>
Assessment	Broadly Implemented
Comments	<p>The reasons for the grade stem mainly from challenges related to KQ 3 of the Methodology.</p> <p>The assessors acknowledge the work that the CSRC has been doing to strengthen its ability to identify and monitor systemic risk in the securities markets and that some of those efforts are leading practices. The assessors also acknowledge that such tools cover all markets. Given the fast pace of growth of both the bond and futures markets, it is critical that the CSRC continues to enhance its ability to monitor systemic risk across different markets including by securing additional qualified staff. In line with the above, the CSRC might wish to consider the potential benefits of expanding the mandate of the steering committee on stock market so that it becomes the venue to discuss both emerging and systemic risks on a periodic basis. Finally, if it has not done so, the assessors encourage the CSRC to add market intelligence meetings to the tools used for systemic risk identification.</p> <p>In addition, given the existence of multiple regulators for key products and markets, it is critical that the current cross-sectoral mechanisms to share information, and monitor risks continue to be strengthened. In particular, data sharing on asset management should continue to be expanded, and efforts to standardize data be given full priority. The authorities should also explore the implementation of improvements in the mechanisms to jointly monitor risks stemming from the bond markets.</p> <p>Finally, the assessors encourage the authorities to consider further strengthening of the</p>

	institutional framework for systemic risk identification. The assessors acknowledge that the FCGR currently provides a venue for the discussion of system risks concerns.
Principle 7	The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
Description	<p>Processes to identify issues that require adjustments to the perimeter of regulation</p> <p>Through its regular supervisory processes and tools, the CSRC obtains critical information to determine whether adjustments to requirements applicable to regulated products, intermediaries or markets are in need of enhancement, and whether new activities or products need to be brought to the perimeter of regulation due to the risk that they may pose to investor protection or systemic risk. In addition, as discussed in Principle 6 the CSRC has developed additional tools to enhance its ability to identify issues that can pose systemic risk.</p> <p>From an institutional perspective such issues are brought to the attention of the executive team via thematic meetings and the chairman working conference system explained in Principle 3. For issues that can pose systemic risk in the stock market, issues are discussed on a periodic basis through a specialized working group described in Principle 6. Minutes are taken of all such meetings that allow for accountability and follow-up.</p> <p>On an annual basis the CSRC also reviews its supervisory and enforcement program and conducts statewide meetings with the regional bureaus. These meetings shed light on issues that deserve attention. In addition, as mentioned in Principle 3, on an annual basis the CSRC review its plan for the year, taking as a starting point an evaluation of the work done the previous year.</p> <p>Finally the <i>Implementation Outline for Building a Government Ruled by Law (2015-2020)</i> promulgated by CPC Central Committee and the SC in December 2015 requires authorities to evaluate rules on a periodic basis after their promulgation and to ensure that laws, regulations and rules inconsistent with the needs of reform and economic and social development are timely amended or repealed.</p> <p>On August 17, 2016, CSRC circulated the <i>Notice concerning the Pilot Program for Post-Legislation Evaluation of Securities and Futures Rules and Normative Documents</i> (CSRC General Office [2016] No. 69) within the entire CSRC system for implementation. The <i>Notice</i> contains detailed rules and descriptions for such aspects of the pilot program as division of duties, work requirements, and evaluation procedures. In view of the considerable body of rules and normative documents for the supervision of listed companies and intermediaries, the pilot program will start with the Department of Listed Company Supervision and the Department of Fund and Intermediary Supervision. The two departments are currently drafting their respective evaluation plans.</p> <p>Issues within CSRC jurisdiction</p> <p>The CSRC tackles emerging issues through its rule-making, supervisory and enforcement powers.</p> <p>In some cases, when rulemaking is needed, the rules are issued first by the SROs, and once they are "mature", they are incorporated into CSRC rules. That was the case for the new prudential framework applicable to securities companies.</p> <p>In other cases the CSRC has opted for a "pilot" approach whereby new rules are "tested" on a small sample of participants and later on extended to the relevant sector, with revisions as</p>

	<p>needed (based on the experience of the pilot). For example, an enhancement to the prudential framework applicable to securities firms (whereby the risk ratios would be apply on a consolidated basis) is currently being tested in a selected number of securities firms.</p> <p>There is evidence that the CSRC proposes new regulations when conditions change. For example, it has been supporting the SC in connection with improvements to the regulatory framework for the regional trading platforms in light of potential risks arising from the lack of a uniform framework.</p> <p>In addition, the CSRC has made changes to its organizational structure to deal with new issues. For example, securities firms and fund management firm were brought into one single department as a response to the evolution in the business models of such firms. Also the department on anti-market misconduct was created recently to ensure that the CSRC provides a prompt response to risks emanating from entities conducting illegal activities.</p> <p>Issues within the jurisdiction of several financial authorities or “new issues”</p> <p>New issues or issues encountered that could potentially fall under the jurisdiction of several financial authorities are elevated to the JMC and then reported to the SC, so that responsibilities can be allocated. A recent example relates to the regulation of internet financing mentioned above, whereby a joint guideline was issued in 2015 by ten different authorities, clarifying responsibilities for different aspects of internet financing.</p> <p>Issues that require legal changes</p> <p>In addition, on a regular basis the CSRC sends recommendations to update the legal framework to the SC. In particular a draft for a new Securities Law is at an advanced stage. The draft has passed the first reading of the Standing Committee of the NPC and is being revised under the supervision of China’s legislative body. The revised Securities Law will be submitted to the Standing Committee for second reading, which is due to take place in December 2016 according to the legislative schedule released by the Standing Committee. Also, the Financial and Economic Affairs Committee of the NPC, the CSRC and other relevant departments have established a drafting team for the Futures Law. The law is in its second draft. Finally, with regard to the Interim Provisions on the Administration of Private Investment Funds, the CSRC is working closely with the Legislative Affairs Office of the SC in legislative efforts to propose recommendations on the document’s revisions.</p>
Assessment	Fully Implemented
Comments	<p>The assessors acknowledge the existence of processes that allow the CSRC to identify emerging issues that deserve attention due to the risk that they might pose to investor protection, liquid and transparent markets or systemic risk. However, the assessors encourage the CSRC to consider the development of a more “structured” framework to discuss emerging risks and their potential impact and probability as a key step to determine actions that need to be taken (for example, enhanced reporting, thematic inspections, etc.). This would be in line with recent changes to the IOSCO Methodology. In this context a risk registry could also be considered.</p> <p>In addition, the implementation of a system for the post-legislation evaluation of rules will be a great enhancement to the regulatory process.</p>
Principle 8	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.

Description	<p>Regulated entities</p> <p>The existing regulatory framework requires regulated entities to put in place mechanisms to identify, monitor and mitigate conflicts of interest. Conflicts of interest obligations exist for intermediaries (see Principles 24 and 31), auditors (see Principle 20), credit rating agencies (see Principle 22), sell side analyst (see Principle 23), and SROs (see Principle 9).</p> <p>The CSRC reviews compliance with the conflict of interest obligations through its licensing and ongoing supervisory program. At the licensing stage, an applicant's policies and procedures to identify and manage conflicts of interest are reviewed and if necessary changes are requested. On an ongoing basis, if problems with compliance are identified, the CSRC can take administrative measures and potentially also impose administrative sanctions. The types of sanctions that can be imposed have been described in Principle 11. As described in Principle 12, there is evidence that the CSRC has imposed administrative measures to address problems of compliance identified in different types of participants.</p> <p>Issuers</p> <p>For issuers, a key mechanism used to address potential misalignment of incentives is disclosure to the shareholders and the public. In addition, for major transactions, approval by shareholders is required. For example, as described in Principle 17 major corporate events, such as mergers and acquisitions require approval by shareholders, who must be given sufficient information to be able to make informed decisions. Related party transactions must also be approved by shareholders. Monitoring of compliance of issuers with their disclosure obligations is conducted via the review programs of the exchanges and the CSRC (mainly via its regional bureaus), as described in Principle 18. As described in Principle 12, there is evidence that both the exchanges and the CSRC have imposed disciplinary and administrative measures in cases where problems were encountered.</p> <p>In addition, as explained under Principle 18, the CSRC conducts on-site inspections of companies that have made public offerings. Such on-site inspections have paid particular attention to corporate governance issues given the role of corporate governance in ensuring appropriate protection of minority shareholders and the quality of financial disclosure.</p> <p>In the case of securitization, the current regulatory framework of the PBoC, the CBRC and the CSRC only allows their offering to qualified investors.</p> <p>The CSRC framework contains limitations on the type of assets that can be securitized (a negative list applies whereby all asset that meet the condition for securitization can be securitized except those included in such list). A prospectus document is required prior to the offering. This document needs to be filed with AMAC. In addition, the legal framework contains a general obligation to provide information during the life of the assets; and specifies the frequency or content of such reporting. Retention requirements have not been imposed, but CSRC staff indicated that in practice most sponsors do acquire an "equity" tranche.</p> <p>The CBRC framework also includes limitations regarding the type of assets that can be securitized, requires the registration of a prospectus with the CBRC, and includes a general obligation to provide information to investors during the life of the assets. In addition, retention requirements apply.</p>
Assessment	Fully Implemented

Comments	<p>The assessors consider that this Principle has been met given the current regulatory framework and supervisory practices in place for intermediaries and issuers.</p> <p>The assessors encourage the authorities to continue paying special attention to governance practices in listed companies as they are key to the protection of minority shareholders and to the quality of disclosure. At the same time the OTC markets should continue to be carefully monitored, given the impact that these markets could have in the overall confidence of investors in the securities markets.</p> <p>From an intermediaries perspective issues of compensation and how these can affect the products they offer to clients should be kept under monitoring. In this same context, and as indicated in Principle 23, the assessors encourage the CSRC to monitor whether this issue remains a challenge in the context of the regulation of research analysis as is the case in other jurisdictions. Also, as the MF industry further develops, issues of fees and commissions, including those related to the distribution of the funds, should also be monitored to ensure that investors are given clear information about costs and the actual performance of the funds after all fees and commissions are deducted.</p> <p>Finally, in advance of the expected changes to the Methodology, the assessors encourage the authorities to review the framework for securitization and consider the need for consistent regulations across both regimes that require (i) stronger disclosure obligations, both at the moment of issuance and over the life cycle of the securities and their underlying assets, potentially supported by the development of standardized disclosure templates, and (ii) retention requirements.</p>
Principles for Self-Regulation	
Principle 9	Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p>Background</p> <p>The CSRC works with a total of 19 “affiliated organizations” in carrying out its regulatory functions. These organizations are responsible for a range of activities, including research and the collection of statistics, investor protection, and IT services as well as SRO activities.</p> <p>For the purposes of Principle 9, there are two main types of SROs:</p> <ul style="list-style-type: none"> • market institutions including the stock and futures exchanges, and CSDC; and • industry associations for the securities industry (SAC), the futures industry (CFA) and the funds management industry (AMAC). <p>Market institutions</p> <p><u>Stock exchanges</u></p> <p>Stock exchanges have obligations under the <i>Securities Law</i> to ensure fair centralized trading (Article 113) and to carry out real time monitoring of market trading and supervision of disclosure by listed companies (Article 115). Article 110 provides that only members of a stock exchange can participate in centralized trading on the stock exchange. The</p>

Membership Management Rules of the stock exchanges set out criteria for admission to membership, including that an applicant meets organizational and systems requirements, has been established with the approval of the CSRC and holds a securities business license issued by the CSRC.

The stock exchanges have developed extensive rules, including listing rules, membership management rules, trading and business conduct rules, and investor suitability rules. Under the *Securities Law*, the *Measures for the Administration of Stock Exchanges*, and their own rules, stock exchanges have authority to take regulatory action against their members for breach of rules.

CSDC

The *Securities Law* and the *Measures for the Administration of Securities Registration and Clearing* require CSDC to establish eligibility rules that must be met for individuals or firms to participate in securities activity. These eligibility rules include provisions on account management, requirements for clearing participants, and requirements for entities providing trustee services for corporate bonds.

The CSDC also has enacted rules dealing with trading and business conduct. Under the *Measures* and the rules of CSDC, the CSDC has authority to impose penalties against legal entities or natural persons that have violated relevant laws and regulations.

Futures exchanges

Under the *Regulations on the Administration of Futures Trading* the CSRC conducts the centralized supervision and administration of the national futures market but the futures exchanges are to adopt a self-regulatory model. Under Article 10 of the *Regulations* futures exchanges have an obligation to make rules for, and supervise, trading on their markets and supervise the conduct of their members.

Article 11 of the *Measures for the Administration of Futures Exchanges* provides that a futures exchange must adopt membership qualification requirements and membership management rules in its constitution. Article 54 of the *Measures* provides that a futures exchange's approval is required for an entity to become a member of the futures exchange. Article 55 provides that a futures exchange must formulate membership management rules setting out the conditions and procedures for obtaining and terminating membership, and provisions on membership supervision and administration.

The constitution of futures exchanges contain detailed criteria for admission to membership, including organizational and capital requirements, and a requirement to be appropriately licensed. Futures exchanges have adopted extensive self-regulatory rules, including trading rules, membership management rules, clearing rules, delivery rules, risk control rules, hedging rules, designated delivery warehouse management rules and standard warehouse receipts management rules. Futures exchanges provide in their constitutions that the exchange can take a variety of disciplinary actions against futures market participants for non-compliance with the exchange's constitution and business rules.

Industry associations

Legislation expressly recognizes industry associations and provides for the role they play: Chapter IX of the *Securities Law* for the securities industry association (SAC); Chapter V of the *Regulations on the Administration of Futures Trading* for the futures industry association (CFA); and Chapter XII of the *Fund Law* for the fund association (AMAC). SAC, CFA and AMAC are non-profit organizations established in accordance with the relevant laws and the *Regulations on the Administration of the Registration of Public Organizations*.

	<p>Membership in an industry association is mandatory for securities companies, futures companies, fund management institutions and custodians.</p> <p>The key functions of these industry associations are described below.</p> <p><i>Professional qualifications system</i></p> <p>The industry associations are responsible for establishing and administering arrangements for the professional qualifications of industry practitioners and managers, including setting minimum standards and administering examinations (Article 176 of the Securities Law; Article 112 of the <i>Fund Law</i> and Article 46 of the <i>Regulations on the Administration of Futures Trading</i>). To this end they have established a program of examination and certification of practitioners and managers. Participants concurred that the programs have helped to raise the standards of the market. For example, the pass rate for the AMAC examination is less than 50%.</p> <p><i>Rulemaking</i></p> <p>The legislation requires industry associations to adopt and enforce disciplinary rules relating to their members. All the industry associations have adopted rules and guidelines on business conduct. In formulating their rules, the industry associations consult with the CSRC, their members, the relevant exchanges (for SAC and CFA) and the public.</p> <p>Some of their rulemaking work is directly mandated by the CSRC; other rules are developed at their own initiative, but in consultation with the CSRC. For example, SAC developed rules for intermediaries in relation to their participation in OTC markets. Among other things, such rules require them to report all transactions in the OTC markets. Once the rules are approved or filed with the CSRC, the industry associations provide training on them.</p> <p><i>For AMAC only</i></p> <p>In addition, to the functions above, AMAC is directly responsible for the registration and ongoing supervision of managers that manage private securities investment funds and the private funds themselves. Neither the fund managers nor the funds are required to be licensed or registered by the CSRC, although the CSRC retains overall responsibility for their compliance with the regulatory regime and in practice conducts its own supervisory activities. See under Principle 28.</p> <p><i>Supervisory function</i></p> <p>All industry associations under their constitutions and rules have power to supervise and conduct inspections of their members.</p> <p>In practice, the associations conduct routine off-site monitoring based on the reports that intermediaries are required to submit. They have also developed annual inspection plans, which in general are risk-based. Some inspections are carried out in conjunction with CSRC inspections, while others are undertaken at the initiative of the associations (see further under Principles 28 and 31). SAC has relied on thematic inspections. It conducted 7 thematic inspections in 2014 (covering 129 members), 9 in 2015 (106 members) and 4 in 2016 (59 members). In the case of the CFA, its expectation is to cover all the firms within 3-4 years, with self-inspections by the firm every 2 years. Thus annually they select a sample of 30-40 firms. AMAC carried out 10 inspections of members who are private fund managers in 2104, 34 in 2015 and 20 members in 2016. In all cases the inspections focus on compliance with their own rules, while CSRC inspections focus on CSRC rules. As indicated under Principle 3 the programs are independent, but there are coordination mechanisms in place.</p> <p><i>Disciplinary function</i></p>
--	--

Under their constitutions and rules all industry associations can impose disciplinary measures on their members for breaches of the SRO rules. For minor issues, the actions that can be taken include interviews, warnings and rectifications. For more serious issues, the actions that can be taken include criticisms, public censure on, temporary suspension and revoke of membership. In practice there is evidence that they have used such powers. For example, SAC imposed 21 self-regulatory matters and 14 disciplinary cases in 2014, 36 SR matters and 36 disciplinary cases in 2015 and 17 SR matters and 9 disciplinary cases in 2016.

Authorization

Capacity

The role and obligations of all SROs, including both market institutions and industry associations, are set out in the relevant legislation. Both market institutions and industry associations have detailed rulebooks that apply to all members in a consistent way. For securities exchanges, these rules include rules dealing with membership, trading and listing. For futures exchanges, rules cover membership trading and the listing of products. For industry associations, rules cover membership and business conduct rules. All rules cover the governance of the exchange or association.

The staffing levels of the industry associations, particularly AMAC, are small relative to the size of their memberships. SAC has a total staff of 100 staff, AMAC has 130 staff and CFA has 60 staff. In some cases, industry associations use outside experts such as lawyers and accountants in carrying out functions such as on-site inspections of their members. That is particularly the case for AMAC. AMAC indicated, however, that it is in the process of hiring additional staff.

Rules

Market institutions

Exchanges are required by the legislation to adopt rules governing their self-regulatory functions (see Article 118 of the *Securities Law* and Article 10 of the *Regulations on the Administration of Futures Trading*). The rules of stock exchanges and futures exchanges, and any amendments to them, must be approved by the CSRC. CSRC also has power to require an exchange to modify its rules. See further under Principle 34.

The CSDC is required to seek the approval of the CSRC when formulating or amending its constitution and business rules.

Industry associations

Industry associations are required by legislation to develop rules governing the conduct of their members (see Article 176 of the *Securities Law*, Article 46 of the *Regulations on the Administration of Futures Trading* and Article 112 of the *Fund Law*). Industry association rules must be filed with the CSRC, but except for major rules they do not require its formal ex-ante approval. However, there is a filing procedure and through it the CSRC can review the rules of the industry associations for legal and regulatory compliance and can require them to revise them if they are inconsistent with relevant regulations or public policies. In practice, the industry associations consult with the CSRC when formulating their rules, and develop them under the CSRC's guidance and supervision. For some specific rules, the CSRC's approval is required. For example, the *Measures for the Administration of Futures Practitioners* provide that the CFA's rules for futures practitioners must be submitted to CSRC for approval. These include the rules governing qualifying examinations, registration and disclosure of qualifications, the code of practice, continuing training, practice inspections, and disciplinary sanctions and appeals, must be submitted to the CSRC for approval; and

Article 18 of the *Measures for the Administration of the Qualifications of Securities Practitioners* provides that the rules for industry qualification examinations, the examination syllabus, administrative rules for professional licenses, code of professional conduct and other such rules formulated by SAC.

Co-operation with the CSRC and other SROs

The stock exchanges and futures exchanges have obligations to cooperate with and provide information and reports to the CSRC (see under the Principle 33 And 34). The *Measures for the Administration of Stock Exchanges* provides that stock exchanges must establish mechanisms for information exchange and joint supervision for targeting improper cross-market trading practices and controlling market risk. Under the supervision of the CSRC, stock exchanges and CSDC have information sharing arrangements. Stock exchanges have signed MoUs regarding regulatory cooperation with CFFEX to strengthen regulatory coordination between cash markets and the financial futures market.

Stock exchanges, the CSDC and the SAC maintain close cooperation on supervision over eligibility criteria for securities industry practitioners, supervision and implementation of codes of conduct, supervision of securities companies, and management of investor suitability. Stock exchanges and the CSDC have established information sharing and cooperation mechanisms with the SIPF to promote investor education and protect their interests.

There is also cooperation between the exchanges and the industry associations in the supervision of market participants. For example, in 2015 and 2016, the CSRC organized SSE, SZE, SAC and AMAC to conduct coordinated on-site inspections of corporate bond issuers, intermediaries, asset-backed securities issuers and credit rating agencies; the CSRC also coordinates inspections with futures exchanges and the CFA on their futures companies' members.

Governance

The basic governance arrangements for both market institutions and industry associations are set out in the relevant legislation. In all cases, the members' general assembly is the supreme organ of power and the board of directors is the decision-making body accountable to the general assembly. Constitutions set out the rights and obligations of members and the rights and obligations for the members' general assembly, the board of directors, and the board of supervisors.

The CSRC has direct involvement in the governance of the SROs.

For both stock and futures exchanges, the board is composed of member and non-member directors. Member directors are elected by the general assembly while non-member directors are appointed by the CSRC –except in the case of demutualized exchanges where they are nominated by the CSRC but approved in shareholders' meetings. In all cases the chairman and vice-chairman are nominated by the CSRC and elected by the board of directors. In the case of stock exchanges, the general manager should be a member of the board. In the case of futures exchanges, the manager and general manager must be appointed and dismissed by the CSRC. Demutualized futures exchange must also have a board secretary nominated by the CSRC and approved by the board.

In the case of industry associations, for both SAC and AMAC the board is also composed of member and non-member directors. Member directors are elected by the general assembly, while non-member directors are appointed by the CSRC. Non-member directors must not exceed one fifth of the total number of directors. In the case of the CFA the board is composed of member directors, special directors and non-member directors. Ordinary

members are nominated by the board or by more than one fifth of the total number of ordinary and special members and be elected in general assembly. Special members include the four futures exchanges and China Futures Margin Monitoring Center, who are ex-officio directors. Non-member directors are appointed by the CSRC and their number must not exceed a fourth of the total number of directors. Some of the non-member directors are representatives of the CSRC.

Exchanges and industry associations have disciplinary committees that deal with more serious breaches of rules. The composition of these committees varies, with some including independent experts (such as judges and lawyers) as well as industry practitioners. The CSRC has a representative on most disciplinary committees, other than for the CFA, which has a lawyer as an independent member.

Avoiding anti-competitive situations and misuse of oversight role

Stock exchanges and futures exchanges have an obligation to create an open, fair and equitable market environment to ensure the normal operation of their market. When establishing or revising relevant business rules, exchanges and the CSDC are required to seek comments from the market to avoid anti-competitive situations. These comments are provided to the CSRC as part of the rule approval process.

When developing or revising relevant business rules, industry associations must also seek comments from their members and submit the rules to the CSRC. During the review, the CSRC analyses whether relevant rules would create anti-competitive situations.

Supervision

Market institutions

The CSRC has power to seek information and documents from the exchanges, to conduct on-site inspections of exchanges and the CSDC, and to conduct investigations. Exchanges are also required to submit regular reports to the CSRC, such as quarterly and annual work reports. These reports contain information on the exchanges' operation and implementation of relevant laws, administrative regulations, rules and policies. Exchanges also have ad hoc reporting obligations, such as the obligation to report suspected market abuse to the CSRC where their powers are inadequate to inquire into or deal with it, or the misconduct is beyond the scope of their responsibilities. See further under Principle 34.

Inspections of stock exchanges

The CSRC commenced its first round of inspections of stock exchanges in 2016. It now plans to do annual inspections. These inspections are thematic and focus on one or two particular areas of exchange operations. In the inspection process, the CSRC first requires the exchange to prepare a self-inspection report made up of a question list and a check list. The CSRC uses this information in the detailed planning of its inspections, including the training of inspection staff. For 2016, inspections were carried out on SSE and SZE with a focus on whether the exchanges had fulfilled their supervisory role effectively. The CSRC has also carried out regular inspections of the NEEQ market since it commenced in 2013, with a particular focus on the way NEEQ monitors and enforces compliance by listed issuers with disclosure and corporate governance obligations.

Inspections of futures exchanges

The CSRC carries out annual inspections of all four futures exchanges. Similar to its approach for stock exchanges, these inspections are thematic and focus on particular areas of concern. As is the case for stock exchanges, in the inspection process, the CSRC first requires a futures exchange to prepare a self-inspection report made up of a question list and a check list. The

	<p>CSRC uses this information in the detailed planning of its inspections, including the training of inspection staff.</p> <p>For 2016 the inspections have had two areas of focus: the use by exchanges of their power to exempt position limits on hedging and arbitrage trading; and the exchanges' investigation into and sanctioning of market misconduct and illegal activity.</p> <p><u>Industry associations</u></p> <p>The supervision of industry associations involves three layers:</p> <ul style="list-style-type: none"> • As public organizations, they are subject to the supervision of the Ministry of Civil Affairs. This layer of supervision goes to their structure, finances and internal organization • There must be a board of supervisors, which is responsible for general oversight and for ensuring there are appropriate checks and balances in the way the associations carry out their functions; • Under the Securities Law, the Fund Law and the Regulations on the Administration of Futures Trading, the CSRC is responsible for guiding and supervising the activities of the industry associations. The CSRC has the ability to guide and oversee their activities through its direct participation in governance arrangements (such as membership on boards and disciplinary committees) and through its involvement in the rulemaking process. In addition, the CSRC can impose reporting obligations on them and can conduct on-site inspections on them. <p>These SROs also provide to the CSRC an annual report, which contains details of the SROs' supervision activities, including off-site monitoring and on-site inspections. The CSRC has also designed a set of indicators, including quantitative measures, to assist it in assessing the self-regulatory performance of the industry associations.</p> <p>In practice, the key mechanisms for CSRC oversight have been (i) the participation in key organs of the associations, (ii) in the rulemaking process, and (iii) the obligation of the industry associations to submit to the CSRC all the reports of the on-site inspections that it conducts, along with the proposals of measures that they will impose. CSRC reviews and analyzes the above information to stay up-to-date with the industries and to better direct and oversee the day-to-day self-regulatory activities of these industry associations. Similar to market institutions, the industry associations have ad-hoc reporting obligations related to the detection of violations of the laws and CSRC regulations.</p> <p>In addition, the CSRC Party Committee Inspection Team carried out two rounds of inspections on the SAC and the CFA between 2010 and 2016; and it has plans to inspect the AMC. The inspections of industry associations focused on personnel management systems, internal control system and financial management system, and also cover the performance of self-regulatory obligations. The inspections led to suggestions on how to improve relevant systems, self-regulatory management and member services.</p> <p>There are also some mechanisms in place for coordination, particularly in connection with the on-site inspection program of the CSRC and the associations, as explained under Principle 3.</p> <p>Professional standards</p> <p>Staff members of stock exchanges and the CSDC follow professional standards of behavior. When performing duties related to securities trading, a senior officer or any other employee</p>
--	---

	<p>of a stock exchange must recuse himself where he or one of his relatives is an interested party (Article 119 of the <i>Securities Law</i>). Stock exchanges, securities companies and the CSDC must keep confidential the accounts opened by their clients (Article 44 of the <i>Securities Law</i>). The <i>Measures for the Administration of Stock Exchanges</i> require a stock exchange to keep confidential instruction information, transaction records and clearing documents relating to securities. Staff members of stock exchanges and the CSDC are expressly prohibited from misusing information for the purposes of committing market abuses, such as insider trading.</p> <p>The staff members of the CSRC, futures exchanges, institutions responsible for monitoring the safe custody of futures margins, futures margin depository banks and other related entities must perform their duties, act in accordance with the law, maintain their honesty and integrity, and keep confidential state secrets and trade secrets of the parties concerned, and must not abuse their posts for improper gains (Article 63 of the <i>Regulations on the Administration of Futures Trading</i>). The <i>Measures for the Administration of Futures Exchanges</i> provides that no employee of futures exchanges is permitted to reveal any inside information or seek illegal gains by use of the inside information.</p> <p>The SAC, the AMAC and the CFA require their staff members to follow professional standards of behavior and to appropriately use information obtained in the course of the SRO's discharge of its responsibilities. They have and enforce working practices for confidentiality and procedural fairness. There are explicit rules relating to procedural fairness in the disciplinary process, such as the right to present evidence and the right of appeal.</p> <p>Staff members of the exchanges are prohibited from trading in the products listed on the exchanges.</p> <p><i>Conflicts of interest</i></p> <p>The potential for conflicts of interest for SROs results from the dual roles they have. Market institutions are mutual, member-owned entities that also have obligations to set standards for and supervise the conduct of members and enforce compliance with SRO rules. Under the legislation, industry associations have the role both of safeguarding the rights and interests of their members (for example, see Article 176 of the <i>Securities Law</i> for SAC), and monitoring and enforcing compliance by their members with their rules.</p> <p>Some features of the Chinese system assist in minimizing the potential for conflict between the different functions of SROs. For example, all exchanges are non-profit institutions and all industry associations are non-profit social organizations. All SROs are subject to the CSRC's supervision, and the CSRC is represented in their governance structure at board level and (with one exception) in their disciplinary committees.</p>
Assessment	Broadly Implemented
Comments	<p>The main challenges relate to KQ 4 a) in connection with KQ 2 a) of the Methodology.</p> <p>The Principles do not require the use of SROs; only that when they are used they are subject to an appropriate level of oversight. In practice the use of SROs varies greatly across the world: from jurisdictions where SROs have a very limited (or even no role) to jurisdictions where they exercise functions of front-line supervisors to a degree that the regulatory authority relies largely on them for the day to day supervision of certain categories of intermediaries and/or markets. By the same token, their nature and governance also varies and there is no one "model" that is best practice for all types of markets. Certain trends can be identified; in particular that, the more the SROs act as front line supervisors, the more</p>

there is a need to strengthen their governance, ensure that they have sufficient resources and that the regulatory authority exercises intense oversight over them.

In the case of China, the SROs exercise front-line supervisory functions under the guidance of CSRC. It is within this context that the assessors have evaluated the CSRC SRO oversight program.

The capacity of exchanges and SROs to exercise their functions (resources assigned)

The assessors note that the role of the exchanges has focused on areas directly related to their function as market operators: monitoring of issuers' compliance with their listing obligations and market surveillance. In some jurisdictions these are not considered self-regulatory functions. However, the exchanges' role in both areas supplements CSRC supervisory programs. As per conversations held with the CSRC, the exchanges and market participants it appears that the human resources dedicated to these functions are in line with practices in exchanges in other jurisdictions. That said, as in other jurisdictions it is critical that the level of resources that the exchanges assigned to them be kept under review.

As for the industry associations, market participants expressed very favorable views of the system of qualification of practitioners. They also highlighted the role of SROs rules in assisting in the implementation of legislative and CSRC requirements and in elevating the standards of the market. That said, in practice, the current level of resources dedicated to on-site inspections aim at ensuring compliance with such rules is limited. However, the assessors acknowledge that under the current approach the associations do not assist the CSRC in supervising compliance with the laws and regulations administered by the CSRC; rather the focus of their on-site inspections is on monitoring members' compliance with their own SRO rules, while the CSRC has a supervisory program for the supervision of the laws and regulations it administers. In such context the current level of resources dedicated to supervision and in particular inspections does not pose the same level of concerns that it would if they were also the main supervisor concerning legal and regulatory requirements. In the case of AMAC their resources are much smaller vis-à-vis the population under its purview; and in practice it has relied in lawyers to fulfill some of its key functions, including the review of fund managers' compliance with registration requirements. However in this particular case the assessors recognize that the Principles do not require the supervision of all private funds, only of hedge funds (HFs) and that for HFs the Principles require a system of supervision commensurate with the risk that the HF industry poses vis-à-vis financial stability –which at the time of this assessment appears limited.

Taken all such comments together the assessors recommend the CSRC to consider the value that a more expansive program of inspections by the industry associations might bring to the system, and in such context assess the level of additional resources that would be needed for its implementation. More generally, the assessors encourage the authorities to consider whether a "full integration" of the rules of the SROs with the "public" rules for purposes of their supervision could further leverage the role of SROs rules in improving market participants' standards.

SRO oversight

There are differences in the tools used to oversee market institutions versus the industry associations.

In the case of market institutions the tools for oversight comprise ex-ante approval of rules, review and authorization of new products, robust reporting obligations and on-site inspections, which are also the key tools used in other large jurisdictions. So far the inspections have been thematic. This is indeed an acceptable practice. However particularly

	<p>in the case of stock exchanges, for which the use of on-site inspections is recent, the assessors recommend that the CSRC assesses whether at least initially comprehensive inspections would be beneficial to have a baseline.</p> <p>In addition, the CSRC appoints the chairman and CEO of the exchanges. This is not a tool used in other large jurisdictions, but it seems to respond to the vision of the authorities of the exchanges as “quasi-utilities” and the key role that has been assigned to exchanges in capital markets development. The assessors acknowledge the benefits of such tool to align the exchanges’ plans with development goals of the authorities. That said, it could have drawbacks and thus in the long run, the CSRC might consider replacing it with the requirement to include independent members in the board.</p> <p>In the case of the industry associations, the major rules need ex-ante approval by the CSRC, while such requirements are waived for the remaining rules. However, there is a filing system in place through which the CSRC can review other rules. Furthermore, in practice, the associations consult closely with the CSRC and act under its guidance in the rulemaking process. If the CSRC disagrees with a proposed rule, the association will not proceed with it. The CSRC can also request an association to amend its rules and the association would comply with such a request. Thus, in this context the lack of an ex-ante system of approval for all regulations does not seem to pose material concerns.</p> <p>The assessors acknowledge that the CSRC Party Committee inspection team has conducted inspections on two of the industry associations and has plans to inspect the AMAC. In this context the assessors recommend the CSRC to consider whether there is a need to institute a formal program of inspections for the industry associations by the corresponding CSRC supervisory team.</p> <p>In addition, similar to the exchanges, to these tools the CSRC has also added others that are not commonly used in other large markets, which is the appointment of CSRC representatives in key organs of the associations including the disciplinary bodies. Such a direct participation adds another layer to the intensity of supervision.</p> <p>Also, in the long run, the CSRC might consider replacing its representatives with the appointment of additional independent members in key bodies of the industry associations.</p> <p><i>Governance and the avoidance of conflicts of interest</i></p> <p>An issue that may need to be review over time is the potential for conflict in industry representation on the disciplinary committees of the industry associations, and the fact that some disciplinary decisions are made by the board of the association. Directly affected parties are not permitted to take part in a disciplinary hearing, but consideration should be given to strengthening the independence of the disciplinary process, for example by having committees comprised of a majority of independent persons (non-members); and making the committees, rather than the board, responsible for imposing sanctions. In the long run, particularly if they were to be given a stronger role in the system, the assessors encourage the CSRC to consider also whether it would be appropriate to require the industry associations to have a dual board, whereby the board for SRO functions is composed of a majority of independent members.</p>
Principles for the Enforcement of Securities Regulation	
Principle 10	The regulator should have comprehensive inspection, investigation and surveillance powers.

Description	<p>Power to inspect and obtain books and records from regulated entities</p> <p>The CSRC has the power to conduct on-site inspections at regulated entities and access and copy materials and documents, including relevant books and records, related to the matters under inspection. The supporting provisions stem from:</p> <ul style="list-style-type: none"> • Article 180 of the Securities Law for securities issuers, listed companies, securities companies, securities investment fund management companies, securities service institutions, stock exchanges and securities registration and clearing institutions; • Article 113 of the Fund Law for fund managers, fund custodians and fund service institutions; • Article 47 of the Regulations on the Administration of Futures Trading, for futures exchanges, futures companies, other institutions engaged in futures business, non-futures company clearing members, institutions responsible for monitoring the safe custody of futures margins and delivery warehouses; • Article 31 of the Interim Measures for the Supervision and Administration of Private Investment Funds (the "Measures for Private Investment Funds") for private fund managers, private fund custodians, private fund distributors and other private fund service providers. • Finally, as described in Principle 9 the CSRC has authority to supervise and require information from industry associations. <p>Generally, the CSRC rules require that notice be given to regulated entities 5 working days before on-site inspections take place, but the CSRC may also inspect a regulated entity without any prior notice to make a fair judgment on its operations. In addition, even when a prior notice of inspection is provided, inspectors may keep the entity uninformed about the items to be inspected, preventing the entity from falsifying or destroying its books and records. The power to conduct unannounced inspections stem from the provisions mentioned above, as they do not impose any limitations to CSRC inspection power.</p> <p>Exchanges</p> <p>The CSRC can conduct or supervise surveillance of trading in the exchanges based on the general supervisory powers granted to it by article 7 of the Securities Law. In addition, the CSRC has the authority to supervise exchanges (cash and futures) pursuant to articles 4 of the Measures for the Administration of Stock Exchanges, and article 5 of the Measures for the Administration of Futures Exchanges, respectively.</p> <p>Recordkeeping</p> <p>Recordkeeping obligations exist for all regulated entities.</p> <ul style="list-style-type: none"> • In general for most intermediaries such recordkeeping obligations are for a period of not less than 20 years. Such obligation stem from: <ul style="list-style-type: none"> • Article 147 of the Securities Law, for securities companies, whereby securities companies must preserve its clients' account opening materials, order records, transaction records and all materials relating to its internal management and business operations; • Article 51 of the Measures for the Supervision and Administration of Futures
-------------	---

	<p>Companies, for futures companies;</p> <ul style="list-style-type: none"> • Article 19 and 36 of the Fund law for fund managers and custodians respectively, • Article 37 of the Measures for the Administration of Stock Exchanges, for stock exchange and its members, which must properly store order information, transaction records and clearing documents arising from securities trading, and • Article 162 for securities registration and clearing institutions. <ul style="list-style-type: none"> • A period of 15 years applies to fund distributors pursuant to article 32 of the Guidelines on Internal Control of Distributors for Securities Investment Funds; and • A period of 10 years for Private Investment Funds, private fund managers, private fund custodians and private fund distributors according to article 26 of the Interim Measures on the Administration and Supervision of Private Funds. <p>In addition, under Article 19 of the Law of the People's Republic of China on Anti-Money Laundering, a financial institution must establish a system to preserve its clients' identity information and transaction records. If a change in the identity information of a client occurs while the business relationship with such client persists, the client's identity information must be updated in a timely manner. After the termination of the business relationship or completion of the transaction, the relevant client's identity information or the client's transaction information must be kept at least for 5 years.</p> <p>Access to identity of clients</p> <p>Regulated entities are required to maintain the records of their clients' identities pursuant to the relevant laws and regulations as detailed above. In particular they are required to obtain beneficial ownership information² through several provisions.</p> <p>Pursuant to article 180 of the Securities Law, 113 of the Fund Law and 47 of the Regulations for the Administration of Futures Trading, the CSRC has broad supervisory powers over regulated entities. As a result of such powers it can ask regulated entities for any information related to their activities, including clients' records and the information therein. In addition, pursuant to the same provisions it has broad investigation powers and as a result of such powers it can also have access to information in the hands of third parties, as will be further discussed in principle 11.</p>
--	--

² See article 7 of The rules on the Administration of Client Identity Identification and Materials and Transaction Recording of Financial Institutions, articles 3 and 4 of the Notice of the People's Bank of China on Further Strengthening the Anti-money Laundering Work of Financial Institutions (No. 391 [2008] of the People's Bank of China) and article 7 of the *Rules for Financial Institutions on Customer Identification and Record Keeping of Customer Identification and Transaction Information*(Order of PBC, CBRC, CSRC, and CIRC(No. 2 [2007]))[*The Identification Rules*].

Assessment	Fully Implemented
Comments	As indicated in the section on preconditions the assessors understand that the Company Law allows joint stock companies to issue unregistered stock, which are essentially bearer shares, they also understand that such possibility does not apply to companies listed in the exchanges or NEEQ, given their dematerialization and the see through system implemented in China. However, the existence of unregistered stock can still create hurdles for intermediaries' compliance with their know your customer obligations, particularly from an AML perspective. As these issues exceed the scope of the IOSCO assessment under this Principle they have not been considered for the grade. That said, the authorities are encouraged to eliminate the ability of companies to issue unregistered stock.
Principle 11	The regulator should have comprehensive enforcement powers.
Description	<p>Authority to investigate breaches</p> <p>Articles 179 of the Securities Law and 112 of the Fund Law provide the CSRC with the authority to investigate and punish violations of laws and administrative regulations relating to supervision and regulation of the securities market.</p> <p>Pursuant to article 180 of the Securities Laws, article 113 of the Fund Law and article 47 of the Regulations for the Administration of Futures Trading, the CSRC can</p> <ul style="list-style-type: none"> • Enter the premises where a suspected illegal act took place to investigate and collect evidence; • Question the parties concerned and the entities and individuals related to the event under investigation and require them to give explanations on the matters related to the event under investigation; • Access and copy property ownership registrations and communication records related to the event under investigation; • Access and copy securities transaction records, transfer registration records, financial and accounting information and other relevant documents and materials of the parties concerned and the entities and individuals related to the event under investigation, and seal-up the documents and materials that might be removed, concealed, damaged or destroyed; • Check the funds, securities accounts and bank accounts of the parties concerned and the entities and individuals related to the event under investigation, and if there is evidence to prove that illegal funds, securities or other relevant properties have been or are likely to be transferred or concealed, or that any important evidence has been or is likely to be concealed, forged, damaged or destroyed, freeze or seal-up the same with the approval of the principal person-in-charge of the CSRC; and • When investigating serious securities-related illegal acts such as manipulation of the securities market and insider trading, with the approval of the principal

person-in-charge of CSRC, may restrict trading of securities by the party involved in the event under investigation, provided that such restriction may not exceed 15 trading days. If the case is complex, the restriction period may be extended for another 15 trading days in the case of cash markets and funds or 30 days in the case of future markets.

Accordingly, based on such articles and provisions the CSRC has the authority to require and obtain from securities firms the records of their clients, which should contain information on all transactions undertaken. Further, pursuant to Articles 2, 3 and 4 of the Provisions on Strengthening the Management of Client Trading Terminal Information and Other Client Information of Securities and Futures Institutions client trading terminal information is an important part of the client's order and trading records and includes but is not limited to telephone number, Internet Protocol (IP) address, Media Access Control (MAC) address and other feature information which can be used to identify the client trading terminal. Securities and futures institutions are responsible for collecting and keeping the trading records of their clients, including IP/MAC addresses, and have the obligation to provide such information to the CSRC as required. In practice, with the widespread application of internet finance, a broader range of client trading terminals are available. Currently, the types and formats of trading data collected by some securities and futures institutions from client trading terminals are not standardized yet. Therefore, in practice, there does exist the issue of incomplete collection of IP/MAC addresses. The CSRC is taking active actions, including but not limited to drawing up relevant regulations and guidelines and enhancing supervision and inspection, to facilitate the resolution of these issues.

The same legal provisions provide the CSRC with the authority to request communication records or obtain such communication records from third parties, including telecommunication companies. They also provide it with the authority to request testimony from third parties, albeit not under oath (since the concept of testimony under oath does not exist under the Chinese legal system).

I In relation to bank account information, the Circular on Issues Related to Inquiry and Freezing of the Account by the Securities Regulatory Authority of a Party Concerned or An Entity or Individual Involved in the Investigated Case in a Banking Financial Institution promulgated in 2012 explicitly states that if in the course of the performance of their duties the CSRC and its regional offices need to inquire or freeze the fund accounts or deposit accounts of a party concerned in securities trading, the relevant financial institution must actively cooperate with it. This Circular further stipulates that the investigators may access and duplicate material related to fund accounts or deposit accounts.

Authority to initiate civil or criminal proceedings

Similar to other civil law countries, the regulator can impose administrative sanctions directly in enforcement matters and does not have to have recourse to the civil courts.

Article 107 of the Criminal Procedure Law provides that the public security authority or the People's Prosecutor Office must initiate official investigations according to their jurisdiction upon the discovery of evidence of a crime. Article 167 provides that any case that requires initiation of public prosecution must be reviewed by the People's Prosecutor to decide whether to proceed with the prosecution. Article 3 of the Regulations on the Referral of Suspected Criminal Cases by Administrative Enforcement Authorities (State Council Decree No. 310) provides that if administrative enforcement authorities suspect that the illegal acts they are investigating may constitute a crime they must refer the case to the public security

	<p>authorities.</p> <p>Under the Notice of the China Securities Regulatory Commission and the Ministry of Public Security on Enhancing Enforcement Collaboration in Combating Securities and Futures Crimes, the CSRC must promptly report evidence of suspected economic crimes discovered in their day-to-day supervision and investigation of securities and futures violations to the public security authorities. Under the Regulations, the CSRC must submit the following materials when referring a suspected criminal case to the Ministry of Public Security: (1) a notice of referral for the suspected criminal case; (2) the related investigation report; (3) a list of items involved in the case and a list of main evidence; (4) the relevant opinions and verification conclusions; and (5) other materials concerning the suspected crime. After referral of the case, the CSRC will provide support and assistance to the public security authority with regard to its investigation and handling of the case, including joint discussion of the case, provision of professional consultation and issuance of professional opinions, etc.</p> <p>Power to suspend trading</p> <p>Article 180 of the Securities Law and Article 47 of the Regulations on the Administration of Futures Trading provide that when investigating serious securities related illegal acts such as manipulation of securities market and insider trading, the CSRC under the approval of its principal person-in-charge can restrict trading of securities by the party involved in the event under investigation, provided that such restriction may not exceed 15 trading days. If the case is complex, the restriction period may be extended according to the statutory requirements.</p> <p>To implement such provisions, the CSRC formulated the Measures of the China Securities Regulatory Commission for the Implementation of Restrictions on the Purchase and Sales of Securities that contain detailed provisions on restricting trading of securities and the freezing and seal-up measures. In practice, if the CSRC finds it necessary during its investigation to adopt measures to restrict securities trading, it must prepare an Application Form for Restriction of Securities Trading and an Application Form for Freezing and Seal-Up, and after being reviewed by the CSRC legal department, submit it to the CSRC leadership for approval. Upon approval, the Application Form for Restriction of Securities Trading is sent to stock exchanges, the securities depository and clearing institution and relevant securities distribution institutions to effect the trading restriction on the accounts concerned, and the Application Form for Freezing or the Application Form for Seal-Up is be sent to banks or securities companies to effect the freezing or seal-up of the property involved in the case.</p> <p>Under the Securities Law and the Measures for the Administration of Stock Exchanges, for the purposes of protecting public interest and investors, stock exchanges have the power to impose a trading suspension on securities accounts, individual stocks and even the entire securities market.</p> <p>Regulatory measures</p> <p>The CSRC has the power to impose regulatory measures on regulated entities. Regulatory measures include: orders to correct, warnings, interviews (whereby a meeting takes place with the representatives of the regulated entity), and suspensions of conducting regulated activities for a period of time. Such measures can be directly imposed by the functional departments.</p> <p>Regulatory measures are not as severe as administrative sanctions and are taken mainly for violations of lower-level normative documents if the violations might not go against</p>
--	--

securities laws and regulations. When regulatory measures, these regulatory measures are also included in the integrity records that the CSRC keeps of all regulated entities and persons. In addition, they are considered for purposes of the rating given to intermediaries, as well as to determine the level of contributions to the investor compensation schemes.

Administrative sanctions

The CSRC can impose administrative sanctions on both regulated entities and third parties that have violated laws or regulations for the securities and futures markets. The law sets out each specific misconduct and assigns a specific sanction or range of sanctions to each. Possible administrative sanctions include: confiscation of illegal gains, money penalties (fines), revocation of the business license and bars from the securities markets. For individual persons found responsible the sanctions can include fines and bars. Similar to the administrative measures, administrative sanctions are included in the integrity records that the CSRC keeps of all regulated entities and persons.

Money penalties are usually set out as a range and often are based on the amount of illegal gains obtained. In most cases the range is of one to five times the illegal gains. In cases where there are no illegal gains or the illegal gains are below certain thresholds established in the corresponding laws or regulations, the level of fines is usually a range instead of a fixed amount. For the violator, the minimum range is 10,000 to 100,000 yuan (for certain violations, i.e., infringement upon clients' interests by securities companies) and the maximum range is 300,000 to 3,000,000 yuan (for market manipulation in the cash markets). If the violator is an entity, on top of the fines imposed on the entity, the CSRC would also fine responsible individuals within the entity, with a minimum range of 10,000 to 50,000 yuan (for certain violations by futures companies) and a maximum range of 50,000 to 500,000 yuan (for illegal offering of CIS).

For a few misconduct, the range of the sanctions is established as a percentage of the funds raised (1% to 5%). These violations mainly include: (i) those involving public offering of securities without the approval of the statutory regulator or disguised as other activities to circumvent public offering approval procedures; and (ii) those involving the offering of securities by any ineligible issuer who has fraudulently obtained approval for such offering.

For the first type of violations, the Securities Law provides that the issuer must return to investors the proceeds derived from the offering, with interest accrued at the interest rate for bank deposits over the same period, and then must be further subject to a penalty equivalent to 1% to 5% of the proceeds.

For the second type of violations, disgorgement is not imposed by law. CSRC staff explained that penalties are mainly imposed on issuers under the Securities Law, but given that the securities of the issuers are held by a large number of investors in the market, the imposition of penalties on the issuers by the regulator will inflict some "secondary damage" to the investors. Specifically speaking, the proceeds from a public offering in the mainland market exceed RMB 100 million on average and therefore, if the regulator disgorges the total proceeds of a fraudulent issuer from a public offering and imposes on the issuer a penalty equivalent to a certain multiple of the proceeds, the issuer might become insolvent and inflict heavy losses on the securities holders. In view of the above, the legislature has to strike a balance between penalizing fraudulent issuers and providing exit for investors when setting the level of penalties. That said, the CSRC has been encouraging a moderate increase in the level of penalties for the second type of violations during the revision of the Securities Law to increase deterrence and eliminate offering frauds.

In general the fines established in the law and/or regulations for futures markets violations

are lower than similar violations in the securities (cash) market for both the companies and the individuals responsible. CSRC senior staff explained that this is a legacy issue.

As mentioned above, pursuant to articles 233 of the Securities Law, articles 77 of the Regulations on the Administration of Futures Trading the CSRC can prohibit the relevant persons from entering into the securities market. The term "prohibition from entering into the securities market" refers to a system, whereby a person is barred from undertaking any securities or futures practice or being a director, supervisor or senior manager of a listed company within a prescribed term or for life, or its securities or futures practice qualification is revoked.

Procedures for the imposition of administrative sanctions

According to the Circular on Further Enhancing the Administrative Penalty Mechanism of the CSRC, when carrying out enforcement actions, the CSRC must assign the investigation and punishment of illegal acts to different departments. Upon completion of an investigation by the investigation department, a case is referred to the Administrative Sanction Committee of the CSRC for judgment. The Administrative Sanction Committee is currently composed of 14 full-time members and is supported by the Office of the Administrative Sanction Committee. The Administrative Sanction Committee works mostly as a collegial panel led by a presiding member, i.e., the presiding member examines the facts and evidence of a case and proposes preliminary actions according to the law, while the final recommendation on penalties are jointly determined by (generally two) other members. Certain cases are, however, handled by a single member of the Administrative Sanction Committee, who both considers the case and proposes the penalty measures. Once the recommended actions are approved by the leadership of the CSRC, the Administrative Sanction Committee will notify the parties concerned of the facts, reasons and basis for imposing the penalties. Pursuant to the Administrative Penalty Law, the affected parties may submit statements and defense in writing, or request for a hearing under the CSRC Rules on Administrative Penalties Hearings. In the event that the statements or defense made either in writing or during hearings are accepted during the review proceedings, the Administrative Sanction Committee must adjust the recommended actions accordingly. Once the final recommended actions are approved by the leadership of CSRC, the CSRC will issue the decision for administrative penalties, market ban or not imposing administrative penalties as provided for by law.

If the administrative penalty involves confiscation of illegal gains or fines, the Enforcement Bureau supervises the corresponding enforcement process. In 2015, the Administrative Sanction Committee established two circuit review groups in Shanghai and Shenzhen, which marked the formal launch of the circuit review mechanism. The two working groups, on behalf of the Administrative Sanction Committee, arrange and hold reviews and hearings, and propose penalty measures, in their locality.

Information on administrative sanctions

The CSRC launched an Internet-based public inquiry platform for dishonesty records, where the public can access information on records of administrative sanctions and market entry bans imposed on market participants. Regulatory measures are not included in the database that is available to the public.

In addition, the Supreme People's Court and CSRC exchange information on dishonest individuals who are subject to enforcement actions by any court in China.

Private right of action

Pursuant to articles 69, 76, 77 and 79 of the Securities Law where false statements, insider

	<p>trading, manipulation or fraud causes losses to clients, the insider trader, manipulator or fraudster is liable to compensate investors in accordance with law. In order to ensure that investors obtain adequate compensation through civil remedies, article 232 of the Securities Law provides that persons liable for both civil compensation and fines, whose property is insufficient to cover both of the payments, shall first bear the liability for civil compensation.</p> <p>The Supreme People's Court requires the existence of an administrative sanction by the CSRC as a prerequisite to admit a civil suit related to fraudulent offers. Authorities are proactively researching the feasibility of eliminating such conditions.</p> <p>In May 2016, CSRC and the Supreme People's Court jointly released the <i>Notice on Implementing the Pilot Program of a Multi-Dimensional Dispute Resolution Mechanism for the Securities and Futures Industries in Certain Regions of China</i>. To enhance the binding effect of mediation, according to the laws and regulation as well as the notice jointly issued by the CSRC and the Supreme People's Court, the mediation agreements reached through notarization, arbitration and the judicial system, can apply for compulsory enforcement by the people's court. The pilot program is now being implemented across the country.</p> <p>In addition, through the creation of the CSISC in 2011, the CSRC has sought to facilitate small investors' ability to exercise their rights in court. Pursuant to Article 15 of the <i>Civil Procedure Law</i>, the CSISC has the power to assist small and medium investors in initiating civil lawsuits against law-breaking entities. Two such cases have now entered the court hearing phase. No class actions are permitted, so the results from these lawsuits are only applicable to those investors who participated in the joint action.</p> <p>The CSRC has also implemented a pilot program named "Shareholding for Voting," under which it advises CSISC, a non-profit organization dedicated to investor protection, on purchasing a small quantity of shares (100 shares) of listed companies to exercise shareholders rights as one of the company's shareholders. In this way, the center seeks to educate shareholders regarding the way to exercise their rights and influence governance practices of listed companies.</p>
Assessment	Broadly Implemented
Comments	<p>The reasons for the grade stem mainly from challenges in connection with KQ 2(b) of the Methodology. As discussed in Principle 3, the framework for the imposition of administrative penalties has deficiencies that can affect the ability of the CSRC to implement a credible enforcement program.</p> <p>Other issues not affecting the grade</p> <p>The assessors acknowledge the different initiatives that the CSRC has implemented to strengthen the ability of small investors to exercise their rights, including the creation of the CSISC that can represent investors in legal suits and the development of a multilevel system of mediation. The authorities are encouraged to continue working towards addressing any remaining challenge that might prevent investors from effectively exercising their rights in courts if they choose to do so. In this context, a class action system could be explored, along with a change in the burden of proof.</p> <p>The assessors encourage the authorities to consider changes to the legal framework in order to explicitly provide the CSRC with stronger legal backing to compel testimony from third parties, and to request records from telephone companies and internet service</p>

	<p>providers. Such powers would need to be accompanied by the tools to ensure cooperation, including the use of the police and the imposition of strong sanctions for non-compliance. In addition, the assessors recommend that the CSRC review whether the provisions to freeze assets would need to be expanded, particularly in line with the expectations of the enhanced MMoU.</p>
Principle 12	<p>The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.</p>
Description	<p>Compliance systems</p> <p>Listed companies must have internal control systems that provide reasonable assurance of the reliability of financial reports, and of the efficiency, legality and compliance of business operations.</p> <p>Securities companies, futures companies and fund management companies are required to have compliance systems and internal control systems. Securities companies must designate personnel responsible for compliance and risk management; futures companies must designate a chief risk officer and fund management companies a chief compliance officer. The CSRC can take action against managers responsible for the supervision of employees who engage in non-compliant conduct. See further under Principles 24 and 31.</p> <p>Issuers monitoring and supervision of licensed firms</p> <p><u>Listed company supervision</u></p> <p>As described under Principles 16-18, the CSRC reviews all prospectuses for public offerings and tender offer documents.</p> <p>The stock exchanges monitor issuers' compliance with listing rules. As part of such monitoring they have developed programs for the review of periodic reports, which are risk-based. They also review material events disclosure.</p> <p>In addition, the CSRC has a program to review annual reports, focusing on compliance with accounting standards that uses an approach that combines risk-oriented and random sampling. Some CSRC regional offices conduct their own reviews of annual reports, depending on their resources. In addition, the CSRC makes use of on-site inspections as a regular tool for monitoring issuers.</p> <p><u>Licensed intermediaries and other regulated entities</u></p> <p>As further explained in Principles 24 and 31, the supervision of all types of intermediaries includes off-site monitoring and on-site inspections. Inspection programs are planned on both a national and a regional basis. See further under Principle 24 and 31.</p> <p>Securities and futures companies are also subject to monitoring and on-site inspections by the relevant SRO (SAC or CFA). Managers of private funds are subject to monitoring and on-site inspections by AMAC and the CSRC.</p> <p>The CSRC also has a supervisory program, including both off-site monitoring and on-site inspections for auditors of listed entities (see under Principle 19) and for CRAs (see under Principle 22). Research reports on securities is mostly provided by securities companies and subject to inspection through the inspection programs for such companies (see under Principle 23).</p> <p>Supervision of markets</p>

The exchanges are responsible for front line supervision of markets, and the way they carry out this role is described under Principle 34 and 36.

Mechanisms to detect and investigate insider trading and other forms of market abuse

The automated systems used by the exchanges have been designed to allow them to conduct real-time surveillance for purposes of ensuring an orderly market, and ex-post analysis aimed at identifying potential instances of market misconduct. In the last year, the stock exchanges reported approximately 370 cases of suspect market conduct to the CSRC. See further under Principles 34 and 36.

Reconstruction of execution and trading

Exchange systems allow reconstruction of all order and trading activity, including the course of trading that led up to suspect trading activity. The real-name system that applies to both securities and futures activity enables these systems to monitor trading activity and the identity of the investor on whose behalf trades are executed.

Intelligence and investor complaints

The CSRC's Enforcement Bureau has a Clue Processing Center that is responsible for collecting, analyzing, and processing clues to violations of securities and futures laws and regulations. In 2014, the CSRC set up an Informant Center responsible for accepting and processing whistle-blowing reports that may serve as clues for investigations.

Whistleblowing reports not suitable as clues in enforcement investigations are forwarded to the Investor Protection Bureau of CSRC, which in turn forwards them to the appropriate CSRC Department. The Anti-Market Misconduct Bureau collaborates with six other authorities including the public security authority to respond to illegal securities and futures businesses.

Petitions, whistleblowing reports, and complaints sent to CSRC are chiefly handled by three departments: the General Office, the Enforcement Bureau, and the Investor Protection Bureau. Whistleblowing involving allegations of misconduct go to the Enforcement Bureau, which makes a decision at its regular meetings whether to open an investigation.

Enforcement

As of July 2016, the CSRC had a total of 640 enforcement staff, including 36 in the Enforcement Bureau, 145 in the Enforcement Task Force, 459 in regional offices (including 63 in Shanghai Commissioner Office and 60 in Shenzhen Commissioner Office). These resources are supplemented by staff of the Securities Crimes Investigation Bureau (SCIB, part of the Ministry of Public Security) located in CSRC offices (30 in the CSRC's central office and 120 in the three largest regional offices). On the role that SCIB plays, see below.

CSRC investigations and sanctions

CSRC formulates an annual enforcement plan. The plan is based on a year-end review aimed at identifying areas where misconduct is common and enforcement attention is needed. On this basis, plans are made for targeted enforcement campaigns. For example, in 2015 the CSRC carried out 8 rounds of thematic enforcement campaigns focused on, among other things, market abuse involving new types of market manipulation, fabricating and spreading misinformation, unlicensed securities brokerage business, disclosure violations in IPO and change of control transactions, and violations common on the NEEQ market. These investigations resulted in a total of 120 major cases, of which 12 were transferred to the police, 71 were transferred for administrative penalties, and 5 for parallel investigations by both administrative and criminal authorities.

	<p>Enforcement Bureau clues come mainly from referrals from the exchanges (about two thirds of all cases) and from referrals from the CSRC's supervision departments (about 20 per cent).</p> <p>When analyzing clues, the Enforcement Bureau could take several different actions. It could keep it on file in cases with unclear facts and no obvious signs of violations; refer to functional departments or regional offices, sometimes suggesting regulatory measures, if the violation is not severe or falls into the scope of day-to-day supervision; start a preliminary investigation if there is indication of violation but further verification is needed or if the case involves violation of information disclosure obligation; or start a formal investigation if the facts are clear and there is clear indication of violations.</p> <p>In 2015, the Enforcement Bureau accepted 723 valid clues to illegal activities and misconduct, and launched new investigations on 345 cases (an increase of 68% from 2014). CSRC also imposed international travel restrictions on 288 suspected wrongdoers; froze RMB 3.751 billion of funds involved in those cases; and referred, reviewed, or imposed sanctions with respect to 273 cases. At the time of the assessment, there were 430 enforcement cases in the preliminary investigation stage, with a further 25 not yet commenced.</p> <p>For breaches of the legislation or SRO rules, there are three layers of enforcement measures available: disciplinary measures imposed by the SROs; administrative measures imposed by the CSRC; and administrative sanctions imposed by the CSRC.</p> <ul style="list-style-type: none"> • Disciplinary measures are imposed on SRO members. • Regulatory measures are imposed on regulated entities, and can be directly imposed by the functional departments. Administrative sanctions are imposed on institutions and individuals and, depending on the severity of the misconduct, are decided on by the Administrative Sanctions Committee. <p>For details of the range of administrative measures and administrative sanctions available to the CSRC, and the process for imposing them, see under Principle 11.</p> <p>In 2015, the CSRC imposed administrative penalties or gave pre-notifications of administrative penalties to 767 institutions and individuals, with associated fines and disgorgements totaling over RMB 5.4 billion, more than 1.5 times the combined amount during the previous decade. It concluded 196 cases, imposed 177 administrative penalties, and made 11 market entry bans. Disgorgements and fines resulting from penalties amounted to RMB 1.1 billion, a 134 percent year-on-year increase. A total of 73 hearings were held.</p> <p>The data above does not reflect all enforcement actions taken by the CSRC. In particular, the data does not include regulatory measures. In general such measures have a remedial nature; however some of them (specifically the suspension of activities) could potentially send stronger signals to the market if they were to be published. In this regard, CSRC senior staff indicated that such type of measure has been used in connection with certain business conduct violations, such as mis-selling.</p> <p><i>Criminal investigations</i></p> <p>The investigation of criminal cases involving the securities industry is typically undertaken by local police under the guidance and coordination of SCIB as the body with specialist responsibility for these investigations, although local police can also independently investigate crimes that involve securities activity.</p>
--	---

Table. CSRC concluded administrative sanction cases

Type of Violation	FY 2013	FY 2014	FY 2015	FY 2016
Disclosure violation	23	36	47	44
Illegal share selling by company directors, supervisors, senior management and major shareholders				3
Insider trading	51	69	64	54
Market manipulation	8	15	18	24
Securities trading by securities practitioners				5
Short selling				
Other	4	43	67	59
Total	86	163	196	189

Source: CSRC.

Table. CSRC Penalties

Fiscal Year	Administrative Penalties (number)	Market Entry Bans (number)	Disgorgements and Fines (RMB million)
2013	79	21	728
2014	158	18	470
2015	177	11	1,100
2016	221	21	4,286
Total			

Source: CSRC.

The CSRC refers cases for investigation by SCIB if they meet criteria set out in publicly available standards. These standards set minimum materiality thresholds, and commonly include minimum monetary levels but use other criteria as well. For example, the thresholds for the referral of insider trading cases specify three alternative criteria: illegal proceeds of at least RMB 150,000; transaction size of at least RMB 500,000; or evidence of repeated conduct.

If the CSRC during the course of an investigation suspects that criminal conduct might be involved that meets referral criteria, it refers the case to SCIB. SCIB conducts an informal review to determine whether sufficient evidence might be available to sustain a criminal charge. If so, they follow the process set out in administrative procedures that apply to all referrals to public security authorities by administrative authorities. A joint meeting between SCIB and the CSRC's Enforcement Bureau and Administrative Sanctions Committee makes the decision on the formal referral of cases to SCIB. SCIB has broad powers to investigate criminal breaches of legislative requirements, such as the power to tap telephones.

SCIB also investigates cases referred by other authorities, cases it identifies on its own initiative, and cases resulting from complaints from individuals or media coverage. Typically, SCIB has around 1,000 cases under investigation. In the last 5 years, the CSRC has referred 300 cases. About two thirds of SCIB cases involve allegations of insider trading or front running ("rat trading"), with the remainder being related to market manipulation, information disclosure in IPOs or by listed companies, or the illegal operation of a securities business.

If at the end of an investigation SCIB considers that a prosecution can be mounted, it refers the case to the prosecutorial authorities. These authorities determine if the referral meets prosecution criteria. If it does not, the case is referred back to the CSRC for administrative sanctions.

In 2015-2016, the CSRC referred 129 clues to Public Security Authorities. Of these, 89 are still under investigation, 12 have had a judicial decision, and 7 are pending a court decision. Of the decided cases, there were 3 market manipulation cases (one of which resulted in imprisonment and 2 in suspended sentences or probation), 10 cases involving trading on non-public information, 9 cases of insider trading, and 1 case of illegal use of information.

Due to the time required to process criminal cases, it generally takes 350 to more than 1,000 days for a referral to result in a criminal judgment, depending on the nature of the case. Consequently, the referrals made in the period mentioned above will see a judgment in one to three years. Based on the court judgments that were issued during 2015-2016 for 23 securities and futures criminal cases and that are available to the CSRC, the principal offenders from 9 cases were sentenced to a combined 37 years in prison; those from 14 cases were sentenced to a term of probation. It is important to note, however that these numbers might not fully reflect the overall criminal court decisions on cases involving securities violations in China, since cases may come from other sources or not be readily known by the CSRC. CSRC senior staff highlighted that criminal authorities are increasingly devoting more attention to securities markets violations. In this regard to build specialization and competence, the Ministry of Public Security has named five economic crime units to centrally process securities and futures cases. Similarly, the Beijing Municipal People's Procuratorate has designated its Second Branch to handle securities and futures crimes and misconducts. And judicial authorities and administrative agencies, through arrangements aimed at creating specialized judicial forces, have further strengthened their stances on the handling of these cases. In this context, the number of cases that result in 5-6 years imprisonment is on the rise.

Illegal offerings of investment products

Pursuant to the Notice of the General Office of the State Council on Responding Forcefully to Illegal Offering of Stocks and Illegal Engagement in Securities Services (State Council General Office), investigation and punishment of illegal securities activity is the responsibility of the provincial government where the activity took place. Nonetheless, the CSRC works with provincial authorities to investigate illegal activities in the securities and futures markets. For example, in 2015, the CSRC regional offices conducted 340 reviews on clues associated with alleged illegal securities and futures activities, transferred 148 such clues to the police and issued 157 confirmations on the illegality of relevant activities to relevant authorities. The CSRC's Anti-Market Misconduct Bureau organizes and coordinates CSRC regional offices in investigating cases or clues of illegal stock offering and ensuring the timely transfer of suspected crimes to public securities authorities.

Assessment	Partly Implemented
Comments	<p>The main challenge affecting the grade refers to the effectiveness of enforcement as per KQ 9 of the Methodology; although the intensity of supervision should be kept under review as per KQ 1, as further explained below.</p> <p>Intensity of supervision</p> <p>KQ1 of the Methodology requires the implementation of an effective system of inspections. Two main issues have been considered for the grade: the intensity of the program for issuers and auditors and the intensity of the program for intermediaries.</p> <p><u>Monitoring program for issuers and information services providers</u></p> <p>The IOSCO Principles require the existence of mechanisms to ensure that issuers provide timely, accurate and complete information not just at the moment of an offering but on an ongoing basis. However, the Principles provide discretion as to the way to achieve such objectives. In general, in addition to the review of prospectuses, there is agreement on the need to develop programs for ongoing monitoring of issuers' compliance with their disclosure obligations, including the quality of financial disclosure. A key component of such programs is the review of periodic reports. In some large markets, such reviews are conducted under a risk-based approach, whereby the selection of the issuers whose reports would be subject to review is based on certain predefined risk criteria. In some cases, there is a requirement that some level of review be conducted of all issuers' reports during a fixed period of time; in such cases the risk-based approach is used to determine the cycle of review and/or the level of review. The appropriate overall balance is highly dependent on country context, including the market structure as well as the confidence that the authorities have in gatekeepers, particularly auditors, and the role that they play in ensuring that the financial information provided by issuers constitutes a fair representation of the financial situation of the company. That is why the Principles give prominent attention also to the oversight regime for auditors. Finally the "risk appetite" of the authorities (i.e. the level of "failures" that they are willing to accept) also influences the decision, although there should be an understanding that no system can deliver a zero-risk environment.</p> <p>In the context of China the assessors note the existence of both a program of the exchanges and a program of the CSRC of review of issuers' reports that complement each other. The exchanges' program focuses on ensuring that the market has timely, accurate and complete information about the issuer. The CSRC program focuses on the quality of financial information, by ensuring issuers' compliance with accounting standards. Both programs follow a risk-based approach. Overall, this approach is aligned with the practices described above. Together the level of coverage appears significant and the use of random sampling adds a prophylactic effect to the program. In addition, the CSRC has included on-site inspections of issuers both to review the quality of their internal controls and risk management as well as to check on specific issues identified. That said, although overall there is agreement that disclosure has improved, the assessors note that concerns remain about the quality of financial disclosure. As will be further discussed below such concerns might largely be a reflection of challenges related to enforcement. However, they raise the question of whether the CSRC should have a more intensive program for the review of periodic reports and in particular financial information in light of the market structure in China and the quality of auditors' work. This could be done by, for example, placing all issuers on a schedule for review of their periodic reports, while leaving the risk-based</p>

approach to determine the cycle and/or level of review. Thus the assessors recommend that the CSRC keeps the monitoring program of issuers, in particular financial disclosure, under review. In addition, as indicated under Principle 19, the assessors recommend that the inspection program for auditors be strengthened by making a more intensive use of comprehensive inspections.

Supervisory program for intermediaries

KQ 1 of the Methodology requires a system of supervision of intermediaries that makes use of inspections. However, the Methodology does not provide hard criteria to judge what the intensity of such a program should be. In general, there is agreement that on-site inspections are a critical component of a program for intermediaries' supervision, as certain aspects of their operation cannot be easily assessed off-site, such as the quality of their internal controls and risk management, many aspects of market and business conduct and the accuracy of reporting. Initially most programs focused on the inspection of individual firms (vertical approach). In large markets such inspections are usually delivered under a risk-based approach, both to determine the firms to inspect as well as the scope or focus of the inspections. In some cases, there is still a requirement that all firms be put on inspection cycle, and in those cases the risk-based approach is used to determine the frequency of the cycle as well as the scope of the inspections. However, increasingly thematic inspections (horizontal approach) are being used, whereby the same topic is assessed across a number of intermediaries. This recognizes the need to ensure that clusters of small risks across a number of intermediaries are not missed, which is otherwise possible when using a "pure" risk-based approach. What the right balance between these two types of inspections should be is highly dependent on country context (i.e. market structure) and the risk-appetite of the authorities, i.e. what level of "failures" they are willing to accept, understanding that no supervisory regime can deliver a zero-risk environment. For many securities markets there appears to be a case for a heavier reliance on thematic inspections, while reserving individual firms' inspections for the "riskier" intermediaries. Notwithstanding the above, there is a prophylactic effect from firms having the expectation that they would be subject to on-site inspections. In some countries such a prophylactic effect is brought to the system via the use of random sampling. In others, by putting all firms on schedule.

The CSRC current approach relies more heavily on thematic inspections for the supervision of intermediaries. The strategy allows the combination of "national" priorities, with the need to ensure also that the "local" context is taken into consideration via the mix of a national plan of inspections along with the plans developed by each regional office. The assessors also appreciate the fact that there is already an expectation that all firms should be inspected within a period of time, but that this has been challenging in practice, particularly for the offices that supervise the bulk of the intermediaries. Such offices have used both risk-based sampling and random sampling to determine the firms to include in their plans, the latter to bring a prophylactic effect to the program.

On balance, the assessors consider that such strategy is reasonable. However, the question is whether in light of the current market structure a more intense program of monitoring, in particular on-site inspections, might be required.

In principle a more intense level of supervision might be warranted for securities firms, given their more complex business models. This is in line with concerns in the market about the need to continue strengthening the internal controls and risk management of securities firms. Such additional intensity could be achieved in different ways. For example, by putting a segment of the population (based on a risk assessment) on a regular review schedule, along with strengthening of thematic inspections. In this context, the CSRC

should consider whether a more structured approach to the identification of themes could be implemented, potentially linked to the process for emerging risk identification. In addition, given the high presence of retail investors, distribution agents (including fund managers in the provision of this function) should also be closely monitored, in particular the implementation of suitability requirements. The assessors are aware that this is already an area of focus of the CSRC, for example, in the context of MFs (as noted in Principle 24) and of the OTC markets (as noted in Principle 33). Finally, as indicated under Principle 29, the intensity of the program for futures companies would need to be adjusted as the futures markets deepen. In such context, the authorities should consider whether a more systematic risk-assessment method should be applied also to futures companies. This same comment is valid also for fund managers.

The assessors recognize that the industry associations also carry out on-site inspections of their members and that their program adds to the overall intensity of supervision of regulated entities. Some industry associations such as the CFA have inspections programs intended to ensure coverage of all firms in a specified time (3 to 4 years). They also acknowledge the efforts made by the CSRC and the SROs to coordinate their supervision efforts, and to join resources to focus on key compliance areas. At the same time, as noted under Principle 9, the focus of industry associations is on compliance by their members with SRO rules rather than with legislative or CSRC rules.

Effectiveness of enforcement

KQ9 of the methodology requires the implementation of an effective enforcement program. Two issues have been considered for the grade: the effectiveness of CSRC enforcement and the effectiveness of criminal enforcement.

The ultimate objective of an enforcement framework is to improve the behavior of the market as a whole. Supervisory authorities should have at their disposal a wide variety of tools from corrective actions to sanctions, including criminal sanctions. There is no predetermined formula for deciding on the balance that needs to be struck between using remediation tools (such as rectification) and sanctions. Nonetheless, the use of appropriate and adequate sanctions is critical in sending messages to the market that poor behavior will not be tolerated. If a regulator relies heavily on remediation tools rather than sanctions, a regulated entity may defer adjusting its behavior until the regulator intervenes, in the knowledge that only at that stage will it need to change its practices and the message to other market participants may not be clear and effective. To be effective as a deterrent, sanctions, including monetary penalties need to be sufficiently large to act as disincentive to poor conduct and not to be treated as cost of doing business and the regulator needs to demonstrate that it is prepared to use these sanctions. Similarly, the threat of criminal sanctions, especially imprisonment, needs to be real and ever present if it is to have a significant deterrent effect. To achieve this, there needs to be coordination by all authorities, including the regulator, criminal investigation and prosecutorial authorities, and the judicial system, and a shared understanding of the importance that criminal sanctions play in the regulation of securities markets.

In the Chinese context, not all elements of an effective enforcement regime appear to be fully in place, as will be further discussed below.

Administrative enforcement

As noted in the description, the CSRC takes active steps to identify and investigate possible breaches of obligations under the regulatory regime, through its supervision activities and its enforcement activities. The issue for the assessment is whether, when non-compliance is established, the CSRC makes fully effective use of the powers it has to ensure that its

	<p>responses to misconduct send appropriate messages to the market about the consequences of poor behavior.</p> <p>The assessors note that in addition to the use of regulatory measures, the CSRC is increasingly taking a more vigorous approach to the use of administrative sanctions for market misconduct such as insider trading and for misconduct by listed companies or in the IPO process. Further, the sanctions applied in recent cases are larger, in some cases going up to the maximum amount permitted by the legal and regulatory framework. This is delivering a clearer signal to the market. As this more vigorous approach is recent, it requires time to take hold. Further it is important that the CSRC monitors that such an approach applies also to business conduct obligations such as mis-selling. That said, the CSRC is bound by the level of sanctions permitted by the law that, as explained under Principle 11, are low for some specific misconduct and thus can lessen the ultimate deterrent effect of CSRC's enforcement program.</p> <p><i>Criminal enforcement</i></p> <p>The assessors have material concerns about the level of criminal enforcement and the level of sanctions imposed. In principle the number of criminal sanctions imposed as detailed above appears low in a market as large as that in China. Furthermore, even when convictions take place, probation has been awarded in many cases. These factors detract from the deterrent effect of criminal penalties.</p> <p>However, as highlighted by the authorities, the assessors note recent actions by the criminal authorities to give more emphasis to this type of violations and by the judiciary to increase the penalties imposed. These actions need to continue to take hold to have a long lasting impact on market participants' behavior.</p> <p><i>Final considerations</i></p> <p>The assessors recognize that many of these limitations are outside the control of the CSRC and are a result of the legislation and judicial practices. Strengthening the legal framework would help to address some of these limitations. The assessors encourage the authorities to continuously monitor their approach to enforcement, to ensure that the right mix of tools is used. Finally, the authorities should work with the Government and prosecutorial authorities to identify and remove obstacles to effective use of the criminal law in the securities markets. In this context the assessors note for example, the constitution in some provinces of dedicated task forces that are bringing much needed focus to criminal enforcement.</p>
Principles for Cooperation in Regulation	
Principle 13	The regulator should have authority to share both public and nonpublic information with domestic and foreign counterparts.
Description	<p>Domestic information sharing and cooperation</p> <p>Article 185 of the Securities Law requires CSRC and other domestic financial regulatory authorities under the SC to establish mechanisms for sharing regulatory and supervisory information and provides that other governmental departments must support CSRC in carrying out supervisory inspections and investigations. Similarly, Article 63 of the Regulations on the Administration of Futures Trading requires the CSRC to establish mechanisms for information sharing with related governmental departments. Neither the Law nor the Regulations require the CSRC to have the approval of any other body to</p>

	<p>establish such mechanisms, nor limit the type of information that the CSRC can share. Accordingly the CSRC can share information on all the areas mentioned in the IOSCO methodology, including (i) matters of investigation and enforcement; (ii) determinations in connection with licensing and authorization; (iii) surveillance; (iv) market conditions and events; (v) client identification, including beneficial ownership information; (vi) regulated entities; and (vii) listed companies and companies seeking listing.</p> <p>International information sharing and cooperation</p> <p>Article 179 of the Securities Law and Article 66 of the Regulations on the Administration of Futures Trading allow the CSRC to establish arrangements with foreign securities and futures regulators for supervisory cooperation in relation to cross-border matters.</p> <p>Neither the Law nor the Regulations require the CSRC to have the approval of any other body to establish such mechanisms, nor limit the type of information that the CSRC can share. Accordingly the CSRC can share information on all the areas mentioned in the IOSCO methodology, including: (i) matters of investigation and enforcement; (ii) determinations in connection with licensing and authorization; (iii) surveillance; (iv) market conditions and events; (v) client identification, including beneficial ownership information; (vi) regulated entities; and (vii) listed companies and companies seeking listing.</p> <p>As per such provisions, the CSRC is also not prohibited from sharing information if there is no MOU in place, but in practice the CSRC has preferred to establish such an arrangement so that there are clear procedures and expectations concerning the use of the information.</p> <p>Unsolicited information</p> <p>The CSRC can provide information to domestic and foreign regulators on an unsolicited basis pursuant to the provisions mentioned above.</p> <p>No requirement for breach of domestic laws</p> <p>The Securities Law and the Regulations on the Administration of Futures Trading do not require “dual illegality” for CSRC to share information with its foreign counterparts. Accordingly, the CSRC can share information with another signatory even if the alleged conduct does not constitute a breach of the laws in China if conducted within China.</p> <p>Bank and brokerage accounts information</p> <p>As explained in Principle 11, the CSRC has the power to obtain information and records identifying the person or persons beneficially owning or controlling bank accounts related to securities and derivatives transactions and brokerage accounts as well as the information necessary to reconstruct a transaction, including bank records.</p> <p>Pursuant to article 180 of the Securities Law and article 47 of the Regulations for the Administration of Futures Trading in connection with article 179 of the Securities Law and article 66 of the same Regulations, the CSRC can share such information with domestic and foreign regulators.</p> <p>Confidentiality</p> <p>See description under Principle 14.</p>
Assessment	Fully Implemented
Comments	IOSCO has made a determination that the Chinese legal framework for international

	cooperation meets the requirements of the IOSCO MMoU.
Principle 14	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>Power to enter into information sharing arrangements</p> <p>Pursuant to Article 185 of the <i>Securities Law</i> and Article 63 of the <i>Regulations on the Administration of Futures Trading</i> the CSRC may establish information sharing mechanisms with other financial regulatory authorities under the SC.</p> <p>Separately, the CSRC is empowered by Articles 179 of the <i>Securities Law</i> and Article 66 of the <i>Regulations on the Administration of Futures Trading</i> to establish arrangements with foreign securities and futures regulators for supervisory cooperation in relation to cross-border matters.</p> <p>Information sharing mechanisms</p> <p>Domestic</p> <p>The CSRC has established several mechanisms to coordinate with other domestic regulators, which include: (i) the FCGR for identification of systemic risk; (ii) the JMC, which serves as a channel to coordinate on policy issues that have a cross-sectoral impact; and (iii) the JMC for bonds, which serves as a channel for the regulators of the bond markets to discuss developments in this market. There is also a MoU among the three Commissions, which provides a basic framework for coordination and cooperation, including exchanges of information. All these mechanisms have been explained in Principle 1. In addition, as explained in Principle 6 based on recent agreements there is regular sharing of information on bond markets among the three financial authorities responsible for the regulation of these markets (CSRC, PBoC and NDRC), and on asset management, the latter between the CSRC and the CBRC.</p> <p>Finally, the authorities have provided evidence that upon request they have provided information pertaining activities of regulated entities in the markets. A recent case involved discussions concerning the participation of insurance companies in the equity markets.</p> <p>International</p> <p>The CSRC has been a full signatory to the IOSCO MMOU since April 2007. In addition, it has signed 63 bilateral MOUs on regulatory cooperation with regulators from 58 countries and regions including the US, UK and Hong Kong. Pursuant to these arrangements the CSRC is able to and does exchange public and non-public information with foreign regulators to facilitate regulatory and supervisory functions. Both the IOSCO MMOU and bilateral MOUs signed by the CSRC cover the detection and deterrence of cross-border misconduct and the discharge of licensing and surveillance responsibilities.</p> <p>Information shared pursuant to the MMOU may be used for enforcement and regulatory purposes and does not require any approval apart from that of the CSRC. Where non-public information is required for judicial assistance between two countries, such as for use in criminal proceedings, such assistance must be provided through judicial assistance channels.</p> <p>Confidentiality</p> <p>CSRC</p>

The CSRC has in place legislative requirements and procedures to preserve the confidentiality of the information it receives for its use.

Article 9 of the *Law of the PRC on Guarding State Secrets and the Regulations on the Disclosure of Government Information ("State Secrets Law")* provides that state secrets include classified information from diplomatic activities and foreign affairs and information to be kept confidential as a commitment to foreign countries. More specifically, the *Rules on the Scope of State Secrets in the Regulation of Securities and Futures* stipulates that any information or document that is connected to a bilateral cooperation program for the regulation of securities and futures that has major impact on the securities and futures market constitutes a state secret.

Article 182 of the *Securities Law* prohibits CSRC staff from disclosing any trade secrets of entities and individuals that they have access to in the performance of their duty. Articles 59 and 63 of the *Regulations on the Administration of Futures Trading* provide that the CSRC is obligated to keep confidential the materials provided to CSRC. CSRC Staff must safeguard state secrets and trade secrets [that come to their knowledge in the course of conducting their duties].

Besides the legislative provisions, CSRC staff is also required to maintain the confidentiality of information they obtain or provide in the course of their duties under confidentiality rules in the *Code of Conduct for the Staff of the China Securities Regulatory Commission*.

Other regulators

For information transmitted by the CSRC to other authorities, the relevant MOUs provide that the non-public information is provided on the basis that its confidentiality will be preserved.

Practice

The Department of International Affairs (Office of Hong Kong, Macao and Taiwan Affairs) at the CSRC handles and acts as the liaison for requests for assistance from overseas regulators.

Requests are divided in two types:

- Enforcement/investigation related: in this case the requests are transferred to the enforcement bureau, which in turn asks the assistance of the regional offices to gather the information.
- Regulatory information (licensing/compliance information): in this case the request is transferred to the relevant functional department.

In both cases, internal approval is needed to remit the information. In the case of regulatory information such approval takes place at the level of the international affairs department. In investigation cases, the approval is done at the level of the office of the chairman. CSRC staff indicated that in both cases the approval is a formal step (an internal notification), and in no case a request has been denied or information not submitted.

If the information requested may be used for judicial proceedings, the request would be referred to the Enforcement Bureau and in parallel notified to the Ministry of Justice (MoJ). After the information is obtained, the CSRC would request the opinion of the MoJ. This process is followed because of the existence of separate instruments for the provision of judicial assistance, and thus the need to ensure proper coordination. In these cases there is also consultation with the Ministry of Foreign Affairs (MoFA). CSRC staff indicated that in

	<p>general the MoFA has not had objections to judicial assistance.</p> <p>From 1 January 2007 to 30 June 2016, the CSRC handled 697 requests for investigation assistance under the IOSCO MMOU and the bilateral MOUs of which 639 responses have been completed. By far the largest number of requests came from the Hong Kong Securities and Futures Commission: there were 547 during this period.</p> <p>In general, the CSRC honors request for regulatory information within a 1-2 month period; requests for assistance within a 2-3 month period; requests for information for litigation purposes (i.e. civil or criminal proceedings) within a 4-5 month period; and requests to obtain audit working papers within an average of 6.5 months. CSRC indicated that the main challenge for cooperation concerning enforcement information is sometimes locating the actual person(s) from whom information is required, given the size of the country.</p> <p>While the CSRC has mostly been providing assistance and information to overseas regulators, with the businesses of China-listed companies becoming more international in nature and the establishment of the Shanghai-Hong Stock Connect, the CSRC has seen an increasing need to request assistance from overseas regulators and has made use of the IOSCO MMOU and the bilateral MOUs for this purpose. In particular, cooperation has intensified with the HK SFC for enforcement purposes, including for purposes of investigating market manipulation (for example during 2016 20 requests for information were submitted).</p>
Assessment	Fully Implemented
Comments	<p>The assessors note that in connection with domestic cooperation, the Principles require that the regulatory authority (i) has the power to enter into information sharing mechanisms and that it (ii) can demonstrate that it provides information when requested. Such requirements have been met. That said, as explained in Principles 1 and 6, it is critical that the authorities continue to work on enhancing their cooperation and information arrangements particularly for purposes of systemic risk identification, so that a set of information is provided on a regular basis. These issues have been discussed and taken into consideration for the grades of Principles 1 and 6.</p> <p>In regard to international cooperation the evidence provided indicates that the CSRC has cooperated with foreign regulators both through the IOSCO MMoU and bilateral MoUs. It also indicates that internal procedures have not prevented it from cooperating. That said, it is critical that the CSRC works towards shortening its response times. This in turn might require that it be given additional resources.</p>
Principle 15	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>Assistance to foreign regulators</p> <p>As indicated in Principle 11, articles 180 of the Securities Laws, 113 of the Fund Law and 48 of the Regulations for the Administration of Futures Trading provide the CSRC with broad investigative powers. As per such powers it can obtain:</p> <ul style="list-style-type: none"> • Contemporaneous records sufficient to reconstruct all securities and derivatives transactions, including records of all funds and assets transferred into and out of bank and brokerage accounts relating to those transactions

- Records of securities and derivatives transactions that (i) identify the client (i.e., name of the account holder and the person authorized to transact business); (ii) the amount purchased or sold; (iii) the time of the transaction; (iv) the price of the transaction; and (v) the individual and the bank or broker and brokerage house that handled the transaction.
- Information located in its jurisdiction identifying persons who beneficially own or control non-natural persons organized in its jurisdiction.

The provisions stated above explicitly state that the CSRC can use all of its powers to fulfill its functions and duties. Pursuant to article 185 of the *Securities Law* and Article 63 of the *Regulations on the Administration of Futures Trading* one of such functions is collaborating with foreign regulators. Such provisions do not contain any limitation on the type of information that can be provided to foreign regulators. As a result, the CSRC can share both public and non-public information, whether in its possession or obtained through exercise of its authority.

The relevant authorities in China are able to provide assistance in respect of judicial matters in accordance with international conventions to which China is a party.

The CSRC has a power to freeze certain assets by its own administrative order in certain circumstances, where the assets relate to an alleged violation of the *Securities Law* and it appears that they may be concealed, moved or dissipated.

No requirement for independent interest

Given the broad powers to cooperate and share information provided by the Securities Law and the Regulations for the Administration of Futures Trading, the CSRC is able to provide assistance to foreign regulators for purposes related to the due administration of securities and futures regulation and enforcement, including enforcement action with respect to insider trading, market manipulation and other violations, the registration and issuance of securities, the regulation of market intermediaries and CIS, and the regulation of markets, exchanges and clearing and settlement agencies. Further, neither the *Securities Law* nor the *Regulations on the Administration of Futures Trading* require the alleged conduct to constitute a breach of Chinese law if conducted in China in order for the CSRC to share information. Accordingly, the CSRC is able to share information with another MoU signatory regardless of whether the CSRC has an independent interest in the matter.

Information on regulatory processes

Information on the regulatory processes and legislation within China is publicly available through the CSRC website and publications.

The CSRC is required under Article 184 of the *Securities Law* to make public the rules and regulations and supervisory work procedures formulated by the CSRC, as well as decisions on penalties imposed for violations of securities laws.

Under Article 47 and 48 of the *Provisions of the China Securities Regulatory Commission on the Procedures for Implementation of Administrative Licensing*, the CSRC is required to publish information regarding its licensing processes, including the criteria for licensing and procedures for license applications. The CSRC is also required under Article 50 of the *Provisions* to publish its decisions on licensing applications unless it involves state secrets, trade secrets or personal privacy.

Financial conglomerates

	<p>Depending on the principal line of business of its financial holding company, a financial conglomerate may be supervised by the CBRC, CSRC or CIRC. The CSRC can share information on conglomerates within its regulatory responsibility, i.e., securities and futures companies, fund companies, stock and futures exchanges and related clearing institutions. Where the regulatory responsibility lies with the CBRC or CIRC, the CSRC can request information about that financial conglomerate from the relevant agency and provide it to the foreign regulator on condition that the confidentiality of the information is maintained.</p> <p>Practice</p> <p>A significant portion of the requests received by the CSRC for cooperation relate to enforcement investigations and require the CSRC to collect information that is not currently in its files. As indicated under Principle 14, the CSRC has answered such requests within a period that varies depending on the nature of the assistance requested from 1-2 months to an average of 6.5 months, the latter where audit working papers are required to be obtained from audit firms. There have been 7 requests for audit working papers emanating from HK and 11 from other jurisdictions. All such requests have been honored. CSRC staff indicated that one of the factors that impacts the time necessary to honor requests is the size of the country which pose challenges to locating persons from whom information is being requested.</p> <p>There have not been requests for assistance in obtaining a court order or urgent injunctions. While there have been some requests related to financial conglomerates, they have mainly involved registration information, punishment record and integrity records of the relevant management staff.</p>
Assessment	Fully Implemented
Comments	<p>The evidence indicates that the CSRC has provided cooperation to foreign counterparties by collecting information on their behalf. That said, as indicated in Principle 14, it is critical that the CSRC works towards shortening its response times. This in turn might require that it be given additional personnel.</p> <p>In addition, as mentioned under Principle 11, in anticipation of the enhanced MMoU, the authorities are encouraged to strengthen the authority of the CSRC to compel information from third parties, including telephone and internet service providers, to review whether changes are needed to current provisions regarding the freeze of assets, and to ensure that all these powers can also be used in the context of requests for cooperation from foreign regulators.</p>
Principles for Issuers	
Principle 16	There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors' decisions.
Description	<p>CSRC regime</p> <p>Public offerings and listings of securities are regulated under Chapters II and III of the <i>Securities Law</i>, various departmental rules, measures and standards issued by CSRC, and the listing rules of the exchanges.</p> <p>China has adopted a merit-based system of regulation of public offerings. Article 10 of the</p>

Securities Law requires all public offerings of securities to be reported to the CSRC for examination and approval prior to the offering and provides that no entity or individual may make a public offering of any securities without the examination and approval. The criteria and requirements for approval are set out in Articles 13 and 16 of the *Securities Law* and in various departmental rules promulgated by the CSRC.³

The following are deemed to be public offerings:

- Offerings of securities made to unidentified offerees.
- Offerings of securities made cumulatively to more than 200 identified offerees.
- Offerings of securities prescribed by law or administrative regulation as public offerings.

Pursuant to article 39 of the *Securities Law*, all shares, corporate bonds and other securities that have been publicly issued are required under Article 39 of the *Securities Law* to be listed on a stock exchange or other venues authorized for securities trading by the SC. Currently, shares of public offering can be listed in the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZE).

Bonds offered to the general public (i.e. all investors including retail investors) are referred as the "big public offering" and must be "AAA' rated. Bonds offered publicly to qualified investors only are "small public offerings" and also need to be rated, although there is not a minimum requirement for the rating, Both regimes are considered public offerings under the Chinese framework and therefore can be addressed to more than 200 investors but in the latter case all of them must be qualified. Both observe the same disclosure requirements

In practice most of the companies choose the "small public offering" regime. As a result, the proportion of retail investors in the corporate bond market is very small (less than 1%). The market is predominantly institutional.

Disclosure requirements

Issuers of publicly offered shares, convertible bonds, and corporate bonds are subject to disclosure and reporting requirements consisting of: a prospectus at the moment of the offering, annual and semi-annual reporting and material events disclosure. In addition equity issuers must submit quarterly reports.

Disclosure for public offerings of securities

Shares

Under Articles 12 and 14 of the *Securities Law*, an application for CSRC's approval of a public offering of shares must be submitted together with the stipulated application documents, including a prospectus.

There is also a requirement under Article 85 of the *Companies Law* that a promoter making a public offering of shares for establishing a joint stock limited company must publish a prospectus. Similarly, Article 134 of the *Companies Law* requires a company making a public offering of new shares to publish a prospectus and its financial reports.

³ See Chapter 2 of the *IPO Measures*, Chapter 2 of the *GEB IPO Measures*, Chapter 2 of the *Securities Issuance Measures*, Chapter 2 of the *Securities Issuance Measures for GEB* and Articles 17 and 18 of the *Corporate Bonds Measures*.

	<p>For initial public offerings of securities that are to be listed on a stock exchange or on the GEB, the <i>Measures for the Administration of Initial Public Offerings and Listing of Shares ("IPO Measures")</i> and the <i>Interim Measures for the Administration of Initial Public Offerings and Listing of Shares on the Growth Enterprise Board ("GEB IPO Measures")</i> require the issuer to publish a prospectus prepared in accordance with requirements set by the CSRC.⁴ The information disclosed in the prospectus must, at a minimum, conform with requirements as to form and content stipulated in the relevant disclosure standards⁵ issued by the CSRC. These disclosure standards require the prospectus to include, <i>inter alia</i>, information about the offering, risk factors, information about the issuer, its business and its management, its competitors and related party transactions, its financial statements, management discussion and analysis, and the intended use of the proceeds from the offering. Regardless of whether there is any specific requirement in the disclosure standards, information that would have a material influence on an investor's investment decision must be disclosed.⁶ The prospectus is effective for six months from the date on which it was last signed by the issuer's directors, supervisors and senior management personnel. Financial statements disclosed in a prospectus must not be more than six months old as at the date of issuance of the prospectus. Under special circumstances the issuer may apply for an extension of up to one month.⁷</p> <p>For secondary public offerings of shares or convertible bonds by listed companies, the <i>Measures for the Administration of Issuance of Securities by Listed Companies ("Securities Issuance Measures")</i> or the <i>Interim Measures for the Administration of Issuance of Securities by GEB Listed Companies ("Securities Issuance Measures for GEB")</i> require the listed company to publish a prospectus in the same terms explained above.</p> <p><u>Corporate bonds</u></p> <p>Article 154 of the <i>Companies Law</i> requires a company offering bonds to publish a prospectus. The <i>Measures for the Administration of Issuance and Trading of Corporate Bonds ("Corporate Bonds Measures")</i> also requires a corporate bond issuer to publish a prospectus in accordance with stipulated requirements.⁸ The required content and form of the prospectus are stipulated in the relevant disclosure standards issued by CSRC.⁹ The disclosure standards require the prospectus to include, <i>inter alia</i>, information about the offering and the issuer, risk factors, credit rating of the bond, financial statements, the intended use of the proceeds and information about the bond trustee. Regardless of whether there is any specific requirement in the disclosure standards, information that would have a material influence on an investor's investment decision must be disclosed.¹⁰</p> <p>The prospectus is effective for six months from the date on which it was last signed by the issuer's directors, supervisors and senior management personnel.¹¹ Financial statements disclosed in a prospectus must not be more than six months old as at the date of issuance</p>
--	---

⁴ See Article 53 of the *IPO Measures* and Article 32 of the *GEB IPO Measures*.

⁵ See *Disclosure Standards No. 1 – Prospectus* and *Disclosure Standards No. 28 – Prospectus of GEB-Listed Companies*.

⁶ See Article 54 of the *IPO Measures* and Article 33 of the *GEB IPO Measures*.

⁷ See Articles 56 and 57 of the *IPO Measures* and Articles 38 and 39 of the *GEB IPO Measures*.

⁸ See Article 43 of the *Corporate Bonds Measures*.

⁹ See *Disclosure Standards No. 23 – Prospectus for Public Offerings of Corporate Bonds*.

¹⁰ See Article 3 of the *Disclosure Standards No. 23 – Prospectus for Public Offerings of Corporate Bonds*

¹¹ See Article 22 of the *Corporate Bonds Measures*.

of the prospectus. Under special circumstances the issuer may apply for an extension of up to one month.¹²

Distribution of prospectuses

Under Article 21 of the *Securities Law*, where an issuer has submitted an application for approval to make an initial public offering of shares, it is required to disclose the application documents in advance in accordance with requirements set by the CSRC. The *Measures for the Administration of Information Disclosure by Listed Companies* ("*Information Disclosure Measures*") further provide that after CSRC has accepted an application for approval of a public offering of shares but before the application is reviewed by the Public Offering Review Committee, the issuer must disclose in advance its draft prospectus on the CSRC's official website.¹³ There are similar requirements in the *IPO Measures* and the *GEB IPO Measures* applicable to public offerings of shares that are to be listed on a stock exchange or the GEB respectively. Under these two *Measures*, the issuer may, in addition, publish the same version of the draft prospectus on its company website no earlier than publication on the CSRC's website.¹⁴

Where the CSRC has approved a public offering of securities, the issuer is required under Article 25 of the *Securities Law* to publish the relevant prospectus before making the public offering and must make the documents available for public reference at a designated place. Article 64 of the *Securities Law* requires the prospectus for a public offering of shares or corporate bonds to be published. The *Information Disclosure Measures* also require an issuer to publish the prospectus for its public offering before making the offering.¹⁵

For initial public offerings of shares that are to be listed on a stock exchange, the *IPO Measures* require the issuer to publish an extract of its prospectus on at least one CSRC-designated newspaper or magazine and post the full text of its prospectus on a CSRC-designated website. The issuer is also required to make the prospectus available for public perusal at its office and the offices of the exchange on which it will be listed, the sponsor and the underwriters for the offering.¹⁶ An issuer of shares to be listed on the GEB is required under the *GEB IPO Measures* to publish its prospectus on a CSRC-designated website and, at the same time, publish a notification in a CSRC-designated newspaper or magazine to inform the public of the website's address and any other means of accessing the prospectus. The issuer must also publish the prospectus on its own website but no earlier than publication on the CSRC-designated website and print media.

For a public offering of shares or convertible bonds by a listed company, the *Securities Issuance Measures* and the *Securities Issuance Measures for GEB* require the listed company to publish its prospectus on a CSRC-designated website and make the prospectus available for public perusal at CSRC-designated venues. Where the company is listed on a stock exchange, it is also required to publish an extract of the prospectus in at least one CSRC-designated newspaper or magazine. Whether the company is listed on a stock exchange or the GEB, it may, in addition, publish the prospectus on other websites no earlier than the publication on the CSRC-designated website and print media.

¹² See Article 47 of the *Disclosure Standards No. 23 – Prospectus for Public Offerings of Corporate Bonds*.

¹³ See Article 13 of the *Information Disclosure Measures*.

¹⁴ See Article 40 of the *IPO Measures* and Article 58 of the *GEB IPO Measures*.

¹⁵ See Article 11 of the *Information Disclosure Measures*.

¹⁶ See Article 62 of the *IPO Measures*.

	<p>The <i>Corporate Bonds Measures</i> require issuers of corporate bonds to publish all required information disclosures (including prospectuses) on the website of the venue on which the bonds will be traded. The information must also be published in at least one newspaper or magazine designated by CSRC.¹⁷ This rule requires the prospectus to be published before the offering.</p> <p><u><i>Advertising outside the prospectus</i></u></p> <p>During the period between the acceptance of a public offering application and its approval by the CSRC, the issuer and any party connected to the public offering are not allowed to promote the public offering through advertising, presentations or other means. When promotion is permitted, neither the issuer nor any of the said parties may exaggerate the merit of the offering or use fraudulent advertising or other illegitimate means to sway or mislead investors, nor may they disclose any information about the issuer other than those already made public by the prospectus or otherwise.¹⁸</p> <p><i>Periodic reports</i></p> <p>Requirements relating to periodic reports are set out in Chapter III Section 3 of the <i>Securities Law</i>, and various departmental rules, measures and standards issued by the CSRC and the listing rules of the exchanges.</p> <p><u><i>Annual reports</i></u></p> <p>Under Article 66 of the <i>Securities Law</i>, listed companies and companies whose bonds are listed for trading must publish an annual report within four months following the end of each financial year. Such provision establishes a basic content for the annual reports, which is further detail in the <i>Information Disclosure Measures</i>¹⁹. Pursuant to such Measures the annual report must include the following:</p> <ol style="list-style-type: none"> (1) Information on the fundamentals of the company; (2) Major accounting data and financial indicators; (3) Information on the issuance of and changes to the shares and bonds of the company, including the total value of shares and bonds, the total number of shareholders and the number of shares held by each of the ten largest shareholders as at the end of the reporting period; (4) Information regarding the persons who hold 5% or more of the shares of the company, the company's controlling shareholders and <i>de facto</i> controllers; (5) Information on the engagement or employment status of directors, supervisors and senior managers, changes to their shareholdings and their annual compensation; (6) Board of directors' report; (7) Management's discussions and analyses; (8) Information on material events during the reporting period and their impact on the company; (9) Full text of the financial statements and audit report; and
--	--

¹⁷ See Article 47 of the *Corporate Bonds Measures*.

¹⁸ See Articles 29 and 31 of the *Measures for the Administration of the Offering and Underwriting of Securities* and Article 40 of the *Corporate Bonds Measures*.

¹⁹ See Article 21 of the *Information Disclosure Measures*.

(10)	<p>Other information stipulated by the CSRC.</p> <p>More detailed rules regarding the contents and format of companies' annual reports can be found in disclosure standards²⁰ issued by the CSRC.</p> <p>Apart from the above, the <i>Information Disclosure Measures</i>²¹ require the annual report to disclose all information that would have a major influence on investors' investment decisions.</p> <p>Issuers of corporate bonds that are listed on either of the two stock exchanges are also required under the respective listing rules of the stock exchanges to publish an annual report within four months following the end of each financial year. The report must include the following information:</p> <p>Information on the general situation of the issuer;</p> <p>Audited financial statements for the financial year;</p> <p>Information on outstanding bonds of the issuer and changes therein, including the situation on the use of proceeds from the bond issues, follow-up credit rating situation, credit enhancements and changes therein, bond repayment and interest payment situation, situation on execution of guarantees for repayment, whether there is any risk of default, situation on bond holders' meetings in the period if any, etc.</p> <p>Conflicts of interest faced by trustee and mitigation measures, if any;</p> <p>Information on any major litigation that the issuer may be involved in or any other events that would have a major impact on the timely payment of the bond; and</p> <p>Any other information required by the law, administrative regulations, rules or as required by the exchange.²²</p> <p><u><i>Semi-annual reports</i></u></p> <p>A listed company or a company whose bonds are listed for trading is required under Article 65 of the <i>Securities Law</i> to publish a semi-annual report within two months following the end of the first half of its financial year. The information required to be included in the semi-annual report is stipulated in Article 65 and in the <i>Information Disclosure Measures</i>²³. The <i>Corporate Bonds Measures</i> prescribe that the issuer of corporate bonds offered to the public must, until maturity of the bonds, issue semi-annual reports.²⁴ More detailed contents and format requirements are found in disclosure standards²⁵ issued by the CSRC.</p> <p>Among other things, the semi-annual report must include financial statements of the company for the relevant period although they need not be audited.</p> <p>An issuer of corporate and enterprise bonds that are listed on either of the two exchanges is also required under the respective listing rules of the stock exchanges to publish a semi-</p>
------	---

²⁰ See *Disclosure Standards No. 2 – Annual Report* and *Disclosure Standards No. 38 – Annual Report for Corporate Bonds*.

²¹ See Article 19 of the *Information Disclosure Measures*.

²² See Chapter 3, Section 2 of the Shanghai Stock Exchange Corporate Bonds Listing Rules and Chapter 4, Section 2 of the Shenzhen Stock Exchange Corporate Bonds Listing Rules.

²³ See Article 22 of the *Information Disclosure Measures*.

²⁴ See Article 43 of the *Corporate Bonds Measures*.

²⁵ See *Disclosure Standards No. 3 – Semi-Annual Report*, *Disclosure Standards No. 31 – Semi-Annual Report of GEB-Listed Companies*, and *Disclosure Standards No. 39 – Semi-Annual Report for Corporate Bonds*.

	<p>annual report within two months following the end of the first half of its financial year. The report must include financial information for the first-half financial year and the other information as required in the annual report.²⁶</p> <p><u>Quarterly reports</u></p> <p>Quarterly reports are required to be published within one month following the end of the third and ninth months of the financial year of a listed company. This requirement and other detailed rules on the contents and format of quarterly reports are spelled out in the <i>Information Disclosure Measures</i>²⁷ and other departmental rules²⁸ issued by the CSRC. The quarterly report must include key accounting data and financial indicators of the company for the relevant period that need not be audited.²⁹</p> <p>Corporate bond issuers that are not listed companies are not required to publish quarterly reports.</p> <p>Disclosure of material events</p> <p>On the occurrence of a major event that may have a considerable impact on the share price of a listed company, Article 67 of the <i>Securities Law</i> requires the company to immediately submit an ad hoc report on the event to the CSRC and the stock exchange and disclose the same to the public, explaining its causes, its current status and possible legal consequences. This provision includes a list of material events and states that such list can be expanded by the CSRC. The <i>Information Disclosure Measures</i> provides an extensive but non-exclusive list of material events, along with indications of the timeframe for disclosure.³⁰</p> <p>Any issuer that has publicly offered corporate bonds must, in accordance with Article 45 of the <i>Corporate Bonds Measures</i>, disclose in a timely manner, the major events that, having occurred before the bonds reach maturity, may impact the solvency of the issuer or the price of the bonds. Such provision establishes a non-exhaustive list of events that must be communicated.</p> <p>Issuers of corporate bonds that are listed on either of the two stock exchanges are also required under the respective listing rules of the stock exchanges to disclose in a timely manner any of the major events enumerated in the rules that may impact the solvency of the issuer or the price of the bonds including any information that may have a major impact on the investment decision of an investor.³¹</p> <p>Where the rules only refer to the obligation to timely disclose, then timely refers to within two trading days.</p>
--	--

²⁶ See Chapter 3, Section 3 of the Shanghai Stock Exchange Corporate Bonds Listing Rules and Chapter 4, Section 3 of the Shenzhen Stock Exchange Corporate Bonds Listing Rules.

²⁷ See Articles 19 and 23 of the *Information Disclosure Measures*.

²⁸ See the *Rules Concerning the Preparation of Information Disclosure Documents by Companies Offering Securities to the Public No. 13 – Special Requirements on the Contents and Format of Quarterly Reports* and the *Rules Concerning the Preparation of Information Disclosure Documents by Companies Offering Securities to the Public No. 20 – Special Requirements on the Contents and Format of Quarterly Reports of GEB-Listed Companies*.

²⁹ See Article 23 of the *Information Disclosure Measures*.

³⁰ See Article 30 of the *Information Disclosure Measures*.

³¹ See Chapter 3, Section 3 of the Shanghai Stock Exchange Corporate Bonds Listing Rules and Chapter 4, Section 3 of the Shenzhen Stock Exchange Corporate Bonds Listing Rules.

	<p>Disclosure for shareholder voting decisions</p> <p>Under Article 102 of the <i>Companies Law</i> a shareholders' meeting must not adopt any resolution that is not explicitly stated in the notice of the meeting.</p> <p>The <i>Rules Governing the Listing of Stocks on the Shanghai Exchange</i> ("<i>Shanghai Listing Rules</i>") and the <i>Rules Governing Listing of Stocks on the Shenzhen Exchange</i> ("<i>Shenzhen Listing Rules</i>") require a listed company's notice of general meeting to disclose full details of all the proposals to be considered at the meeting. The company must also disclose on the relevant exchange's website or designated website other materials essential for shareholders to make reasonable judgments on the matters to be discussed.³²</p> <p>Responsibility for information disclosure</p> <p>Under various provisions in the relevant laws, departmental rules and measures, criminal or administrative penalties may be imposed on issuers, sponsors and other professionals involved in non-compliance with disclosure requirements. Parties involved may also be liable to compensate investors who suffer losses due to the non-compliance.</p> <p>Criminal liabilities</p> <p>The <i>Criminal Law</i> has two criminal offences pertaining to information disclosure.</p> <p>Under Article 160 of the <i>Criminal Law</i>, whoever issues shares or company or enterprise bonds by concealing important facts or falsifying major information in the prospectus on share offer, subscription forms or measures for offer of company or enterprise bonds shall, if the amount involved is huge, and the consequences are serious, or if there are other serious circumstances, be sentenced to fixed-term imprisonment of not more than five years or criminal detention and shall also, or shall only, be fined not less than 1% but not more than 5% of the funds illegally raised.</p> <p>Where a legal person commits the crime as mentioned in the preceding paragraph, it shall be fined, and the persons who are directly in charge and the other persons who are directly responsible for the crime shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention.</p> <p>Under Article 161 of the <i>Criminal Law</i>, where a company submits to shareholders and the general public false financial and accounting reports, or reports concealing important facts, thus causing serious harm to the interests of shareholders or others, the persons who are directly in charge and the other persons who are directly responsible for the crime shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention and shall also, or shall only, be fined not less than RMB 20,000 but not more than RMB 200,000.</p> <p>Administrative penalties</p> <p>Article 63 of the <i>Securities Law</i> requires the information disclosed by an issuer or listed company to be truthful, accurate and complete and not contain any false records, misleading statements or major omissions.</p> <p>The <i>Information Disclosure Measures</i> and <i>Corporate Bonds Measures</i> further require the directors, supervisors and senior management personnel of an issuer or a listed company</p>
--	---

³² See Article 8.2.1 of both the Rules Governing the Listing of Stocks on the Shanghai Stock Exchange and the Rules Governing Listing of Stocks on the Shenzhen Stock Exchange.

	<p>to ensure the information disclosed by the issuer or listed company is truthful, accurate, complete, timely and fair.³³</p> <p>Under Article 193 of the <i>Securities Law</i>, any issuer, listed company or other party who is required to disclose information or issue a report fails to comply with the relevant requirement or discloses information or issues a report containing a false record or misleading statement, or which omits major information, is liable to be issued a warning and fined between RMB 300,000 and RMB 600,000 by the CSRC. Management or other directly responsible personnel are liable to be issued a warning and pay a fine between RMB 30,000 and RMB 300,000. Where the contravention arises from instructions given by a controlling shareholder or <i>de facto</i> controller, the controlling shareholder or <i>de facto</i> controller is also liable for the same penalties.</p> <p>In addition, under Article 59 of the <i>Information Disclosure Measures</i>, where a party who is required to disclose information or any of its directors, supervisors or senior management personnel of any of its shareholders or <i>de facto</i> controllers violates the requirements of the <i>Measures</i>, the CSRC may, among other things, issue warnings, put the party's or the individual's non-compliance on public records and declare the individual to be unsuitable to serve in his position. The CSRC has similar powers in relation to contraventions of the requirements under the <i>Corporate Bonds Measures</i>.³⁴</p> <p>Where a sponsor has submitted sponsorship-related documents to CSRC or a stock exchange containing any false records, misleading statements or major omissions, or has abetted, aided or been involved in the submission of any document containing any false records, misleading statements or major omissions, CSRC may suspend or, in very serious cases, revoke its sponsorship qualifications pursuant to the <i>Administrative Measures for the Administration of Sponsorship in Securities Offerings and Listings</i> ("<i>Sponsorship Measures</i>"). Similarly, individual representatives of the sponsor who are implicated in the contravention may have his representative qualifications suspended or revoked by CSRC.³⁵</p> <p>Where potential issuers have submitted application documents to the CSRC containing false records, misleading statement or major omissions, the CSRC may terminate the review of the application and ban the applicant from submitting any new application for public offerings of securities within 36 months.³⁶ Professionals such as auditors, lawyers, valuation agents who are found to have issued reports or opinions for a public offering containing any false records, misleading statement or major omission are banned from submitting any document to CSRC for the purposes of public offerings applications within 36 months while their firms are banned from doing so for a period of 12 months.³⁷</p> <p>SSE and SZSE may also impose disciplinary measures and sanctions under their respective listing rules, including public censure and identifying persons involved as not suitable to serve as a director, supervisor or senior manager of a listed company.³⁸</p>
--	---

³³ See Articles 3 and 58 of the *Information Disclosure Measures* and Article 4 of the *Corporate Bonds Measures*.

³⁴ See Article 58 of the *Corporate Bonds Measures*.

³⁵ See Articles 67 and 69 of the *Sponsorship Measures*.

³⁶ See Article 66 of the *IPO Measures*, Articles 51 and 52 of the *GEB IPO Measures*, Article 66 of the *Securities Offering Measures* and Article 56 of the *Securities Offering Measures for GEB-Listed Companies*.

³⁷ See Article 66 of the *IPO Measures*, Article 53 of the *GEB IPO Measures*, Article 69 of the *Securities Offerings Measures* and Article 63 of the *Securities Offerings Measures for GEB-Listed Companies*.

³⁸ See Chapter XVII of the *Rules Governing the Listing Stocks on the Shanghai Stock Exchange* and Chapter XVI of the *Rules Governing Listing Stocks on the Shenzhen Stock Exchange*.

	<p>Civil liabilities</p> <p>Pursuant to articles 69, 76, 77 and 79 of the Securities Law where false statement, insider trading, manipulation or fraud causes losses to clients, the insider trader, manipulator or fraudster shall be liable for compensation in accordance with law. In order to ensure that investors obtain adequate compensation through civil remedies, article 232 of the Securities Law provides that persons liable for both civil compensation and fines, whose property is insufficient to cover both of the payments, shall first bear the liability for civil compensation.</p> <p>As noted under Principle 11 there is not an active culture of exercising private rights of actions and the courts are yet to develop sufficient expertise of securities matters. However, the CSRC has implemented a series of initiatives aimed at empowering investors and shareholders. These have been described in Principle 11.</p> <p>Derogations</p> <p>As noted above, the law requires that disclosure be truthful, accurate and complete and not contain false records, misleading statements or major omissions. However, the standards on the contents and format of information disclosure issued by the CSRC³⁹ provide that where there is sufficient evidence to prove that the disclosure may involve state secrets, trade secrets or would violate laws or regulations protecting confidentiality or cause severe damage to the issuer's interests, the issuer can apply to the CSRC for an exemption.</p> <p>Article 5 of the <i>Disclosure Standards No. 2 – Annual Report</i> provides that a listed company need not disclose information otherwise required to be disclosed under the Standards due to it being a trade secret or for other reasons. The current framework does not require the company to obtain approval beforehand of the CSRC or the exchange, but it is required to provide the specific reasons for not disclosing the relevant information. On an ex-post basis, the stock exchanges may review the rationality of such reasons and if they are not found valid, they may demand supplementary disclosure or take self-regulatory measures against the relevant parties.</p> <p>Suspension of trading</p> <p>The stock exchanges are responsible for decisions to suspend or resume trading in circumstances where there appears to be inadequate disclosure. Where any information that has not been disclosed by the company is difficult to keep confidential, has leaked or is disclosed by the media and may have a great impact on the share price, the stock exchange may suspend trading and resume it once the disclosure is made by the company.⁴⁰ The stock exchanges have similar power to suspend trading of listed corporate and enterprise bonds.⁴¹</p> <p>Restrictions on trading by persons with inside information</p> <p>Under Article 73 of the <i>Securities Law</i>, persons with inside information are prohibited from trading in the relevant securities or tipping others. Under Article 202 of the <i>Securities Law</i>, persons who trade while possessing inside information are liable to orders to divest,</p>
--	---

³⁹ [Disclosure Standards No. 23 – Prospectus for Public Offerings of Corporate Bonds].

⁴⁰ See Article 12.5 and 12.7 of the Rules Governing the Listing of Stocks on the Shanghai Stock Exchange and Article 12.7 of the Rules Governing Listing of Stocks on the Shenzhen Stock Exchange.

⁴¹ See Chapter 6 of the Shanghai Stock Exchange Corporate Bonds Listing Rules and Chapter 6 of the Shenzhen Stock Exchange Corporate Bonds Listing Rules.

	<p>confiscation of the gains and a fine of at least the amount of the gain or up to five times the gain.</p> <p>Cross border matters</p> <p>There has not been any public offering or listing of shares by a foreign issuer in China as it is currently not allowed.</p> <p>In 2015, the CSRC launched a pilot program to allow foreign issuers to offer RMB-denominated bonds in China ("panda bonds"). Foreign issuers wishing to make a offering of bonds are subject to the same requirements as domestic issuers. They are required to apply for CSRC approval and publish prospectuses in accordance with the requirements under the <i>Securities Law</i> and the disclosure standards issued by CSRC that are applicable to offerings of corporate bonds.</p> <p>By the end of 2016, foreign issuers had made 46 offerings of panda bonds, raising RMB 83.6 billion in aggregate.</p> <p>Regulatory practices</p> <p><i>Prospectuses Review</i></p> <p><u><i>Shares</i></u></p> <p>Approval of shares for public offering takes place at the CSRC central office. The sponsor submits the application for approval of public offering to the Department of Public Offering Supervision, along with the draft prospectuses and related documents for IPOs and secondary offerings. The Department has about 100 staff, with 80 handling applications.</p> <p>The staff reviews the application for compliance with the criteria and requirements set out under the <i>Securities Law</i> and the relevant <i>Measures</i> promulgated by the CSRC⁴² for the approval of the public offering and the prospectus for completeness, sufficiency and timeliness of the information contained therein. There is an internal meeting to discuss the application.</p> <p>If the staff considers that the application meets all the requirements, then it is submitted to the Public Offering Review Committee for the Main Board or, in the case of a proposed listing on the GEB, the GEB Offering Review Committee for deliberation. The Public Offering Review Committees are set up in accordance with Article 22 of the <i>Securities Law</i> and Article 2 of the <i>Measures</i> for the CSRC Offering Review Committee. The Public Offering Review Committees comprise professionals from within the CSRC and relevant external experts outside of the CSRC and are appointed by the CSRC. There are 25 members on the Main Board's Public Offering Review Committee, including 5 internal professionals and 20 external experts, and some of them may serve as full-time members. There are 35 members on the GEB Offering Review Committee, including 5 internal professionals and 30 external experts, and some of them may serve as full-time members. 7 members are drawn from the relevant Committee to deliberate on each application. Under Article 22 of the <i>Securities Law</i>, the role of the Committees is to examine the application, cast votes to decide on the application and provide their examination opinions to the CSRC. The CSRC makes the final decision on whether to approval the application. CSRC staff informed that in practice, the CSRC has followed the recommendations of the Committee in all applications to date.</p>
--	---

⁴² See Article 13 of the *Securities Law*, Chapter 2 of the *IPO Measures*, and Chapter 2 of the *GEB IPO Measures*.

The CSRC has promulgated several rules to regulate the daily administration of the work of the committees. Both the law and the corresponding rules contain provisions to deal with potential conflicts of interest, in particular recusal mechanisms (article 23 of the Securities Law) and the corresponding liability that would arise for a breach of such obligation (article 228 of the Securities Law). The Measures also include the possibility for a company to ask for the recusal of a member.

When an issuer has completed its public offering, the relevant stock exchange reviews the issuer's public offering for compliance with the quantitative requirements (such as market capitalization and shareholders' spread) under its listing rules before listing the issuer.

CSRC staff indicated that there is a "success" rate of about 70 percent, 20 percent withdraw their application and about 10 percent are rejected.

Corporate bonds

Applications for CSRC's approval of corporate bonds public offerings are handled by the CSRC's Department of Corporate Bonds. The Department has about 37 staff, with 7 responsible for reading applications. The procedures are similar to those for equities except that unlike share offerings, applications for corporate bonds offerings are not reviewed by the Public Offering Review Committees. CSRC makes the final decision on whether to grant the applications based on the review done by CSRC staff.

Periodic Reports Reviews

Both stock exchanges have programs to review annual and other periodic reports issued by listed companies. The main objective of the programs is to ensure that issuers provide accurate, complete and timely information to investors, although they also support CSRC's program to review compliance with accounting standards.

All annual reports are reviewed, but those of certain listed companies, selected by the exchanges based on a combination of a risk-based approach and random sampling, are subject to more intensive examination.

In the case of the SSE, about one-third of the main board listed companies are selected for intensive review on an annual basis. The SSE has about 72 staff members responsible for reviewing periodic reports.

In the case of the SZSE, about 20 percent of the mainboard and SME board-listed companies and 50 percent of the GEBlisted companies are selected for intensive review. The SZSE has about 150 staff dedicated to this function. The selection is done using a risk-oriented approach. Risk levels are assigned taking into consideration such factors as the companies' information disclosure track record, internal governance records and financial performance.

Where there are deficiencies in the information disclosure in the reports, the exchanges issue query letters to the companies concerned to require their explanation or clarification. These letters and the companies' responses to them are public. Where there has been a breach of listing rules, the exchanges may follow up imposing disciplinary measures or initiating disciplinary actions with a view to imposing disciplinary sanctions under the listing rules.

Table. Exchanges Reviews

	2013	2014	2015

	Number of reports reviewed	N.A	10208	10957
	Number of supervisory letters issued	N.A	1227	845
	Disciplinary actions	N.A	27	30
<p>Source: CSRC.</p> <p>In cases where the exchanges' review uncovers potential violation of laws and regulatory requirements, the exchanges would refer them to the CSRC regional offices where the listed companies involved are located for further investigation or on-site inspections of the companies.</p> <p>Finally, as will be further explained under Principle 18, the CSRC has a program of review of annual reports, which focuses on compliance with accounting standards and the quality of audit work. As indicated therein, the CSRC uses a combination of risk-based and random sampling. Overall the program allows the CSRC to cover about 20-30 percent of the issuers on an annual basis. The CSRC regional offices may also conduct reviews of the annual reports of listed companies located within their jurisdiction depending on their resources. For example, two of the large regional offices conduct a general review of the annual reports of all the listed companies within their jurisdiction. For high risk companies or companies whose performance has dramatically changed from one year to the next, they take a closer look and if necessary they conduct an inspection. In contrast, some of the regional offices focus their resources on on-site inspections as further explained below.</p> <p>Material events disclosure review</p> <p>Both exchanges carry out ex-post reviews of material events disclosures of listed companies. Where there are issues with a disclosure, the relevant exchange would query or seek clarification from the company. The exchange may require follow-up disclosure if more detailed information or clarification of the initial disclosure is needed.</p> <p>The exchanges also monitor the share price movements and information in the media and from other sources (such as complaints received) on the listed companies. Where there is significant share price movement or where such monitoring suggests that there may be undisclosed material information, the relevant exchange would query the listed company concerned and require that they make the disclosure or announcement.</p> <p>Both the SSE and SZE have done away with ex-ante reviews conducting ex-post supervision promptly following disclosure of material events and inquiries when necessary.</p> <p>On-site inspections</p> <p>On-site inspections of listed companies are conducted by the CSRC regional offices where the listed companies are located. These can be initiated by CSRC central office or by the regional offices themselves. They may be thematic inspections or inspections targeted at specific companies where issues have arisen.</p> <p>Newly-listed companies are inspected to check that they have properly implemented corporate governance requirements and robust internal control mechanisms.</p>				
Table. CSRC On-site Inspections				
	2013	2014	2015	

Listed companies	566	666	630
Bond issuers	N.A	N.A	105

Source: CSRC.

Market participants indicated to the assessors that although concerns remain about the quality of financial information, in general information disclosure by listed companies has improved largely due to more rigorous supervisory and enforcement measures undertaken by the CSRC and the stock exchanges as described above.

Enforcement has also been stepped up recently with the CSRC imposing market entry bans and higher administrative fines for disclosure violations. This was exemplified by three high-profile cases that took place between 2013 to 2016 involving listed companies that had fabricated financial data to obtain approval for their IPOs. The companies in the first two cases were sanctioned with market entry bans and fines while the third company was fined and de-listed under newly introduced rules. In all cases, the responsible persons, including sponsors, underwriters and other intermediaries, were similarly sanctioned with market entry bans and/or fines. The major shareholders, sponsors and/or underwriters of the companies set up funds to compensate affected investors after they were urged to do so by the CSRC.

Table. Disclosure violations

	2012	2013	2014	2015	2016
Administrative sanctions	32	23	36	75	69
Administrative measures	108	204	164	221	256

Source: CSRC.

NDRC framework

The public offering of enterprise bonds is regulated by the NDRC pursuant to the Regulations on Administration of Enterprise Bonds (the 'Enterprise Bonds Regulations'). Enterprise Bonds can be traded in the interbank market and/or exchanges and in the latter case are governed by the listing rules of the exchanges.

Issuers of publicly offered enterprise bonds must satisfy the criteria set out in Article 12 of the Enterprise Bonds Regulations, Article 3 of the NDRC Notice on Further Improving and Enhancing Enterprise Bonds Supervision (NDRC Caijin [2004] No. 1134) and must obtain the prior approval of the NDRC⁴³.

⁴³ Article 11 of the Enterprise Bonds Regulations required approval from both PBoC and NDRC, either at the provincial level where the issue is a local enterprise or at the central level where the issuer is a central enterprise. While the Regulations have not been formally revised, the requirement has been simplified such that the current practice is that only NDRC's approval is required: See NDRC General Office's Opinion on Simplifying Application Procedures, Enhancing Risk Prevention and Reforming Supervisory Fashion (NDRC General Office Caijing [2015] No. 3127)

	<p>Where the issuer is a company, the Securities Law also applies, including the criteria for the public offering of bonds by companies under Article 16 of the Securities Law.</p> <p>Under Articles 13 to 15 of the Enterprise Bonds Measures, and the NDRC General Office's Opinion on Simplifying Application Procedures, Enhancing Risk Prevention and Reforming Supervisory Fashion (NDRC General Office Caijin [2015] No. 3127) an issuer of enterprise bonds is required to prepare a prospectus which the issuer must submit as part of the approval application to the NDRC and publish it after it is approved.</p> <p>The required content and form of the prospectus are stipulated in the Disclosure Guidelines for Offering of Enterprise Bonds issued by the NDRC. The Guidelines require the prospectus to include, inter alia, information about the offering and the issuer, risks and measures to counter the risks, credit rating of the bond, financial statements and the intended use of the proceeds. With regard to the use of proceeds, the disclosure has to provide an overview of the projects to be financed with the proceeds; related approval, review, or filing status; market information and profit forecast for these projects, funding structure of the projects and execution; plans and management systems for the use of proceeds, etc.</p> <p>Under Article 2 of the NDRC Notice on the Issuing Amount and Approval of First Batch Enterprise Bonds in 2007 (NDRC Caijin [2007] No. 602) the issuer is further required to disclose all information that would have major impact on the investor's decision to purchase the bonds.</p> <p>The financial statements in the prospectus must be audited and must cover the latest three financial years and the most recent accounting period.</p> <p>Before the offering, the prospectus must be published on the websites of the NDRC, the issuer, the underwriter and the bond registration and custody organization,⁴⁴</p> <p>The issuers of enterprises bonds listed on the SSE or the SZE must, in accordance with the relevant provisions of the regulatory authorities and the trading places, disclose major events and submit periodic reports in similar terms to any company with listed bonds. For corporate bonds and debt financing instruments, issuers are required to comply with the disclosure requirements of the exchange market and interbank market and other regulations. By the same token, they are subject to the monitoring programs of the exchanges and/or NAFMII depending on the market in which they are traded.</p> <p><i>Practice</i></p> <p>Applications for NDRC's approval of public offerings of enterprise bonds are handled by the central NDRC. The NDRC has about 75 staff, with 70 responsible for technical review of the projects proposed to be funded via the enterprise bond issue. The NDRC has commissioned the NAFMII and the CCDC to conduct a technical evaluation of the issuance conditions of the enterprises bonds issuers, the solvency of the issuer as well as the completeness of the declaration materials and the adequacy of information disclosure. The NDRC is responsible for the final approval of the issuance based on its review of the projects and the assessment done by NAFMII and CCDC. In addition, NDRC has a program in place to monitor enterprise bond issuers, whereby it conducts on-site inspections on them on an annual basis.</p>
--	---

⁴⁴ Article 2 of the NDRC Notice on the Issuing Amount and Approval of First Batch Enterprise Bonds in 2007 (NDRC Caijin [2007] No. 602)

Assessment	Broadly Implemented
Comments	<p>The main issue affecting the grade relates to KQ5 of the Methodology. Concerning KQ 5 of the Methodology, the assessors note the existence of a system to monitor compliance by issuers with their disclosure obligations. The CSRC reviews all prospectus. The exchanges have developed programs for the review of periodic and ad-hoc reports, which are risk-based. While not all reports are subject to review the coverage is significant, as the data provided above indicates. The exchanges have primarily used supervisory letters to address disclosure issues, which is consistent with the objective of such reviews –although the use of other enforcement measures should be kept under review. In addition, the CSRC central office has a program of review of annual reports, which focuses on financial disclosure. The program is also risk-based. Depending on resources, some of the regional offices also conduct reviews of the annual reports. Altogether the coverage of the program appears significant, and random sampling adds a prophylactic effect. Finally, the use of on-site inspections adds an important layer to the program, as it allows the CSRC to conduct more in-depth review of internal controls and corporate governance as well as to check on specific issues identified. While this tool is not commonly used by other large jurisdictions as a regular component of their programs for issuers’ monitoring, the assessors consider that the characteristics of the market and the need to improve the quality of financial disclosure justify such a more “intrusive” approach. That said, while there is general acknowledgement that the quality of disclosure has improved in practice, concerns remain, particularly in regard to the quality of financial disclosure by listed companies. As stated in Principle 12, this raises the question of whether the CSRC should have a more intensive program for the review of periodic reports and in particular financial information in light of the current market structure, and other key factors such as the comfort that the authorities have in auditors’ work. This could be done by, for example, placing all issuers on a schedule for review of their periodic reports, while using the risk-based approach to determine the cycle and/or the level of review. Therefore, the assessors recommend that the CSRC keeps the monitoring program of issuers, in particular financial disclosure, under review. In tandem, as stated under principle 19, the program for auditors’ supervision should be strengthened given the critical role that they play attesting to the reliability of issuers’ financial information. As a result, resources constraints need to be addressed.</p> <p>Finally, the key issue of concern is whether enforcement measures that are being taken are sufficiently rigorous to affect the behavior of listed companies thus ensuring lasting improvements in the quality of disclosure. As stated above and in Principle 12 there is evidence that the CSRC is taking a stronger stance on enforcement in all areas, including listed companies. Such an approach requires more time to take hold, and thus to see a more substantive effect in the quality of disclosure and perceptions of the market. As a result, it is critical then that such approach continues and is strengthened. Further, the use of criminal enforcement needs to also be strengthened. Finally, the limited level of penalties that can be imposed on certain types of violations such as violations of disclosure requirements, as per the current legal framework, affects the authorities’ ability to deliver a credible enforcement program. The assessors acknowledge that the latter two issues are outside of the control of the CSRC; but encourages (i) the authorities to reach out to the criminal enforcement authorities with a view to persuading them about the need to prioritize securities offenses, and (ii) to review the legal framework for administrative and criminal enforcement.</p> <p>Other issues not considered in the grade</p>

	<p><i>Deadline for submission of annual reports</i></p> <p>The assessors note that the deadline for submission of annual statements is long compared to other large jurisdictions. The assessors encourage the CSRC to consider shortening such deadline at least for larger companies.</p> <p><i>The multilayered system for equity markets</i></p> <p>As indicated elsewhere, Principles 16-18 apply to issuers who raise funding via a public offering or whose securities are publicly traded. As a result, on the equity side the regime applicable to issuers that raise capital through the NEEQ or the regional platforms has not been included in this assessment. However, as commented in Principle 33, it is critical that the authorities keep a holistic view of capital raising activities to ensure that all methods used are carried in a way that they do not undermine investors' confidence in the capital markets. This requires a careful balancing of disclosure and corporate governance obligations, as well effective use of enforcement powers.</p> <p><i>Bond markets</i></p> <p>As indicated elsewhere, given the scope of the Principles the assessment does not cover the regime applicable to issuers that raise capital in the interbank bond market –as such is a wholesale market. That said, the assessors note that the disclosure requirements for bonds under all regimes aim at the same objective of requiring true, accurate and complete disclosure, and that in practice the requirements are roughly aligned as they include initial disclosure via a prospectus and the submission of semi-annual reports, an annual audited report and material events. Therefore, it would be useful to work on eliminating any difference not justified by the difference in the investors or the particular nature of the instrument, and to continue working on enhancing coordination and cooperation, including in the context of enforcement to foster the objectives of investor protection, liquid markets and financial stability.</p> <p>As already agreed by the authorities, the assessors recommend the implementation of a harmonized regime for the issuance of bonds. Such regime could indeed differentiate disclosure requirements based on the type of investors to which the offer is addressed. For bonds offered to retail investors the requirements of the CSRC could potentially be used as a model. The level of disclosure required for offers addressed to qualified investors and the level of review by the regulatory authority would be determined by the level of comfort of the regulators on the investors' ability to obtain and assess the information they need through market means. For example, in other large jurisdictions offers exclusively addressed to qualified investors are not subject to prospectus nor periodic information requirements (from a regulatory perspective). In some markets a hybrid approach is being developed whereby such offers are subject to some disclosure requirements (such as the preparation of an offering memorandum) that may be reviewed by the regulator, but overall the regime is more streamlined than the regime for offers to retail investors. In addition, in line with the agreements reached in the JMC for Bonds, the assessors recommend that coordination mechanisms be established to ensure a consistent administration of such a regulatory regime and consistent enforcement. On the latter, as agreed by the authorities, coordination by the CSRC seems the optimal solution.</p> <p><i>The existence of a merit based regime for public offerings</i></p> <p>Finally, particularly in the context of equity markets where the investor population is predominantly retail, and market-based solutions to align incentives for issuers and intermediaries with investors' interest are still evolving, a merit-based approach involving ex-ante vetting of the quality of public issuers may be considered a prudent way to protect</p>
--	--

	<p>retail investors. Further, in principle, such an approach is not incompatible with the IOSCO Principles. However, a merit-based approach has its disadvantages, the most significant of which are the potential moral hazard and reputational risks to the regulator. Such an approach could encourage investors to abdicate their own responsibility to assess the risks and suitability of their investments. It could lead to excessive reliance on the regulator and expectations that the regulator would ensure the safety of investments when it is not possible for investment risks to be eliminated. In addition, the review process to assess the merits of a public offering is intensive and requires considerable regulatory resources. It is noteworthy that the CSRC has on hand a backlog of about 600 applications for initial public offerings. In this context the assessors welcome initiatives by the CSRC aimed at further strengthening the role of disclosure in investment decisions, in particular initiatives to (i) ensure that issuers and gatekeepers comply with their responsibilities, including through enhanced supervision and enforcement, (ii) educate investors and enhance their ability to exercise their private right of action, and (iii) foster the growth of institutional investors under enhanced supervision. This could also support a move by CSRC to a regime that relies more on disclosure. A similar approach could be taken by NDRC.</p>
<p>Principle 17</p>	<p>Holders of securities in a company should be treated in a fair and equitable manner.</p>
<p>Description</p>	<p>Rights and equitable treatment of shareholders</p> <p><i>Election of directors and supervisors</i></p> <p>Shareholders of a joint stock limited company have the authority to elect and change directors and supervisors of the company (other than those appointed to represent employees) pursuant to Articles 37 and 99 of the <i>Company Law</i>. They also have the authority to determine the remuneration of the directors and supervisors.</p> <p><i>Corporate changes</i></p> <p>Under Articles 103 of the <i>Company Law</i>, a shareholder is entitled to one vote per share held. The following corporate changes require a two-thirds majority of the votes held by shareholders present at a shareholders' general meeting:</p> <ul style="list-style-type: none"> • Alterations to the company's articles of association; • Changes to the company's registered capital; and • Merger, division, dissolution of the company or a change in the corporate form of the company. <p>The following transactions also require the approval of a two-thirds majority vote at a shareholders' general meeting pursuant to Article 121 of the <i>Company Law</i>:</p> <ul style="list-style-type: none"> • Major asset purchases or sales made within one year exceeding 30% of the company's total assets; and • Guarantees granted within one year exceeding 30% of the company's total assets. <p>Under the listing rules of the stock exchanges, listed companies are also required to obtain shareholders' approval for the following matters:</p> <ul style="list-style-type: none"> • Large transactions that exceeds any of the specified percentages of the company's total assets, net assets, operating income, net profit and the specified absolute

	<p>amounts;⁴⁵</p> <ul style="list-style-type: none"> • Related-party transaction of an amount exceeding RMB 30 million and 5 % of absolute value of audited net assets where related-party shareholders are not allowed to vote;⁴⁶ • Change in the use of proceeds raised by the company;⁴⁷ • Repurchase of shares⁴⁸ where a two-thirds majority vote is required under Article 45 of the <i>Rules for the Shareholders' Meetings of Listed Companies</i>; and • Merger by absorption where a two-thirds majority vote required.⁴⁹ <p>Changes to the rights attached to preferred shares are governed by Article 5 of <i>Guidelines of the State Council on Launching the Pilot Program for Preferred Shares</i>. Under Article 5, holders of preferred shares have the right to attend and vote at a shareholders' general meeting that is considering any of the following:</p> <ul style="list-style-type: none"> • Alterations to the company's articles of association concerning preferred shares; • A single or cumulative reduction of registered capital of the company by more than 10%; • Merger, division or dissolution of the company or a change in its corporate form; • Issuance of preferred shares; and • Other matters specified in the company's articles of association. <p>Any resolution on the above matters require a two-thirds majority of the votes of all ordinary shareholders as well as a two-thirds majority of the votes of the preferred shareholders</p> <p>The listing rules of the exchanges require a listed company's notice of general meeting to disclose full details of all the proposals to be considered at the meeting. The company must also disclose, on the relevant exchange's website or a designated website, other materials essential for shareholders to make reasonable judgments on the matters to be discussed.</p> <p>General meetings and proxy voting</p> <p>Article 102 of the Company Law provides that a company must provide 20 days' notice for an annual general meeting and 15 days' notice for an interim general meeting.</p> <p>In accordance with Article 20 of Rules for Shareholders' General Meetings, shareholder general meetings should take place physically in a meeting venue. Besides, web-</p>
--	--

⁴⁵ See Article 9.3 of the *Shanghai Listing Rules and Shenzhen Listing Rules*.

⁴⁶ See Article 10.2.5 of the *Shanghai Listing Rules and Shenzhen Listing Rules*.

⁴⁷ See Article 11.2.1 of the *Shanghai Listing Rules and Shenzhen Listing Rules*.

⁴⁸ See Article 11.6.2 of the *Shanghai Listing Rules*.

⁴⁹ See Article 11.7.4 of the *Shanghai Listing Rules*.

conference or other means that are safe, economical and convenient for shareholders to attend general meetings should also be provided pursuant to laws, administrative regulations, CSRC regulations or by-laws of the companies. Shareholders attending general meetings in any one of the means should be regarded as being present.

An interim general meeting is required to be held within two months of the occurrence of any of the following:

- The number of directors falls below the minimum required under the *Company Law* or below two-thirds of the number stipulated in the company's articles of association;
- The company has failed to make up for a loss equivalent to one third or more of the company's paid-up capital;
- A meeting is requested by one or more shareholders who hold collectively at least 10% of the company's shares;
- A meeting deemed necessary by the company's board of directors; and
- A meeting is requested by the company's board of supervisors.

Shareholders may appoint proxies to attend and vote on their behalf at a shareholders' general meeting pursuant to Article 106 of the *Company Law*. Article 9 of *Code of Corporate Governance for Listed Companies* (the "*Code of Corporate Governance*") further provides that shareholders may either attend and vote at a general shareholders' meeting in person or appoint a proxy to do so, and that both means of voting carry the same legal effect.

Listed companies are required under Article 8 of the *Code of Corporate Governance* to use all possible means, including fully utilizing modern information technologies, to increase the proportion of shareholders attending general meetings. The time and venues for the meetings must be arranged in such a way as to maximize the number of shareholders attending.

Pursuant to Article 10 of the *Code of Corporate Governance*, the board of directors, independent directors and qualified shareholders (as defined in the company's bylaws) of a listed company may solicit shareholders' votes for a general shareholders' meeting. However, they are not allowed to pay shareholders for their votes and sufficient relevant information must be disclosed to the shareholders whose votes are being solicited.

Ownership registration and transfer of shares

Under Article 130 of the *Company Law*, where registered shares are issued, a company must keep a register of shareholders. Under Articles 96 and 97 of the *Company Law*, the register must be kept at the company's premises and shareholders have the right to inspect the register.

The *Measures for the Administration of Securities Registration and Clearing* (promulgated by CSRC in 2006) established a centralized share registration system for listed companies. Under these *Measures*, the SD&C preserves complete files of the shareholders of listed companies.

Shareholders of listed companies can transfer their shares freely with a few exceptions.

	<p>The exceptions are as follows:</p> <ul style="list-style-type: none"> • Article 141 of the <i>Company Law</i>: <ul style="list-style-type: none"> • Shares held by the originators of a company cannot be transferred within one year from the date of incorporation of a company. • Shares issued by a company prior to its initial public offering cannot be transferred within one year from the date on which the publicly offered shares are listed on a stock exchange. • A director, supervisor or senior manager of a company may not transfer any share within one year from the date on which the company's shares are listed on a stock exchange, nor transfer more than 25% of his or her shares in the company in each year thereafter. These persons are also not allowed to transfer any of their shares within six months after they leave office. • Article 5 of the <i>Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors</i>: A foreign investor in A shares of a listed company must not transfer A shares within a period of three years of their acquisition. • Article 98 of the Securities Law. In takeover deals, the stocks held by the acquirer in the acquired company are not allowed to be transferred within 12 months after the conclusion of the takeover. • Article 46 of Measures for the Administration of Material Asset Reorganizations of Listed Companies. <ul style="list-style-type: none"> • Section 1, shares obtained through asset purchases by designated parties of listed companies are not allowed to transfer within 12 months after the conclusion of share offering. Such shares are not allowed to transfer within 36 months under any of the following circumstances: <ol style="list-style-type: none"> a. where the designated parties are controlling shareholders, actual controllers or controlled affiliates of the listed company; b. where te designated parties obtain actual controllership by subscribing the shares on offer; or c. where the designated parties purchase the shares with the assets which they have owned for no more than 12 months on an ongoing basis. • Section 2 If it is such a deal as that under the Section 1 of Article 13, the original controlling shareholders, the original actual controllers and the controlled affiliates, as well the designated parties who either directly or indirectly obtain shares of a listed company from the aforementioned parties, shall publicly promise not to transfer the shares within 36 months after the conclusion of the transaction. Designated parties other than the acquirers and acquirers' affiliates should make a public promise not to transfer the shares of a listed company acquired with assets within 24 months after the completion of share offering. • Article 38 of the <i>Measures for the Administration of Issuance of Securities by Listed Companies</i>: Shares issued privately by a listed company cannot be transferred
--	--

within 12 months from the end of the issuance. The shares subscribed by the controlling shareholders, *de facto* controllers or any enterprise controlled by the controlling shareholders or *de facto* controllers of the company cannot be transferred for 36 months.

Dividends and other distributions

Article 4 of the *Company Law* provides that the shareholders of a company shall enjoy the right to benefit from the assets of the company pursuant to law. Article 81(9) of the *Company Law* requires the bylaws of a company to specify the method of profit distribution of the company.

Profit distribution plans of a company must be approved by shareholders' meeting in accordance with Article 37(6) while it is the responsibility of the company's board of directors under Article 46(5) to work out the company's profit distribution plans.

Under Article 186 of the *Company Law*, where a company is dissolved, after having paid the liquidation expenses, employees' salaries, social insurance premiums, statutory compensations and taxes, and having cleared up its debts, the company must distribute its remaining assets among its shareholders in proportion to their shareholdings. In practice, companies may issue preferred shares and common shares. The remaining assets may be distributed among common shareholders and preferred shareholders.

Takeover bids and other changes of control transactions

Takeover bids

Takeovers and other change of control transactions are governed by the *Securities Law* and the *Measures for the Administration of the Takeover of Listed Companies* (the "*Takeover Measures*") issued by the CSRC.

Under Article 88 of the *Securities Law*, if an investor wants to acquire additional shares in a listed company when, through securities trading on a stock exchange, the investor has already acquired and holds 30% of the outstanding shares of the company either individually or collectively with other persons by virtue of an agreement or other arrangement, he must issue a tender offer to all the shareholders of the company to acquire all or a portion of the company's shares. A similar requirement applies under Article 96 of the *Securities Law* to an investor who has acquired and holds 30% of the shares of a listed company through negotiated acquisitions.⁵⁰

Article 56 of the *Takeover Measures* applies to an investor (who is not a direct shareholder of the listed company) who indirectly acquires more than 30% of the shares by virtue of investment relations, agreements or other arrangements. Such an investor is required to extend a general takeover offer to all shareholders of the company for all the shares in the company or reduce his shareholding below 30% within 30 days. If the investor reduces his shareholding below 30%, any acquisition of shares in the company thereafter must be made through a tender offer to all shareholders of all or a portion of the company's shares.

Under Article 35 of the *Takeover Measures*, the offer price for the shares in a tender offer must not be lower than the highest price at which the offeror had acquired the same class of shares in the target company within the six-month period prior to the indicative notice of the tender offer.

⁵⁰ See also Chapters III and IV of the *Takeover Measures* that set out more detailed provisions on the requirements for tender offers in these situations.

	<p>Article 25 of the <i>Takeover Measures</i> requires a tender offer to be for at least 5% of the issued shares of the company.</p> <p><i>Other change of control transactions</i></p> <p>Besides takeover bids, the obligation to make a tender offer under the <i>Takeover Measures</i> also applies to other transactions and circumstances that could result in a change in control unless an exemption is granted by the CSRC.</p> <p>Under Article 62 and 63 of the <i>Takeover Measures</i>, the purchaser or shareholder in certain circumstances may apply to the CSRC for an exemption from the obligation to make a tender offer. These include the following:</p> <ul style="list-style-type: none"> • Where a listed company is under serious financial stress, a reorganization proposal from an acquirer to save the company has been approved by the Shareholders' General Meeting, and the acquirer has promised not to transfer the shares within 3 years; • Where investors purchase new shares of a listed company, upon the approval of the non-affiliated shareholders in Shareholders' General Meeting, and the investors' holding in that company exceeds more than 30% of the outstanding shares, and the investors promise not to transfer the newly purchased shares within 3 years, and the General Meetings exempt the investors from making a tender offer; • Where the investors' ownership in that company exceeds 30% of the outstanding shares as a result of equity reduction by the company purchasing shares back from certain shareholders with a set price approved by the Shareholders' General Meeting. <p>Under Article 51 of the <i>Takeover Measures</i>, management buyouts require the approval of the company's board of directors and shareholders. The board resolution approving the buyout must be adopted by a majority of the non-interested directors with at least a two-thirds majority of the independent directors (who must comprise at least half the directors on the board). If approved by the board, the matter must be submitted to a general shareholders' meeting for approval. The independent directors are required to engage an independent financial adviser and to present their opinion and the opinion of the financial adviser on the proposed buyout to the shareholders. Shareholders' approval of the buyout requires a simple majority of the votes held by non-interested shareholders present at the meeting. No assets of the company itself can be used to fund the buyout.</p> <p><i>Disclosure requirements for mandatory tender offers</i></p> <p>Pursuant to the Securities Law and the <i>Takeover Measures</i>, an offeror must submit a tender offer report to the exchange and inform the target company about the tender offer. At that stage the exchange conducts a "formality" review of the report. The offeror must, at the same time, publicly issue an indicative notice summarizing the tender offer report. After the announcement, the exchange will conduct ex-post monitoring, and would make inquiries to the company if issues are spotted.</p> <p>The tender offer report must include <i>inter alia</i> the following information:</p> <ul style="list-style-type: none"> • Information about the offeror and whether it intends to further increase his shareholding within the 12 months following the acquisition;
--	---

- The terms of the offer, including the offer price, conditions of the offer and the offer time limit;
- An analysis of the acquisition's impact on the target company, including whether the offeror has made arrangements to avoid any potential competition between the offeror and the target company and to ensure the independence of the target company; and
- Plans on adjustments to be made in the ensuing 12 months to the target company's assets, business, personnel, organizational structure and articles of association.

In the case of a full tender offer, the offeror must disclose in the tender offer report the risk of the target company being de-listed and the follow-up arrangements for remaining shareholders to sell their shares in the event of a de-listing.

Equal and fair opportunity to participate

Article 90 of the *Securities Law* as well as Article 37 of the *Takeover Measures* require that a tender offer must remain open for between 30 and 60 days, and the offeror may not withdraw its offer during that time.

Under Article 92 of the *Securities Law*, the terms and conditions of a takeover bid must apply equally to all shareholders of the target company. Article 26 of the *Takeover Measures* requires the offeror to treat all shareholders of the target company fairly. Shareholders holding shares of the same type must be treated equally.

Where, in a partial tender offer, the number of shares obtained through pre-bid acceptance exceed the shares scheduled to be purchased, Article 43 of the *Takeover Measures* requires the offeror to purchase from all the accepting shareholders on a pro-rata basis.

Pursuant to Article 97 of the *Securities Law*, where after the takeover bid, the shareholding spread of the target company no longer conforms to the listing requirements, the stock exchange shall terminate the company's listing. The remaining shareholders of the target company shall have the right to sell their shares to the offeror on terms identical to those under the tender offer.

The *Takeover Measures* impose specific duties on the target company's directors in the event of a tender offer. In particular, Article 32 requires them to obtain the professional advice of an independent financial advisor and make a recommendation to the shareholders on whether to accept the offer.

Holding the company and its directors responsible in case of violations of law

Under Article 147 of the *Company Law*, directors, supervisors and senior managers owe their company duties of loyalty and diligence, are required to observe the law, administrative regulations and the company's articles of association, and are prohibited from accepting bribes or other illegal payments and from appropriating the company's assets. Article 148 sets out a further list of prohibited conduct which includes misappropriation of the company funds, providing unauthorized loans or guarantees out of company's funds, self-dealing, unauthorized disclosure of company secrets and any behavior that is disloyal to the company.

Article 151 of the *Company Law* allows shareholders to take derivative actions against errant directors and senior managers. Where a director or senior manager violates any

provision of the law, administrative regulations or the company's articles of association and causes a loss to the company, and the board of directors or supervisors fail to take legal proceedings against the director or senior manager after having receive a request to do so from shareholders who collectively hold more than 1% of the company's shares, the shareholders have the right to commence legal proceedings at a people's court in their own names.

Shareholders also have a right of action under Article 152 if a director or senior manager violates a provision of the law, administrative regulations or the company's articles of association and thereby causes harm to the interests of the shareholders.

Article 69 of the Securities Law provides that if there are any false records, misleading statements or major omission in a prospectus, bond prospectus, periodic report, ad hoc report or any other information disclosure material, the issuer or listed company are jointly liable to compensate any person who suffers a loss as a result. A director, supervisor, or senior manager of the issuer or listed company, as well as the sponsor or underwriter, is also jointly liable to compensate unless he is able to prove that he was not at fault. If a controlling shareholder or *de facto* controller of the issuer or listed company is at fault, he and the issuer or listed company are jointly liable for compensation.

Company insolvency and bankruptcy

The *Enterprise Bankruptcy Law* provides detailed procedures for the liquidation of insolvent companies. Under Chapter VIII of the *Enterprise Bankruptcy Law*, in appropriate cases, an insolvent company may be allowed by the court to restructure while continuing its business operations under an insolvency administrator. Otherwise, an insolvent company may be liquidated under the provisions of Chapter X of the *Enterprise Bankruptcy Law*. Upon the court declaring the company bankrupt, the company must cease operations and have its assets managed by a liquidation administrator with a view to paying off its creditors and distributing its remaining assets to its investors.

Disclosure of interests in shares of listed companies

Substantial holdings

The prospectus of a company offering securities to the public is required to contain full disclosure of the originators, shareholders holding 5% or more of the shares of the company, *de facto* controllers and controlling shareholders, as well as related parties.⁵¹

Under Article 86 of the *Securities Law*, when an investor's shareholding in a listed company reaches 5 %, the investor is required to lodge a report with the CSRC and the relevant stock exchange, inform the listed company and make a public announcement within 3 days. For shareholders holding 5% or more, every 5% increase or decrease in the shareholding must be reported and announced within three days. For the purposes of Article 86, the shareholding of an investor includes the shareholding of persons acting in concert with him. There are more detailed provisions on the disclosure of shareholding interests under Chapter II of the *Takeover Measures*, including provisions setting out the information to be included in the disclosure report.

Article 66 of the *Securities Law* requires the top 10 shareholders of a listed company to be disclosed in the company's annual report. Under Article 21 of the *Information Disclosure Measures*, information on all shareholders who each hold 5 percent or more of the shares

⁵¹ See Articles 33 and 35 of the *Disclosure Standards No. 1 – Prospectus* and Articles 33 and 25 of the *Disclosure Standards No. 28 – Prospectuses of GEB-Listed Companies*.

of the company, controlling shareholders and *de facto* controllers, must be disclosed in the annual report.

Holdings by directors and senior management

The prospectus of a company offering securities to the public is required to include information on the shareholdings of the company's directors, supervisors and senior managers.⁵² Information on the status and changes in the shareholdings of a listed company's directors, supervisors and senior managers must be disclosed in the company's annual report.

Under Article 11 of the *Rules on the Management of Shares Held by the Directors, Supervisors and Senior Management Officers of Listed Companies and the Changes Thereof* a director, supervisor or senior manager of a listed company must notify the listed company of, and the listed company must announce on the web site of the stock exchange, any change of the shares in the listed company held by such director, supervisor or senior management officer, within two trading days of the occurrence of the change.

Disclosure of intention to reduce shareholding

According to Article 8 of the *Rules on Share Sales by Substantial Shareholders, Directors, Supervisors and Senior Managements of Listed Companies*, where the substantial shareholders (who control or own more than 5% of the equity of a listed company) plan to reduce their shareholding through auction on stock exchanges, they are required to disclose their intended sales 15 trading days prior to their first sale. Information to disclose includes but is not limited to: number of stocks to sell, origin of these stocks, time of sale, methods of selling, pricing range, and reasons for sale, etc. On 27 May 2017, the CSRC released the revised *Rules on Share Sales by Substantial Shareholders, Directors, Supervisors and Senior Managements of Listed Companies* (CSRC Announcement [2017] No.9), which has expanded the ex-ante disclosure requirement to include directors, supervisors and senior managements of listed companies.

In addition, sales of shares by directors, supervisors and executives should be disclosed within 2 trading days after they sell shares, as required under Article 11 of *Administration Rules for Equity and Equity Changes of Directors, Supervisors and Senior Managements in the Listed Companies*. The disclosure must be made in the form of an ad hoc report prepared in accordance with the relevant formatting guidelines (for SSE: *Guidelines on Ad hoc Announcement No. 98 – Announcement of Shareholding Reduction Plans of Shareholders of Listed Companies/Plan Implementation Progress Reports*; for SZSE: *Format of Announcement of Pre-disclosure of Shareholding Reduction by Large Shareholders of a Listed Company*). The report is submitted to the exchange where the company is listed and is available publicly.

Legal infrastructure to enforce compliance

Under Article 193 of the Securities Law, if any issuer, listed company or other person who is required to disclose information or furnish any report fails to comply with the requirement, or makes a disclosure or furnishes a report containing any false record, misleading information or omitting major information, the CSRC may impose administrative penalties including a rectification order, a warning or a fine between RMB 30,000 and RMB 600,000.

⁵² See Article 59 of the *Disclosure Standards No. 1 – Prospectus* and Articles 56 of the *Disclosure Standards No. 28 – Prospectuses of GEB-Listed Companies*, Article 11 of the *Disclosure standards No. 11 – Prospectus of Listed Companies Offering Securities to the Public* and Article 30 of the *Disclosure standards No. 35 – Prospectus of GEB- Listed Companies Offering Securities to the Public Disclosure Measures*.

	<p>As the frontline supervisors of listed companies, the two exchanges monitor compliance with ongoing disclosure requirements, including the disclosure of changes in shareholdings of substantial shareholders, directors, supervisors and senior management, through their routine reviews of the companies' periodic reports and ad hoc disclosures. If a violation of regulatory requirements is discovered, the exchanges would alert the CSRC to follow up with further investigation and regulatory actions.</p> <p>Cross border</p> <p>As noted above under Principle 16, there have been no offerings of securities by foreign issuers in China.</p>
Assessment	Fully Implemented
Comments	<p>As indicated in the description, the legal framework makes adequate provision for the treatment of shareholders and the responsibilities of company officers and directors. In addition, the assessors note all the initiatives implemented by the CSRC to empower investors and shareholders to exercise their rights.</p> <p>The assessors note that certain liability provisions apply only to directors and senior managers, and not to supervisors. The assessors are satisfied with the explanation provided by the CSRC that such difference may reflect the different duties of supervisors compared to directors and senior executives. Directors and senior executives perform the duties related to the company's operation and management, they are active decision makers and managers of the company, and they are subject to a broader scope of duty of loyalty and more complex standards of fiduciary duties. In comparison, supervisors generally have the duty of supervising the company's affairs and mainly have the obligation of supervising compliance of the company's decision making and management activities.</p> <p>With regard to shareholders meeting, it is noted that under the law, the notice period for convening an interim meeting is 15 days even where the resolutions tabled for approval are on important matters requiring a two-thirds majority vote. This minimum notice period may be short in comparison with the standards in other major markets. The assessors note that online voting is available in China and is often implemented in practice. The key issue would be whether investors can also get all the necessary information to take decisions on line. This would mitigate the need for a long notice period.</p> <p>Finally, the assessors recommend that the CSRC reviews the appropriateness of changing the system for notification of substantial shareholding (where only changes of 5 percent need to be reported) to align it with the standards in other major markets. The CSRC has informed the assessors that the relevant rules are under review.</p>
Principle 18	Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.
Description	<p>Requirements for financial statements</p> <p><i>Public offerings and listings</i></p> <p>For public offering and listing, the issuer is required to submit to the CSRC and to the stock exchange audited financial statements for the latest three years or since its incorporation.</p> <p>Under Article 30 of the <i>Measures for the Administration of Initial Public Offerings and Listing</i></p>

of Shares (the "IPO Measures") and Article 18 under the *Measures for the Administration of Initial Public Offerings and Listing of shares on the Growth Enterprise Board* (the "GEB IPO Measures") an issuer seeking to list its shares on the main board of a stock exchange or on the GEB is required to prepare its financial statements in accordance with the applicable accounting standards for business enterprises and a CPA must have issued an unqualified audit report on the financial statements. Similar requirements for unqualified audits apply to listed companies seeking to make secondary public offerings of shares or convertible bonds.⁵³

Under Article 14 of the *Securities Law*, an issuer intending to make a public offering of new shares must submit an application, including financial statements, to the CSRC for approval. Article 13 of the *Interim Regulations on the Administration of the Issuance and Trading of Stocks* further requires that the application include audited financial statements for the latest three financial years or since the establishment of the issuer.

Similarly, Article 52 of the *Securities Law* requires that an issuer seeking a listing on a stock exchange must submit to the relevant stock exchange audited financial statements for the latest three financial years. The listing rules of the SSE and SZSE contain similar provisions.

For public offerings of corporate bonds, under Appendix 4-1 of the *Disclosure Standards No. 24 – Application Documents for Public Offerings of Corporate Bonds*, the issuer must submit its financial reports and the relevant audit reports for the three latest financial years and the current accounting period.

Under Article 66 of the *Securities Law*, an issuer making a public offering of shares or corporate bonds must issue a prospectus for the offering and publish its financial statements. Prospectuses for public offerings of securities (whether shares, convertible bonds or corporate bonds) are required to include the issuer's financial statements and the related audit reports for the latest three financial years and for the current accounting period. This requirement is stipulated in:

- Article 71 of the Disclosure Standards No. 1 – Prospectus;
- Article 66 of the Disclosure Standards No. 28 – Prospectus of GEB-Listed Companies;
- Article 39 of the Disclosure Standards No. 11 – Prospectus of Listed Companies Offering Securities to the Public;
- Article 45 of the Disclosure Standards No. 35 - Prospectus of GEB-Listed Companies Offering Securities to the Public; and
- Article 48 of the Disclosure Standards No. 23 – Prospectus for Public Offerings of Corporate Bonds.

Periodic reports

Listed companies and companies with corporate bonds listed for trading on an exchange are required under Article 66 of the *Securities Law* to publish an annual report with financial statements for the relevant financial year within 4 months of the end of the financial year. Article 21 of the *Measures for the Administration of Information Disclosure by Listed*

⁵³ See Article 8(2) of the *Securities Issuance Measures for Listed Companies* and Article 9(4) of the *Securities Issuance Measures for GEB-Listed Companies*.

	<p><i>Companies</i> requires that the annual report sets out the full text of the financial statements and the relevant audit reports.</p> <p>Listed companies are further required to publish semi-annual and quarterly reports within two months from the end of the first half of their financial years and one month from the end of the first and third quarters of their financial years respectively. The semi-annual report must include financial statements for the relevant half-year while the quarterly report must include the key accounting data and financial indicators for the relevant quarter. The financial information in the semi-annual and quarterly reports need not be audited.⁵⁴ Companies with corporate bonds listed for trading are required to publish semi-annual reports, but not quarterly reports.</p> <p>Accounting standards and contents of financial statements</p> <p>Required standards</p> <p>Under Article [25] of the <i>Accounting Law</i>, all companies and enterprises in China are required to prepare and present financial statements in compliance with the unified accounting system which includes the <i>ASBE</i>. Hence, financial statements required to be disclosed in public offering and listing documents and in annual reports and other periodic reports of listed companies must be prepared in accordance with the <i>ASBE</i>.</p> <p>There has not been any public offering or listing by foreign issuers in China. In principle, if a foreign issuer did make a public offering or lists in China, any financial statement that it is required to provide in China would have to be prepared in accordance with the <i>ASBE</i> or accounting standards recognized as equivalent by the MoF.</p> <p>Standards setting and interpretation</p> <p>The MoF, is the financial department under the SC responsible for administering China's national accounting work in accordance with Article 7 of the <i>Accounting Law</i>. Under Article 8 of the <i>Accounting Law</i> the MoF is charged with the responsibility of formulating and promulgating a unified accounting system for the country, which includes accounting standards.</p> <p>The MoF has established a China Accounting Standards Committee (CASC) to provide advice on the formulation of accounting standards. The CASC consists of [22] members and [160] consultants from a broad range of interests including government departments (including the Chief Accountant of the CSRC), academia, professional accounting associations, and the business community. The MoF has promulgated a <i>Process for the Formulation of Accounting Standards</i> that provides an open and transparent process of exposure to interested parties directly and to the public through the CASC website. In line with international good practice, the setting of accounting standards follows a due process comprising of four steps:</p> <ul style="list-style-type: none"> • Initiation. The Accounting Department of the MoF initiates a new project to develop a new standard and seeks comments from the CASC. Based on comments received, the Accounting Department develops a proposal for setting the new standard. • Drafting. The Accounting Department prepares and submit the exposure draft of the new standard to CASC for approval;
--	---

⁵⁴ See Article 65 of the *Securities Law* and Articles 22 and 23 of the *Measures for the Administration of Information Disclosure by Listed Companies*.

- **Exposure.** Once the CASC approves the exposure draft, the Accounting Department solicits comments from interested parties (including the regional financial departments and other competent departments under the SC) as well as the public by publishing the draft on the CASC's website and other major media; and
- **Release.** The Accounting Department revises the draft for the CASC taking into consideration the comments received. After reviewing the final draft, the CASC submits the standard to MoF for approval and issuance.

Roadmap for convergence with IFRS

The MoF released a roadmap in April 2010 for continuing and full convergence with IFRS. Following the development and issuance of eight new or amended standards in 2014, the IFRS Foundation and the MoF issued a Joint Statement in November 2015 noting that the Chinese Accounting Standards (i.e., the *ASBE*) had substantially converged with IFRS and that those standards had significantly enhanced the quality and transparency of financial reporting in China.

Given the level of convergence with IFRS and the effective endorsement by the IFRS Foundation the *ASBE* can be viewed as being a high and internationally acceptable quality.

Contents of financial statements

The *ASBE No. 30 - Presentation of Financial Statements* require financial statements to include balance sheets, income statements, cash flow statements, statements on changes to owners' equity and notes to the financial statements. CSRC's *Rules Concerning the Preparation of Information Disclosure documents by Companies Offering Securities to the Public No. 15 – General Provisions for Financial Reports* further provide that financial statements must include comprehensive notes covering the following:

- basic information about the company;
- the basis of preparation of the financial statements;
- significant accounting policies and accounting estimates, taxes, combinations, notes to financial items;
- changes in scope of consolidation;
- interests in other entities;
- risks associated with financial instruments;
- disclosure of fair value of assets, related parties and related party transactions, share-based payments, contingencies, subsequent events, other material events; and
- notes to significant items in the financial statements of the parent company.

Article 14 of the *ASBE- Basic Standards* stipulates that an enterprise must provide clear and understandable accounting information so that it is easily understood and used by users of financial reports.

Article 15 of the *ASBE- Basic Standards* requires enterprises to adopt consistent accounting policies for the same or similar transactions or events that occur in different periods and shall not change policies arbitrarily. It also provides that the accounting information should be comparable across periods and where a change in accounting policy is necessary it

should be explained in notes. Such changes are subject to retrospective treatment under the *ASBE No. 28 - Changes in Accounting Policies and Accounting Estimates and Correction of Errors*, so that adjustments are made to the comparative data of the prior accounting period to enable comparison.

Monitoring and enforcing compliance with accounting standards

Annual reports review program

The CSRC has in place a program to review annual reports issued by listed companies that mainly aims at monitoring compliance with accounting standards. The program is administered by the CSRC's Department of Accounting, which has about 30 staff members (with about 15 staff engaged in the monitoring of listed companies' annual reports and the remaining 15 staff engaged in auditors' supervision). In carrying out its supervisory functions the Department of Accounting is supported by personnel at the 38 CSRC regional offices.

The oversight of annual report audits is guided by the CSRC's Rules for Oversight of Annual Report Audits which sets out the division of supervisory responsibilities, work principles, key risks to watch out for, important procedures to be performed and the archiving of supervisory documents relating to the oversight of annual report audits.

The Department of Accounting reviews about 20-30% of the annual reports issued by listed companies in each year. This is a complete review of the annual report. If significant problems are found, the case is referred to the regional office for an on-site inspection.

Table. CSRC Review of Financial Statements to Assess Compliance with Accounting Standards

	2013	2014	2015
Reviews of financial statements	415 listed companies	520 listed companies	563 listed companies

Source: CSRC

When selecting annual reports for review, the Department adopts an approach combining risk-oriented sampling and random sampling.

Risk-oriented sampling

Focus is given to companies with high-risk profiles, namely:

- Companies that have had wildly fluctuating profit levels, e.g., companies whose net profit has changed by 50% or more or have shown a pattern of alternating profit-making and loss-making from year to year;
- Companies that have been given non-standard audit opinions for the current accounting period or several consecutive periods;
- Companies with shares currently designated as Special Treatment (ST) by the stock exchanges, especially those that have been given a trading suspension warning, and companies with ST shares in the previous period and that have been warned of the risk of delisting in the current period;
- Companies that are under scrutiny by the media;
- Companies that are going through material asset reorganizations during the

current period;

- Companies operating in emerging industries or under new business models, e.g., those in the gaming industry or film and television industry; and
- Companies in sectors that are under the regulatory scrutiny of CSRC in the current period.

Adjustments may be made to the sampling standard from year to year in light of the common regulatory issues identified by CSRC and of changes to accounting standards in that year. For example, in 2014, the MoF released three new accounting standards and amended five of the original standards. The annual reports review in that year was accordingly focused on whether the new standards were duly implemented by companies significantly impacted by the standards.

Random Sampling

A certain number of companies without a high-risk profile will also be chosen at random.

The Department may also review financial statements of a listed company at any time if specific issues arise with the company.

Exchanges review program

As indicated in Principle 16, the exchanges also have a program of review of periodic reports. While their main objective is to determine whether accurate, timely and complete disclosure is being provided to the market, it also serves as a complement to CSRC's review of reports for purposes of determining compliance with accounting standards.

Enforcement

Articles 26 of the *Accounting Law* prohibits companies and enterprises from engaging in any act that violates the unified accounting standards promulgated by the MoF, i.e., the *ASBE*. The legal liabilities for non-compliance are set out in Chapter VI of the *Accounting Law*.

Under Article 33 of the *Accounting Law*, the MoF, and the securities and insurance regulatory authorities are responsible for supervision and inspection of accounting material issued by entities within their regulatory remit.

The CSRC has specific rules that require listed companies to comply with accounting standards and to rectify any errors or non-compliance of accounting standards in their financial statements. Failure to rectify defects in the financial statements may result in the stock exchange suspending a company's listing. The relevant provisions are Articles 6 and 7 of the *Rules Concerning the Preparation of Information Disclosure Documents by Companies Offering Securities to the Public No. 14 – Non-Standard Unqualified Audit Opinions and Treatments for Related Matter* and Article 5 of the *Rules Concerning the Preparation of Information Disclosure Documents by Companies Offering Securities to the Public No. 19 – Corrections of Financial Information and Their Disclosure*.

Apart from specific rules requiring compliance with accounting standards, Article 63 of the *Securities Law* requires that information (including financial information) disclosed by an issuer or listed company to be truthful, accurate, complete and not contain any false entries, misleading statements or major omissions.

Under Article 193 of the *Securities Law*, where there is any false record or misleading or major omission in any report submitted by an issuer or listed company or in any

	<p>information it has disclosed, the CSRC shall issue a rectification order and a warning to the issuer, listed company, and a warning to the person-in-charge or any other person held to be directly responsible. The CSRC shall also impose an administrative penalty in the form of a fine ranging from RMB 300,000 to RMB 600,000 on the issuer or listed company, and from RMB 30,000 to RMB 300,000 on the person-in-charge or other persons held to be directly responsible. Where a controlling shareholder or <i>de facto</i> controller of an issuer or listed company instigated the irregularity, he is also subject to the same punishment.</p> <p>Where the violation is potentially criminal, i.e., a violation of Article 160 or 161 of the <i>Criminal Law</i>, the CSRC would refer the case to the competent judicial authority for prosecution.</p> <p>Practice</p> <p>CSRC staff indicated that the reviews showed that the majority of the reports are compliant with the accounting principles. There is a small percentage where significant problems are found. In such cases the CSRC has asked for restatements and other measures, such as administrative sanctions, have been imposed. Six listed companies in 2015 and 12 in 2016 have been subject to administration sanctions for accounting treatment violations.</p>
Assessment	Fully Implemented
Comments	<p>As indicated above the CSRC has a program of review of financial statements to ensure their compliance with accounting standards. The program allows coverage of the whole population in roughly four to five years; but the use of random sampling strengthens the prophylactic effect of such reviews. This program is complemented by the exchanges' program of review of periodic reports and in some regions, by the regional offices reviews of annual reports; thus supporting the efforts to ensure the quality of financial information. Finally the on-site inspections bring another layer to the program. Nevertheless given concerns about the quality of financial disclosure the assessors recommend that the CSRC keeps the coverage of its program of review of annual reports under review as indicated in Principle 16. This issue was considered for the grade of Principle 16. In addition, as mentioned under Principle 16, an issue of concern is the extent to which enforcement actions are sufficiently vigorous to have sufficient deterrent effect and affect issuers' behavior. This issue has been considered in the grade of Principle 12.</p>
Principles for Auditors, Credit Ratings Agencies, and Other Information Service Providers	
Principle 19	Auditors should be subject to adequate levels of oversight.
Description	<p>Regulatory framework</p> <p>All CPAs and audit firms are subject to regulation under the <i>Law on Certified Public Accountants</i> ("CPA Law").</p> <p>Under Article 5 of the <i>CPA Law</i>, the MoF and the provincial-level financial bureaus have the overall responsibility to supervise and guide the activities of CPAs, public accounting firms and institutes of certified public accountants.</p> <p>Under Article 9 of the <i>CPA Law</i> to qualify as a CPA, a person must have passed the requisite unified national examination, have engaged in auditing practice for more than</p>

two years, and not have any criminal record or been subject to administration punishment within the last five and two years respectively. The CPA unified national examination is formulated by the MoF and conducted by the Chinese Institute of Certified Public Accountants (CICPA).

Registration of qualified persons as CPAs is carried out by the regional institutes of certified public accountants pursuant to Articles 9, 10 and 12 of the *CPA Law*. The MoF has the final say on the registration as it has the authority under Article 11 to order the cancellation of any registration that is inconsistent with the *CPA Law*. Where an institute of certified public accountants has refused a registration application, the applicant may appeal to the MoF or the provincial-level financial bureau.

CPAs are required to satisfy continuing education requirements under the *Continuing Professional Development System for Chinese Certified Public Accountants* administered by CICPA and the regional institutes of certified public accountants. Pursuant to Article 37 of the *CPA Law*, the regional institutes of certified public accountants carry out annual inspection of CPAs registered under them to verify that they remain qualified in accordance with the requirements of the *CPA Law* and that they have fulfilled CPD obligations before renewing their CPA registration.

Under Article 25 of the *CPA Law*, the establishment of a certified public accounting (CPA) firm is subject to the approval of the MoF or the provincial-level financial bureau. .

In addition to the approval required under the *CPA Law*, audit firms intending to provide audit services for the securities market are required to obtain the joint approval from the CSRC and MoF to provide "securities services" under Article 169 of the *Securities Law*. Qualification requirements for obtaining the joint approval are spelled out in the *Notice of the Ministry of Finance and the CSRC Concerning Accounting Firms Engaging in Securities and Futures Business*. Among other requirements, the audit firm must:

- Have been established for more than five years;
- Have a sound quality control and internal management system that is effectively implemented, and have good professional ethics and competence in practice;
- Have at least 200 CPAs who are 65 or younger, of whom at least 120 have been continuously practicing for the last five years;
- Have at least 25 partners at least half of whom must have practiced in the firm for more than three years; and
- Have at least RMB 5 million in net assets and revenue in the preceding year of at least RMB 80 million of which at least RMB 60 million must be derived from the provision of auditing services.

The audit firm must satisfy the qualification requirements on a continuous basis after obtaining approval from the CSRC and the MoF.

Of the more than 7000 CPAs registered under the *CPA Law* nationwide, only 40 have been approved to provide securities services. As of December 31, 2015, these 40 audit firms had on average of 642 CPAs and 2,308 staff members, while all the audit firms nationwide had on average about 14 CPAs and 41 staff members.

CSRC staff indicated that the number of audit firms approved by CSRC has dropped from a high of about 70 firms in 2005 to the present number. This was primarily as a result of

	<p>mergers and acquisitions among the firms in response to a strategy launched by CICPA in 2006 of promoting the development of bigger and more competitive Chinese accounting firms that are capable of competing on a global scale.</p> <p>Audit firms that are approved to provide securities services are subject to the ongoing supervision of the CSRC pursuant to Articles 179 and 180 of the <i>Securities Law</i>. The CSRC exercises supervisory oversight of these firms in respect of their provision of audit services for securities market purposes, independent of the auditing profession. The CSRC has the powers to determine the qualification criteria for audit firms to provide securities services, promulgate rules to govern the firms' provision of auditing services for securities market purposes, conduct on-site inspections of the firms, investigate the firms for suspected violations of regulatory requirements and impose administrative penalties on the firms and their staff as well as suspend or revoke the CSRC's approvals for the provision of securities services in the event of violations.</p> <p>Audit firms that provide securities services are required under various rules promulgated by the CSRC to adhere to industry-accepted business and ethical standards. These rules include the <i>Measures for the Administration of Issuance and Underwriting of Securities</i>, the <i>Interim Measures for Administration of Initial Public Offerings and Listings on the Growth Enterprise Board</i>, the <i>Measures for the Administration of Issuance and Trading of Corporate Bonds</i>, the <i>Measures for the Administration of Information Disclosure by Listed Companies</i>, the <i>Measures for the Administration of Material Asset Reorganizations of Listed Companies</i>, the <i>Measures for the Administration of the Takeover of Listed Companies</i> and the <i>Measures for the Supervision and Administration of Unlisted Public Companies</i>.</p> <p>In providing audit services, CPAs are required under Article 21 of the <i>CPA Law</i> to produce audit reports in accordance with the audit procedures set in the relevant professional standards and rules. The key sets of professional standards are the <i>Standards of Practice for Chinese Certified Public Accountants</i> and the <i>China Code of Professional Ethics of Certified Public Accountants</i> (the "CPA Code") See the descriptions under Principles 20 and 21 for further details on these standards.</p> <p>Auditors' oversight</p> <p><i>Oversight and enforcement functions</i></p> <p>Pursuant to Articles 179 and 180 of the <i>Securities Law</i>, the CSRC is empowered to supervise and make inspections on audit firms that provide securities market services. The CSRC's oversight of these firms is independent of the self-regulation of CPAs through the CICPA and the regional institutes of certified public accountants.</p> <p>As the CSRC department in charge of supervising audit firms, the Department of Accounting is responsible for the overall planning, organization, coordination, supervision and guidance of the CSRC's supervisory efforts, including the:</p> <ul style="list-style-type: none"> • drafting and interpretation of regulatory policies and regulations; • review, approval and administration of the securities services qualification of audit firms; • establishment and improvement of supervisory information systems; • organization and supervision of CSRC's oversight of annual reports audits and on-site inspection of audit firms;
--	---

- imposition of regulatory measures against audit firms;
- arrangement, guidance, training, coordination and assessment of the audit and oversight programs of CSRC regional offices and stock exchanges; and
- participation in international exchanges and cooperation relating to audit oversight.

As noted under Principle 18, the Department of Accounting is also in charge of supervising listed company's compliance with accounting standards. The Department has about 30 staff, with roughly 10 engaged in the supervision of audit firms. In carrying out its supervisory functions over the audit firms, the Department of Accounting is supported by personnel at the 38 CSRC regional offices. There are over 200 staff members at the regional offices who engage in audit firm supervision, and some of them also engage in supervision of listed companies.

The CSRC undertakes two types of regular reviews of the audit procedures and practices of the firms that audit financial statements of public issuer: oversight of annual report audits and on-site inspection of audit firms. The purpose of these reviews is to determine the extent to which an audit firm has, and adheres to, adequate quality control policies and procedures to address all significant aspects of auditing.

Oversight of annual report audits

As indicated under Principle 18, the oversight of annual report audits is guided by the CSRC's *Rules for Oversight of Annual Report Audits* which sets out the division of supervisory responsibilities, work principles, key risks to watch out for, important procedures to be performed and the archiving of supervisory documents relating to the oversight of annual report audits.

The review of annual report audits is conducted every year during the annual report season. The CSRC takes a risk-oriented approach to identify the public issuers that should be subject to review. For high risk issuers the CSRC engages with the audit firm ahead of the audit process to provide guidance on potential issues of focus. Ex-post it reviews the audited annual report and the quality of audit work. For low-risk issuers, a number of annual reports are selected for ex-post review. The CSRC also reviews the quality of audit work for these issuers.

In carrying out the oversight of annual report audits, the CSRC aims to ensure that the audit firm and its CPAs –perform their duties diligently and comply with the relevant laws, regulations and the CSA;

- adhere to the philosophy of risk-based audit;
- improve audit procedures;
- adopt audit methods and techniques rationally;
- fully understand the listed company and its business environment;
- prudently assess the risks arising from potential material misstatement and fraud;
- fully implement control testing and substantive procedures; and

	<ul style="list-style-type: none"> • obtain sufficient and appropriate audit evidence to arrive at a reasonable audit conclusion. <p>The overall objective of this review is to improve the quality of financial information disclosed by public issuers.</p> <p>The review of the audit work involves reviewing the overall audit strategy, specific audit plans and audit summary for the audit of the public issuer as well as the issuer's financial reports comprising its financial statements and the audit report.</p> <p>It may also involve the CSRC regional offices conducting on-site supervision where appropriate. Where such supervision is conducted, the relevant regional office checks on-site whether the audit firm has allotted sufficiently competent persons and sufficient time to conduct the audit in accordance with its specific audit plan; whether the audit firm has conducted the audit in accordance with the audit priorities stated in the audit plan and any matters highlighted by the relevant CSRC regional office. The CSRC also investigates whether there was any material disagreement between the audit firm and the client on audited items, how any disagreement was resolved, and whether the audit firm found any defects in internal control and the audit firm's assessment thereof.</p> <p>On-site inspections</p> <p>On-site inspections of audit firms are guided by the CSRC's <i>Rules for Inspection on the Securities and Futures Business of Accounting Firms and Asset Appraisal Agencies (2015 Revision)</i> (the "Inspection Rules") and <i>Guidelines for Inspection on the Securities Services of Accounting Firms</i>. The Inspection Rules provide for the division of supervisory responsibilities, scope of inspection, organization and implementation, and investigation and processing.</p> <p>On-site inspections are carried out by the CSRC's regional offices. They can be comprehensive or targeted.</p> <p>A comprehensive inspection involves a thorough inspection of the internal governance, quality control system and quality practices of the audit firm. The standards for the assessment of the firm's internal governance, quality control system and quality practices of the audit firm include regulatory requirements, the CSA and the CPA Code.</p> <p>The choice of firms for comprehensive inspections each year are made in accordance with either of the following two selection models:</p> <p>(a) dual-random model, whereby the target auditors will be randomly selected from the group of auditors who have <u>not</u> been subject to a comprehensive inspection in the preceding three years; and</p> <p>(b) an issue- or risk-driven model, in which the focus will be placed on auditors fitting any of following descriptions:</p> <ul style="list-style-type: none"> • being frequently named in complaints by internal departments or regional offices of CSRC or exchanges in regard to the quality of its practice; • being frequently questioned by the media or named in a complaint or whistleblowing report in regard to its engagements; • being subject to numerous administrative sanctions, administrative regulatory measures, or self-regulatory measures in recent years; • being found, during inspections, to have poor implementation of regulatory rules
--	--

or, due to many engagements having long been signed by a small number of practitioners, a perfunctory quality control process;

- charging service fees at rates far below the industry norm;
- being found, during inspections, to have undertaken a large number of new engagements related to securities in recent years, most of which are of the high-risk variety; or
- being involved in multiple mergers or divisions, major changes with shareholders or partners, or frequent changes of engagement team.

The *Inspection Rules* provide that, in principle, an inspection of the internal governance and quality control system of an audit firm must be conducted by the CSRC at least once every three years. In practice, in addition to the firms selected by CSRC headquarters for on-site comprehensive inspection, each regional office selects a certain number of firms at random from those that have not been subject to a comprehensive inspection in the last three years.

A targeted inspection is conducted where circumstances arise that warrant the inspection. In particular, Article 8 of *Inspection Rules* provides that where an audit firm has been involved in any of the circumstances listed in the Article, inspection of the relevant items shall be conducted as warranted by the situation, and if necessary, the internal governance and quality control system of the firm as well. The circumstances are:

- merger or division involving the firm;
- material change of shareholders, partners or senior management of the firm;
- frequent change of CPAs in the firm;
- a significant issue concerning the firm has been discovered in the course of ongoing supervision;
- the firm is involved in a complaint or a report by a whistle-blower;
- the firm is challenged by any major public media;
- the firm provides securities or futures related services for the first time;
- the firm is engaged by a securities and futures institution to replace an existing auditor without justification;
- the firm charges fees outside normal ranges;
- the number of clients or the scale of the business of the firm does not match the practice or risk-bearing capacity of the firm;
- the firm has failed to file its business for record as required; and
- other matters requiring an inspection.

CSRC staff also indicated that it coordinates with the MoF at the planning stage.

In 2015, the CSRC conducted inspections (either comprehensive or targeted) on 32 audit firms (representing 80% of all the audit firms authorized to provide securities services), and spot-checks on 225 audit engagements (representing 8% of the total number of listed companies in China). The CSRC has conducted either a comprehensive or targeted inspection of every audit firm under its supervision at least once in the last three years.

Table. CSRC On-site inspections on audit firms

	2013	2014	2015
Comprehensive	3	2	7
Targeted	116	132	139

Source: CSRC.

Enforcement actions

The CSRC has at its disposal various regulatory measures that it can take against audit firms and their employees. These measures include: rectification orders; disciplinary interviews; warning letters; determinations as unsuitable person; orders to make public statement; orders to attend training; orders to submit regular reports; temporary non-acceptance of documents relating to administrative licensing; orders to suspend the provision of securities services; and revocation of authorization for the provision of securities services.

CSRC also has the power to impose administrative penalties. Under Article 223 of the Securities Law, any securities service provider (including an audit firms who fails to act with diligence and care, resulting in any misrepresentation, misleading statement or material omission in documents prepared or issued by it, shall be ordered to make corrections, have its securities service license suspended or revoked, and be subject to a fine of no less than one time and no more than five times its business revenue, and its manager in charge directly responsible and other persons directly responsible shall be given a warning, have his or her practice qualification revoked, and be subject to a fine of no less than RMB 30,000 and no more than RMB 100,000. Pursuant to the Provisions on Banning Access to the Securities Market, any persons who have violated laws may be subject to a 3 to 5 year, 5 to 10 year or lifetime market bar, depending on the severity of the violation.

Where the violation is potentially criminal, the CSRC would refer the case to the competent judicial authority for prosecution.

As indicated below, the CSRC has imposed both regulatory measures and administrative sanctions on audit firms and the individual auditors.

Cooperation mechanisms with CICPA

CSRC's Department of Accounting has established a routine supervisory cooperation mechanism with the CICPA. Both sides regularly organize joint training seminars for audit firms with securities service licenses, share information on respective inspection plans and follow-up actions on inspection findings, exchange ideas on the formulation and implementation of auditing standards, and have ad hoc discussions on important issues.

Table. Enforcement measures against audit firms and auditors				
	2013	2014	2015	2016
Regulatory measures	15 audit firms 39 CPAs	11 audit firms 73 CPAs	21 audit firms 97 CPAs	19 audit firms 88 CPAs
Administrative sanctions	4 audit firms	4 audit firms	2 audit firms	5 audit firms
Source: CSRC.				
Assessment	Broadly Implemented			
Comments	<p>KQ4 requires the existence of a process to perform regular reviews audit procedures and practices. The assessors acknowledge the increased attention that the CSRC is placing on auditors' work due to their role in ensuring the quality of financial information not just in the context of issuers (which is the focus of Principle 19) but also of all types of securities intermediaries. It also notes its willingness to impose enforcement measures on audit firms, as demonstrated by the data provided above. That said, the assessors note that while the CSRC has aimed to conduct comprehensive inspections in audit firms every three years, this has been difficult to achieve in practice, due to resource limitations. Instead, the CSRC has used targeted inspections more often to achieve coverage of the audit firms. Such approach appears to be in need of strengthening, particularly in light of the role of auditors as gatekeepers. Furthermore, a more comprehensive program for audit firms would balance out the need for a more intensive program for monitoring issuers' financial disclosure. In such context, and given that the whole financial sector relies on the quality of auditors work, the authorities are encouraged to consider the creation of a specialized oversight body for the audit profession as some of the large jurisdictions have done. This could ensure the existence of dedicated resources for the oversight of auditors, and allow the CSRC to redistribute internal resources.</p>			
Principle 20	Auditors should be independent of the issuing entity that they audit.			
Description	<p>Independence requirements</p> <p>Under Article 35 of the <i>CPA Law</i>, the CICPA is responsible for formulating professional standards and rules for CPAs and for implementing them after obtaining approval from the MoF. The standards for independence of external auditors in China are set out in the <i>China Code of Professional Ethics for Certified Public Accountants</i> ("<i>CPA Code of Ethics</i>") issued by the China Ethics Standards Board for CPAs under the CICPA. The <i>CPA Code of Ethics</i> parallels the <i>International Code of Ethics For Accountants</i> issued by the International Ethics Standards Board for Accountants. Accordingly, the <i>CPA Code of Ethics</i> deals with all aspects required by this Principle.</p> <p>Article 10 of Chapter III of the <i>CPA Code of Ethics No. 1 – Fundamental Principles of Professional Ethics</i> provide that "when providing audit and review services and other</p>			

	<p>assurance services, a certified public accountant shall maintain his or her independence in substance and in form and his or her objectivity may not be impaired by his or her having any interest in the recipient of such services”.</p> <p>Auditor independence requirements when providing audit services are set out in further details under the <i>CPA Code of Ethics No. 4 – Independence for Audit and Review Engagements</i>.</p> <p>Article 5 of Chapter II of the <i>CPA Code of Ethics No. 4</i> defines “independence” as comprising independence of mind and independence in appearance. Articles 6 to 8 sets out a three-step conceptual framework to be applied by CPAs in dealing with the issue of independence:</p> <ul style="list-style-type: none"> • Identify threats to independence; • Evaluate the significance of the threats identified; and • Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. <p>If appropriate safeguards are not available or cannot eliminate the threats or reduce them to an acceptable level, the CPA is required to eliminate the circumstances giving rise to the threats or decline or terminate the audit engagement. A CPA should use professional judgment when applying the conceptual framework.</p> <p>Chapters III to XVII of the <i>CPA Code of Ethics No. 4</i> set out specific situations and relationships that could threaten a CPA’s independence. The provisions describe how the situations and relationships may create threats to independence and the safeguards that may be applied to eliminate the threats or reduce them to an acceptable level. The situations and relationships covered are as follows:</p> <ul style="list-style-type: none"> • Economic interests • Loans and guarantees • Business relationships • Family and personal relationships • Employment relationships with audit clients • Temporary staff assignments • Members of an audit engagement team who have recently served as a director, senior executive or special employee of an audit client • Concurrent capacity as a director or senior executive of an audit client • Long-term business relationships with audit clients • Provision of non-assurance services to audit clients • Fees
--	---

- Compensation and evaluation criteria
- Gifts and Hospitality
- Actual or threatened litigation
- Reports that include restriction on use and distribution

These are not meant to be exhaustive. Under Article 4 of the *CPA Code of Ethics No. 4*, CPAs are expected to be vigilant in identifying threats to independence and to apply the conceptual framework to deal with any threat to independence that may arise when providing audit services, whether or not the threat arises from one of the situations or relationships described in the *Code*.

Rotation of auditors is mandated under Article 3 of the *Provisions on the Regular Rotation of Reporting Certified Public Accountants for Securities and Futures Auditing Engagements* (issued jointly by the CSRC and the MoF) for audit engagements with “relevant entities”, i.e., listed companies, companies that make IPOs of securities, organizations that trade in securities and futures, securities and futures exchanges, securities investment funds and their management companies, and securities registration and settlement organizations. A reporting CPA may not continue to provide auditing services to a relevant entity for more than five years.

The *CPA Code of Ethics No. 4* has provisions on long association of senior personnel (including partner rotation) with an audit client. Where the audit client is a public interest entity (e.g., listed company), Chapter XI requires rotation of the key audit partner after five years and a “cooling-off” period of two years before the partner may be re-admitted to the audit engagement team for the client. Threats related to long association of other partners must also be evaluated and, depending on the circumstance, rotation or regular independent quality reviews must be performed.

Chapter XII of the *CPA Code of Ethics No. 4* imposes independence requirements on auditors in relation to the provision of non-assurance services to their audit clients, including the prohibition of the provision of some of these services where it is not possible to mitigate the threat to independence. The non-assurance services include assuming management responsibility for an audit client, preparation of accounting records and financial statements, valuation services, taxation services, internal audit services, IT system services, litigation support services, legal services, recruiting services and corporate finance services.

Self-interest, self-review, advocacy, familiarity and intimidation are identified in Article 6, Chapter II of the *CPA Code of Ethics No. 2 – Conceptual Framework for Professional Ethics* as categories of threats to compliance with the fundamental principles of professional ethics. The Chapter goes on to provide examples of circumstances that give rise to each category of threats and safeguards that may be employed to respond to them. There are also provisions in the *CPA Code of Ethics No. 4* that explain how the above categories of threats may arise from the situations and relationships described in that *Code* and how they should be addressed.

Appointment and removal of auditors

The *Code of Corporate Governance for Listed Company* issued by the CSRC requires the audit committee of a listed company to be responsible for, inter alia, recommending the appointment or replacement of external auditors and overseeing the interaction between

	<p>the company's internal and external auditors.⁵⁵</p> <p>Article 169 of the <i>Company Law</i> provides that a company's auditors may be appointed or dismissed by shareholders in a general meeting or by the company's board of directors in accordance with its articles of association. For listed companies, however, Article 159 of the <i>Guidelines for the Articles of Association of Listed Companies</i> issued by the CSRC requires a listed company's articles to provide that the appointment of an audit firm must be decided by its shareholders in a general meeting and that its directors shall not appoint any audit firm without shareholders' approval.</p> <p>A listed company is required under CSRC's rules and the listing rules of the SSE or SZSE to report and disclose the appointment or dismissal of its auditors in a timely manner. Pursuant to the Information Disclosure Measures such disclosure needs to take place within two trading days. Under CSRC's rules, the company is required to provide the specific reasons for replacing an audit firm together with publication of the relevant shareholders' resolution that approved the replacement.⁵⁶</p> <p>Under disclosure standards promulgated by CSRC, public issuers of corporate bonds are required to disclose the dismissal and replacement of their auditors in their periodic reports.⁵⁷ The <i>Guidelines for Format of Information Disclosure of Ad hoc Reports on Corporate Bonds No. 30 – Change of Intermediaries</i> issued by the stock exchanges further require corporate bond issuers to disclose a change of auditors promptly as a material event.⁵⁸</p> <p>Ensuring compliance with independence requirements</p> <p><i>Firm's policies and procedures</i></p> <p>Article 9 of the <i>CPA Code of Ethics No. 4</i> requires audit firms to establish policies and procedures in accordance with the <i>Quality Control Standards No. 5101 – Quality Control of Accounting Firms for Audit and Review of Financial Statement, Other Assurance and Related Service Engagements</i> ("Quality Standards"). The <i>Quality Standards</i> require policies and procedures to ensure that the firm and its personnel (including experts and other personnel who are engaged by the firm who are required to satisfy the independence requirement) are independent as required under the <i>CPA Code of Ethics No. 4</i>.</p> <p>The <i>Quality Standards</i> require policies and procedures to be established to enable the firm to:</p> <ul style="list-style-type: none"> • Communicate the independence requirements to its personnel; • Identify and evaluate circumstances and relationships that create threats to independence and apply appropriate safeguards to eliminate the threats or reduce
--	---

⁵⁵ Article 54 of the *Code of Corporate Governance for Listed Companies*.

⁵⁶ See Article 39 of the *Rules on the General Shareholders' Meetings of Listed Companies*, Article 51 of the *Measures for the Administration of Information Disclosure by Listed Companies*, Article 11.12.7 of the *Rules Governing the Listing of Stocks on Shanghai Stock Exchange*, Article 11.11.4 of the *Rules of Shenzhen Stock Exchange on the Listing of Shares* and Article 11.11.5 of the *Rules of Shenzhen Stock Exchange on the Listing of Shares on the Growth Enterprise Board*.

⁵⁷ See Article 15 of the *Standards Concerning the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No. 38 – Annual Reports on Corporate Bonds* and Article 15 of the *Standards Concerning the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No. 39 – Semi-Annual Reports on Corporate Bonds*.

⁵⁸ See Articles 14 to 20 of the *Quality Standards*.

	<p>them to an acceptable level, or, if necessary, to withdraw from the engagement.</p> <p>The policies and procedures must also require:</p> <ul style="list-style-type: none"> • The partner in charge of an engagement to provide the firm with relevant information about the engagement to enable the firm to evaluate the overall impact on independence; • The firm's personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that the firm may take appropriate action; and • The firm to collect and communicate relevant information to appropriate personnel of the firm so that: • The firm and its personnel can determine whether they satisfy independence requirements; • The firm can maintain and update its records relating to independence; and • The firm can take appropriate action regarding identified threats to independence. <p>Appropriate action by the firm and the relevant engagement partner includes applying appropriate safeguards to eliminate the threats to independence or to reduce them to an acceptable level, or withdrawing from the engagement.</p> <p>The firm should provide training on its policies and procedures on independence to all personnel who are required to be independent. The firm should also obtain written confirmation of compliance with its policies and procedures on independence from such personnel.</p> <p><i>CSRC's monitoring and enforcement</i></p> <p>As noted under Principle 19, the CSRC has in place an ongoing supervisory program comprising oversight of annual report audits and on-site inspections of audit firms to monitor compliance with regulatory requirements, standards of practice and code of professional ethics including independence requirements. Also as noted, the CSRC has a variety of regulatory measures and administrative penalties that it may impose on the audit firm or its employees found to be in breach. Where there is a suspected violation of criminal law, the CSRC is able to refer the case to the judicial authority for criminal prosecution.</p>
Assessment	Fully Implemented
Comments	Issues concerning the intensity of the supervisory program over auditors have been taken into consideration for the grade of Principle 19.
Principle 21	Audit standards should be of a high and internationally acceptable quality.
Description	Required standards

	<p>Article 165 of the <i>Company Law</i> requires all Chinese companies to prepare financial and accounting reports at the end of each financial year and have the reports audited by a certified public accountant in accordance with the law. Article 21 of the <i>Law on Certified Public Accountants</i> ("CPA Law") requires public accountants performing audit engagements to issue reports in accordance with the applicable standards and rules of practice including the <i>Standards of Practice for Chinese Certified Public Accountants</i> (the "CSA").</p> <p>There has not been any public offering or listing by foreign issuers in China. In principle, if a foreign issuer makes a public offering or lists in China, any financial statements that it is required to disclose in China must be prepared in accordance with the <i>ASBE</i> or accounting standards recognized as equivalent by the MoF, and audited in accordance with the <i>CSA</i> or auditing standards recognized as equivalent by the MoF.</p> <p>Standards setting and convergence with ISA</p> <p>Article 35 of the <i>CPA Law</i> charges CICPA with the responsibility of establishing professional standards and rules for CPAs. The standards and rules must be reported to the MoF and take effect upon the MoF's approval.</p> <p>The <i>CSA</i> are developed by the China Auditing Standards Board ("CASB") within CICPA pursuant to Article 35. The CASB comprises 31 members drawn from the CPA profession, governmental authorities, experts and scholars in accounting, auditing, law and other relevant fields. The majority of the members are non-practicing CPAs from relevant regulators such as the MoF, the State-Owned Assets Supervision and Administration Commission ("SASAC"), the CBRC and the CSRC.</p> <p>The setting of auditing standards follows a due process similar to the setting of the <i>ASBE</i>. The consultation is open and transparent, and takes into account the comments and recommendations of all relevant stakeholders. In accordance with Article 35 of the <i>CPA Law</i>, auditing standards are implemented only after being approved and promulgated by the MoF.</p> <p>The <i>CSA</i> are of a high and internationally acceptable quality. They were first issued in January 2007 and revised in November 2010. The revision achieved full convergence with the clarified <i>International Standards on Auditing</i> ("<i>ISA</i>") issued by the International Auditing and Assurance Standards Board ("IAASB") in February 2009, as announced in a joint statement issued by the IAASB and the CASB in November 2010. The <i>CSA</i>, however, have two additional standards dealing with the verification of capital contribution and the communication between predecessor and successor CPAs which are not covered under the <i>ISA</i>. The additional requirements were included to reflect the unique circumstances and business practices in China where the verification of capital contribution in equity joint ventures forms an importance practice area of CPAs and because Chinese companies frequently change statutory auditors. The IAASB recognized in the joint statement that such additional requirements may be necessary and are acceptable where they do not conflict with <i>ISA</i>.</p> <p>There is currently an arrangement between the Chinese Mainland and the Hong Kong SAR affirming the equivalence and mutual recognition of the <i>CSA</i> and the Hong Kong Auditing Standards. As of February 2015, the financial statements of 45 out of 204 Hong-Kong listed mainland companies were audited in accordance with <i>CSA</i>.</p> <p>Mechanisms to ensure compliance</p> <p><i>Firm's policies and procedures</i></p> <p>The <i>Quality Standards</i> require audit firms to establish a quality control system that includes</p>
--	---

	<p>policies and procedures that address the following key elements:</p> <ul style="list-style-type: none"> • Leadership responsibilities for engagement quality within the firm; • Standard of professional ethics; • Acceptance and continuance of client relationships and specific engagements; • Human resources; • Engagement performance; • Engagement working papers; and • Monitoring and control. <p>The firm must document its policies and procedures and communicate them to the firm's personnel.⁵⁹</p> <p>CSRC's monitoring and enforcement</p> <p>As noted under Principle 19, the CSRC has in place an ongoing supervisory program comprising oversight of annual report audits and on-site inspections of audit firms to monitor compliance with regulatory requirements, standards of practice and code of professional ethics. Also as noted, the CSRC has a variety of regulatory measures and administrative penalties that it may impose on the audit firm or its employees found to be in breach. Where there is a suspected violation of criminal law, the CSRC is able to refer the case to the judicial authority for criminal prosecution.</p>
Assessment	Fully Implemented
Comments	Issues related to the intensity of the supervisory program over auditors have been taken into consideration for the grade of Principle 19.
Principle 22	Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.
Description	<p>Use of ratings for regulatory purposes</p> <p>A credit rating is mandatory for publicly-offered corporate and enterprise bonds as discussed under Principle 16⁶⁰</p> <p>Regulatory framework</p> <p>PBoC role</p> <p>Pursuant to SC decisions, the PBoC is the lead regulator for CRAs. All firms that want to provide this type of services must fulfill record filing procedures regulated by the PBoC.</p>

⁵⁹ See Articles 6 and 7 of the *Quality Standards*.

⁶⁰ See article 19 of the Corporate Bond Measure and Article 3 of the NDRC Notice on the Issuing Amount and Approval of the First batch Enterprise Bonds in 2007 (NDRC Caijin [2007] No. 602).

	<p>The record filing procedures require that the CRAs report to the PBoC about certain issues of the companies for reference. The basic requirements for CRAs are set forth in the Credit Rating Supervisory Guidelines issued by the PBoC in 2006.</p> <p>According to Guiding Opinions of the PBoC on Credit Rating Management, Notice of the PBoC on Promoting the Reform of the Credit Rating Management in Credit Market, and Notice of the General Office of the PBoC on the CRAs Coding and Further Strengthening the Administration of Credit Rating, the branches of the PBoC are responsible for implementing the record filing administration of CRAs. To this end, the CRAs need to apply to the PBoC branches in their own district for record filing, and provide the corresponding record filing materials. The PBoC branches are responsible for their verification via off-site review and on-site inspections. Once the information is verified, the PBoC branches report the relevant information to the PBoC headquarter in formal documents, and submits the relevant record filing materials.</p> <p>The record filing materials include business license, institutional credit code, shareholder information, location, the procedures and methodologies of credit rating, internal control mechanism and management system, business qualification, and certification of the operating capability. Details can be found in Guiding Opinions of the PBoC on Credit Rating Management and Notice of the PBoC on Promoting the Reform of the Credit Rating Administration in Credit Market.</p> <p>On an ongoing and periodic basis CRAs must submit statistical reports and relevant materials to PBoC branches, including rating business data, default data, a monthly report, an annual report, financial statements, and reports on major events.</p> <p>The PBoC branches are responsible for the routine supervision of CRAs. Such program comprises both off-site analysis and on-site inspection. In 2016, PBoC Headquarters carried out off-site verification work of relevant business information of CRAs nationwide. In 2015, a total of 65 CRA (including branches) on-site inspections were conducted by 23 PBoC branches. As a follow up, the PBoC branches interviewed the executives of CRAs where problems were found to ensure that rectification measures were taken.</p> <p>License by the relevant regulatory authority</p> <p>In addition, a firm that wants to conduct bond credit rating must obtain a license or recognition from the regulatory authority of the securities or market for which credit rating services would be provided. These are the CSRC for ratings of corporate bonds that are to be listed, NDRC for ratings of enterprise bonds and PBoC with NAFMII for debt financing instruments traded on the Inter-bank Bond Market. There are separate requirements applicable to each such recognition.</p> <p>CSRC, NDRC and PBoC, NAFMII have licensed 7, 6 and 6 CRAs respectively. Of these, 3 CRAs are licensed by all three authorities, 2 are licensed by both NDRC and NAFMII, and 1 is licensed by both CSRC and NDRC.</p> <p>As indicated under Principle 1, in 2016 the PBoC, the CSRC and the NDRC jointly drafted the Provisional Regulation for the Credit Rating Industry in order to promote the regulation and supervision of the credit rating industry and implement unified access standards. The draft has been sent to the public for comments.</p> <p>CSRC licensing requirements</p> <p>Credit rating agencies ("CRA") that engage in securities related business, such as providing credit ratings of publicly offered corporate bonds, are required to obtain the approval of the CSRC pursuant to Article 169 of the Securities Law. This requirement applies to CRAs</p>
--	--

that are located outside China whose credit ratings are used for regulatory purposes in China. More detailed provisions on the licensing of credit rating agencies are specified in the Interim Measures for the Administration of Credit Rating Services in the Securities Market ("Credit Rating Measures") promulgated by the CSRC.

The scope of "securities rating business" is defined as credit rating services provided in respect of any of the following rated objects:

- (1) bonds, asset-backed securities and other fixed income or debt-like structured financing securities issued with approval of the CSRC in accordance with law;
- (2) bonds, asset-backed securities and other fixed income or debt-like structured financing securities traded in a stock exchange, excluding treasury bonds;
- (3) issuers, listed companies, unlisted public companies, securities companies, and securities investment fund management companies of the securities mentioned in Items (1) and (2); and
- (4) other rated objects stipulated by CSRC.

Article 7 of the Credit Rating Measures sets out the criteria for a credit rating agency to obtain a securities rating business license as follows:

- (1) It has Chinese legal person qualification, and both its paid-in capital and its net asset are not less than 20 million yuan;
- (2) It has at least three senior managers that satisfy the requirements under the Credit Rating Measures and at least 20 rating professionals that have the securities business qualification, of which, at least ten rating professionals must have credit rating experience of at least three years, and at least three rating professionals must have the qualification of certified public accountants of China;
- (3) It has a sound and well-operated internal control mechanism and a sound and well-operated management system;
- (4) It has sound business rules, including the division and definitions of credit ratings, rating criteria, rating procedures, rating committee system, rating result publication system, rating tracking system, information confidentiality system, and archival management system of its securities rating business;
- (5) It has not been subjected to criminal punishment for the latest five years and not been subjected to administrative punishment due to illegal business operations for the latest three years, and is not being investigated due to suspicious illegal operations or crime;
- (6) It has no bad credit record at the administrative departments for taxation, industry and commerce and finance, etc., self-disciplinary organizations or commercial banks, etc.; and
- (7) Other conditions prescribed by the CSRC for the protection of investors or public interests.

Pursuant to Article 8 of the Credit Rating Measures, a senior manager who is responsible for the securities rating business in a CRA must, inter alia, satisfy the stipulated fit and proper criteria, have passed the securities rating business senior manager qualification examination and obtained securities business qualification, and have the relevant professional knowledge and management abilities.

	<p>Governance requirements</p> <p>The governance requirements for securities rating agencies are set out in the Credit Rating Measures promulgated by the CSRC and are supplemented by requirements under the Code of Practice of Securities Credit Rating Agencies ("Code of Practice") and the Detailed Rules for the Ratings Services of Securities Credit Rating Agencies for the Securities Market (Provisional)("Detailed Rules") issued by the Securities Association of China (SAC).</p> <p>The Code of Practice and the Detailed Rules apply to all securities rating agencies as they are required under Article 34 of the Credit Rating Measures to take up membership of the SAC.</p> <p>The Credit Rating Measures, Code of Practice and Detailed Rules include requirements that address the following:</p> <p>Obligations related to the quality and integrity of the rating process</p> <p>Rating methodology</p> <p>Under Article 5 of the Credit Rating Measures, a securities rating agency is required to establish a sound rating methodology and quality control system, comply with the relevant code of conduct, professional ethics and business rules, and apply their expertise with due diligence and prudence.</p> <p>Under Article 7(4) of the Credit Rating Measures, a securities rating agency must have well-developed business rules that cover the classification and definitions for its rating grades, rating standards, rating process, as well as the rules for its rating committee, publication of rating results, follow-up ratings, confidentiality, and the management of archives related to its securities rating service.</p> <p>Article 8 of the Code of Practice provides that a securities rating agency must use rating methodologies that are rigorous and systematic, and that its opinions must be based on a thorough analysis of all relevant information within its knowledge.</p> <p>Rating committee</p> <p>Article 16 of the Credit Rating Measures require a securities rating agency to establish a rating committee, which is to be the highest body for determining the agency's credit ratings. The rating committee shall examine the preliminary assessment reports submitted by the rating team, make decisions and determine the credit ratings.</p> <p>Updating credit ratings</p> <p>Securities rating agencies are required to update their credit ratings as new information becomes available. Under Article 19 of the Credit Rating Measures, securities rating agencies must establish a system for issuing follow-up ratings. An initial rating report must state clearly the items that will be subject to follow-up ratings. For as long as the rated object validly exists, the agency must keep track of material changes affecting the rated object, including the policy environment in which the rated object operates, the rated object's industry risks, its operational strategy and financial position. The agency must analyze the impact of these factors on the rating grade, and issue follow-up rating reports on a regular or ad hoc basis as necessary.</p> <p>Record keeping</p> <p>Article 23 of Credit Rating Measures requires a securities rating agencies to establish an archive management system under which the agency must archive clients' engagement letters, source materials used in preparing rating reports, working papers, preliminary</p>
--	--

rating reports, final rating reports, final opinions and meeting minutes of the rating committee, materials related to follow-up ratings and the follow-up rating reports etc. The material must be retained for at least ten years or for five years after the expiry of the rating contract or the date on which the rated object ceases to exist, whichever is longer.

Resources

Articles 7, 8 and 15 of the Credit Rating Measures, and provisions under the Code of Practice and Detailed Rules, list the resources required of securities rating agencies to ensure the provision of high quality credit rating services. These include a requirement that an agency must have at least 20 rating professionals who are qualified to provide securities services of which at least ten must have three or more years' credit rating experience and at least three must be CPAs qualified in China.

Independence and avoidance of conflicts of interest

Conflicts of interest policy

Article 3 of the Credit Rating Measures stipulates that a securities rating agency must be independent, objective and fair when providing its services.

Article 42 of the Code of Practice requires a securities rating agency to implement a written conflicts of interest prevention system to identify, manage and disclose conflicts of interest that may arise from conducting its securities rating business. The system should:

- (1) clarify the situations where conflicts of interest may arise and establish mechanisms for the management of conflicts;
- (2) establish a Chinese wall and recusal system and clarify the situations where the agency or its rating professionals should recuse themselves;
- (3) clarify that in the event a rating professional leaves the agency and is subsequently employed by an issuer previously rated by him or by an institution that he had frequent contact with, the agency must examine the related rating work done by that rating professional.
- (4) Establish a system for the reporting and disclosure of all potential and actual conflicts of interest in a clear, simple, detailed, conspicuous, comprehensive and timely manner.

Prohibited business

Article 12 of the Credit Rating Measures stipulates that a securities rating agency, which has any of the following interests with an object being rated, must not accept an engagement to rate the object:

- (1) Both the securities rating agency and the institution or securities issuer being rated are controlled by the same de facto controller;
- (2) The same shareholder simultaneously holds 5% or more of the shares of the securities rating agency and the institution or securities issuer being rated;
- (3) The institution or securities issuer being rated and its de facto controller directly or indirectly holds 5% or more of the shares of the securities rating agency;
- (4) The securities rating agency and its de facto controller directly or indirectly holds 5% or more of the shares of the securities issuer or the institution being rated;
- (5) The securities rating agency or its de facto controller has bought or sold the securities being rated within six months before carrying out the securities rating; and

	<p>(6) Any other circumstances prescribed by the CSRC for the protection of investors or public interests.</p> <p>Under Article 13 of the Credit Rating Measures, a securities rating agency must establish a recusal system under which a rating committee member or rating professional of the agency must recuse himself in any of the following circumstances from carrying out securities rating of the object being rated:</p> <p>(1) He himself or any of his lineal relatives holds 5% or more of the shares of the institution or the securities issuer being rated, or is the de facto controller of the institution or the securities issuer being rated;</p> <p>(2) He himself or any of his lineal relatives is the director, supervisor or senior manager of the institution or the securities issuer being rated;</p> <p>(3) He himself or any of his lineal relatives is the person in charge or project signer of the accounting firm, law firm, financial consultancy or other securities service agency as hired by institution or the securities issuer being rated;</p> <p>(4) He himself or any of his lineal relatives holds RMB 500,000 or more of the securities being rated or the securities issued by the institution being rated; or accumulatively concludes transactions of RMB 500,000 or more with the institution or securities issuer being rated; and</p> <p>(5) Any other circumstances as affirmed by the CSRC that will sufficiently affect the principle of independence, objectivity or fairness.</p> <p>Business segregation</p> <p>A securities rating agency is required under Article 14 of the Credit Rating Measures to establish a clear and rational organizational structure that appropriately divides the functions of its internal bodies and establish a Chinese wall system. The department for its securities rating business must be independent of other business departments of the agency.</p> <p>Rating professionals' compensation</p> <p>Article 14 of Credit Rating Measures stipulates that the staff performance evaluation and compensation system adopted by securities rating agencies must not adversely affect the independence, objectivity, fairness and consistency of the work of their rating professionals.</p> <p>Disclosure of conflicts of interest</p> <p>Article 63 of the Detailed Rules stipulates that securities rating agencies must disclose, in a timely manner, the following information on their websites, the website of the SAC, and other websites designated by the CSRC:</p> <ul style="list-style-type: none"> • actual and potential conflicts of interest in the performance of their securities rating business; • measures employed to manage and control these conflicts; and • the potential consequences. • Article 63 further sets out a non-exhaustive list of situations involving actual or potential conflicts of interest that must be disclosed. These situations include:
--	---

- The securities rating agency has received from the issuer being rated compensation that is unrelated to the credit rating services provided;
- The securities rating agency, its de facto controller, any of its directors, supervisors, senior managers or rating professionals engaged in the rating or any of their lineal relatives holds directly or indirectly 5% or more of the shares or derivatives of the institution or the securities issuer being rated; and
- The securities rating agency's directors, supervisors, senior managers or rating professionals engaged in the rating or any of their lineal relatives is the de facto controller of the institution or securities issuer being rated, or is a director, supervisor or senior manager thereof, or is in any employment relation with it.

Contingency fees

Article 36 of the Code of Practice requires a securities rating agency to refrain from entering into contingency fee arrangements with clients and to commence the rating process only after its fees have been paid in full.

Responsibilities to the investing public and rated entities

Disclosure of credit ratings

Article 19 of the Credit Rating Measures stipulates that securities rating agencies must establish a rating results announcement system. Each rating result must include the rating grade assigned to the rated object and the corresponding rating report. The rating report must explain the credit rating issued in clear and concise language.

Articles 44 and 45(6) of the Code of Practice requires securities rating agencies to publish their rating results on their company's own website and the website of the SAC in a timely manner, including the initial rating result and all follow-up rating results as well as rating actions. Any change in the information must also be disclosed in a timely manner.

Article 19 of Credit Rating Measures stipulates that in the case that a rated entity or a rated securities issuer has objections to the rating report issued by a securities rating agency and has engaged another agency to issue a second rating report, both the original agency and the current agency must announce their rating results.

Information to enable understanding of ratings

A securities rating agency is required under Article 11 of the Credit Rating Measures to file a record of the classification and definitions of its rating grades, its rating methodology and rating procedures with the Securities Association of China within 20 days of obtaining a securities rating service license. It must also publish the same material on the website of the Securities Association of China, its own website and through other public media. Where there is any change to the classification and definitions of its rating grades, its rating methodology and rating procedures, it must be similarly filed and published.

Information on historical default rates

Under Article 21 of Credit Rating Measures, securities rating agencies are required to use effective statistical methods to assess the accuracy and stability of their rating results. The results of the assessments must be announced to the public through their own websites and the website of the Securities Association of China. Article 52 of the Code of Practice requires the assessment to include historical default rates and rating migration rates.

Protection of non-public information

	<p>Article 22 of the Credit Rating Measures requires securities rating agencies to establish a confidentiality regime to protect information related to their provision of securities rating services. Securities rating agencies and their staff have an obligation to keep confidential the state secrets, trade secrets and personal information that come to their knowledge during the provision of securities rating services.</p> <p>Articles 55 to 58 of Code of Practice have set forth more detailed confidentiality provisions including a prohibition on the use of non-public information obtained in the course of providing securities rating services to seek a profit or to trade on such information, and a requirement to implement procedures to prevent the disclosure of non-public information, including rating results that have not been officially announced, to any party outside or within the agency who are not involved in the rating assessment and determination.</p> <p>Practice</p> <p>Licensing</p> <p>Article 9 of Credit Rating Measures stipulates that a CRA who applies for the securities rating service license must submit the following materials to CSRC:</p> <ol style="list-style-type: none"> (1) an application report; (2) photocopy of its Business License of Enterprise Legal Person; (3) its articles of association; (4) its register of shareholders and their contributions, mode of contributions, ratio of contributions, background materials, and explanations about whether any of the shareholders are related parties; (5) financial reports audited by an audit firm qualified to offer services relating to securities and futures; (6) description and credentials of senior managers and rating professionals; (7) description of the internal control mechanisms, management system and their implementation; (8) description of its business rules and their implementation; and (9) other materials as may be required by the CSRC. <p>Under Article 10 of the Credit Rating Measures states that the CSRC is to review and decide on an application of a CRA for the securities rating service license in accordance with the statutory requirements and procedures and principles of prudential regulation, and taking into full account of the need of market development and fair competition.</p> <p>In practice, besides reviewing the material submitted by the applicant, the CSRC consults other relevant regulators of the applicant to check on its compliance track record. The CSRC also conducts background checks on the senior managers of the applicant and an on-site inspection of the applicant's offices to verify that its internal control and management systems are in place.</p> <p>Ongoing supervision</p> <p>Reporting requirements</p> <p>Article 30 of Credit Rating Measures requires a securities rating agency to submit an annual report to the CSRC regional office where the agency is registered within four months from the end of each financial year. The annual report must include, among other things, the agency's basic information, operating performance, audited financial report, information</p>
--	--

on material lawsuits, and statistical information regarding the accuracy and stability of the ratings it has issued. The directors and senior managers of the agency must include their signed opinions in the annual report to confirm its contents or present their comments and reasons if they have any objections.

The same Article also requires each securities rating agency to submit quarterly reports containing such information as its operating performance and financial data to the CSRC regional office where the agency is registered within ten days from the end of each quarter. Where an agency's operations or management will or may be affected by a significant event, it must submit an interim report immediately to the relevant CSRC regional office stating the cause, current situation and potential consequences of the event.

Article 33 provides that if any securities rating agency no longer meets the requirements for a securities rating services license, it must submit a written report of that fact immediately to the CSRC regional office where the agency is registered and make a public announcement of the same. The regional office shall order the agency to rectify the non-compliance within a specified time, during which no securities rating service may be offered by the agency. If the agency is unable to meet the requirements within the time limit, the CSRC will terminate the agency's license.

Inspections

Article 31 of Credit Rating Measures provides that CSRC regional offices shall carry out off-site or on-site inspections on the internal control, management system, operations, risk status, practices, and financial situation of securities rating agencies.

In practice, CSRC carries out routine on-site inspections on all securities rating agencies at least once a year. The scope of the inspection may vary but would at least cover the following areas:

- compliance with criteria for the securities rating services license;
- internal control and management systems;
- standard of rating information disclosure;
- consistency in the formulation and application of rating methodology and procedures and consistency in rating results.

In 2015, six inspection teams conducted on-site inspections on the seven securities rating agencies. The teams were led by the CSRC and supported by the relevant CSRC regional offices, the SSE, SZE, CSDC and SAC. CSRC staff indicated that about 20-30 engagements were selected for review for each CRA. The inspections looked at the overall cycle of the engagement. The inspection findings were highlighted at one of the CSRC's regular press conferences and the inspection reports on each CRA were made available on the CSRC website.

Enforcement

Articles 198, 200, 202, 223, 225 and 226 of the Securities Law and Articles 35 to 41 of Credit Rating Measures provide detailed rules on the regulatory measures and administrative penalties that can be imposed on a securities rating agency that has violated laws, regulations or relevant rules.

According to Article 32 of Credit Rating Measures, if a securities rating agency or its rating professionals violate the provisions of the Measures, the competent CSRC regional office

	<p>may issue a warning letter to the agency, arrange supervisory interviews with its persons-in-charge or senior managers, and order the agency to rectify within a specified time limit. If the agency fails to rectify within the specified time limit, the CSRC may reject the rating reports issued by said agency. Articles 198, 200, 223, 225, 226, 233 of the Securities Law and Articles 35 to 41 of the Credit Rating Measures also allow CSRC to impose market bars and fines on CRAs.</p> <p>Following the on-site inspections conducted in 2014 and 2015, CSRC imposed 7 and 12 regulatory measures respectively on the securities rating agencies and their personnel. The measures imposed were rectification orders, warning letters and regulatory interviews with senior management. In all cases, a record was made against the integrity record of the agency or personnel.</p>
Assessment	Fully Implemented
Comments	<p>Given the significant overlap among the lists of the different authorities, the assessors have focused the assessment on the CSRC regime and the grade reflects the assessment of such regime. The governance rules in the Credit Rating Measures, the Code of Practice and the Detailed Rules were modeled on the provisions in the IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies (2008). The rules are comprehensive and the CSRC has in place an intensive oversight program involving both off-site monitoring and on-site inspections. The assessors concur with the CSRC in its statement that the supervision of the securities rating agencies can be challenging, particularly due to the lack of internationally or generally accepted standards for credit ratings methodologies. The enforcement measures used is an issue that the CSRC should be kept under review. This issue has been considered for the grade of Principle 12.</p> <p>As indicated above, the assessors note work already underway to harmonize the regime for the regulation of CRAs. The authorities should proceed to finalize and implement the draft Provisional Regulation for the Credit Rating Industry.</p>
Principle 23	Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.
Description	<p>Background</p> <p>There are about 183 companies authorized to provide investment consultancy services, with 84 of them being specialized firms dedicated exclusively to securities investment consultancy. Among the total of 183, about 100 companies release research reports. In addition, as of the end of Jun 2017, 110 futures companies in China were licensed to conduct investment consultancy service.</p> <p>Licensing requirements for securities and futures investment consultancy service providers</p> <p>Firms and individuals engaged in the business of providing securities and futures investment consultancy are regulated by the CSRC under the Interim Measures for the Administration of Securities and Futures Investment Consultancy ("Investment Consultancy Measures").</p> <p>Under Article 2 of the Investment Consultancy Measures "securities and futures investment consultancy services" is defined as direct or indirect paid consultancy services such as securities and futures analyses, forecasts or advice given by institutions engaged in</p>

	<p>securities and futures investment consultancy and their individual consultants to securities and futures investors or clients through any of the following means:</p> <ul style="list-style-type: none"> • Pursuant to a commission from an investor or client; • Holding lectures, seminars, analyst meetings etc. in respect of securities and futures investment; • Publishing articles, commentaries or reports on securities and futures investment in newspapers or magazines, or through radio stations, television stations or other public communications media; • Through telephone, facsimile, computer networks or other telecommunications systems; and • Other means as determined by the CSRC. <p>The provision of securities or futures research reports is therefore regulated under the Investment Consultancy Measures.</p> <p>Under the Investment Consultancy Measures, both firms and individuals providing securities and futures investment consultancy services must be authorized by the CSRC.⁶¹ Individuals may only provide such services as employees of an authorized firm.⁶²</p> <p>Securities business firms, futures brokerage firms and their staff who provide securities and futures investment consultancy services are also required to obtain CSRC's approval to provide securities and futures investment consultancy services.⁶³ (Article 3 of the Investment Consultancy Measures)</p> <p>To obtain the requisite business license a firm must satisfy the following criteria:⁶⁴</p> <ul style="list-style-type: none"> • If the firm will provide either securities or futures investment consultancy services only, the firm must have more than five full-time employees who are qualified to engage in securities or futures investment consultancy business respectively. If the firm will provide both securities and futures investment consultancy services, it must have more than 10 full-time employees who are qualified to engage in securities or futures investment consultancy business. • At least one member of the firm's senior management must be qualified to engage in securities or futures investment consultancy business; • Have more than RMB1 million in registered capital; • Have a fixed business office and the necessary communication and other information-transmission facilities relevant to its business; • Have formulated articles of association for the company;
--	--

⁶¹ See Article 3 of the *Investment Consultancy Measures*.

⁶² See Article 12 of the *Investment Consultancy Measures*.

⁶³ See Article 3 of the *Investment Consultancy Measures*.

⁶⁴ See Article 6 of the *Investment Consultancy Measures*.

	<ul style="list-style-type: none"> • Have a sound internal management system; and • Other criteria as may be stipulated by the CSRC. <p>Separately, under Article 6 of the Trial Measures for the Futures Investment Consultancy Services of Futures Companies (“Futures Consultancy Measures”), if a futures company wants to also undertake futures investment consultancy services, it must satisfy the following criteria:</p> <ul style="list-style-type: none"> • Its registered capital shall not be less than RMB 100 million and net capital shall not be less than RMB 80 million; • Its risk control indicators for the six months prior to the date of application continue to meet the regulatory requirements; • It must have at least one senior management personnel who has more than 3 years of experience in the futures business and has obtained futures investment consultancy qualification, and have no less than 5 personnel who have more than 2 years experience in the futures business and have obtained futures investment consultancy qualification. The senior management and personnel must not have any adverse integrity record in the past three years and are not being investigated by the authorities for any suspected violation of the law; • It must have a comprehensive management system for conducting futures investment consultancy business; • In the past three years, it has not been subject to any administrative or criminal penalties for any illegal operations, and there has not been any case where it was being investigated by a competent authority on suspicion of any major violation of law. • No regulatory measures have been imposed on the firm in the past one year pursuant to Article 59, paragraph 2, or Article 60 of the Regulations on the Administration of Futures Trading; • other conditions prescribed by the CSRC. <p>Individual consultants must obtain a qualification certificate and a business practice certificate from the CSRC in order to provide securities or futures consultancy services. to obtain a qualification certificate he or she must satisfy the following criteria:⁶⁵</p> <ul style="list-style-type: none"> • Be a citizen of the PRC; • Have full capacity for civil conduct; • have good integrity, honesty and excellent professional ethics; • Have not been subject to punishment for any criminal offence or administrative penalty for any major violation relating to securities or futures business;
--	--

⁶⁵ Article 13 of the Investment Consultancy Measures.

- Educational qualification at college level or above;
- Have more than two years' experience in securities business (if applying for securities investment consultancy qualification); or more than two years' experience in futures business (if applying for futures investment consultancy qualification);
- Have passed the requisite qualification examinations set by the CSRC; and
- Other criteria as may be stipulated by the CSRC.

General obligations under the Investment Consultancy Measures

In providing securities and futures investment consultancy services to investors or clients, Article 19 of such Measures requires firms and their staff to conduct themselves with due care, honesty and diligence.

Regulation of securities analysts

Firms and individual analysts who provide securities research reports are required to comply with the Investment Consultancy Measures and the Interim Provisions on the Release of Securities Research Reports ("Research Reports Provisions") promulgated by the CSRC as well as the Professional Standards for the Release of Securities Research Reports (the "Professional Standards") and the Code of Professional Conduct for Securities Research Analysts (the "Analysts Code") issued by the SAC. These contain provisions directed at eliminating, avoiding, managing or disclosing conflicts of interest that can arise as well as directed at a firm's compliance systems and senior management responsibility as described below.

Analysts trading and financial interest

Individual securities or futures investment consultants (including analysts) are prohibited from buying shares or securities that have the nature and function of shares, and futures for themselves under Article 24(4) of the Investment Consultancy Measures.

Under Article 13 of the Research Reports Provisions, securities companies and securities investment consulting agencies must take effective management measures to prevent personnel who produce and issue securities research reports from seeking improper interests for themselves and their related parties by taking advantage of the publication of securities research reports, and from divulging the contents of and views expressed in securities research reports before they are released.

Securities companies and securities investment consulting agencies are required under Article 23 of the SAC's Professional Standards to prohibit their research analysts from serving in any internal or external positions that could negatively affect their independence and objectivity, including serving as independent directors of listed companies. The same prohibition appears in the Article 17 of the Analysts Code that applies to individual analysts.

Firm's financial interest and business relationships

Under Article 12 of the Research Reports Provisions, securities companies and securities investment consulting agencies must establish a sound preventive mechanism for conflicts of interest related to the publication of securities research reports and clarify the management process, matters to be disclosed and operational requirements, so as to effectively prevent conflicts of interest between the publication of securities research

	<p>reports and their other securities businesses.</p> <p>Under Article 14 of the Research Reports Provisions, securities companies and securities investment consulting agencies must strictly implement a Chinese wall between their securities research reports business and other securities businesses to prevent the departments and personnel from taking advantage of the publication of the securities research reports. Under Article 6, personnel engaged in the publication of securities research reports are prohibited from concurrently engaging in any business where there may be conflicts of interest, such as proprietary trading in securities and securities asset management.</p> <p>Analysts reporting lines and compensation</p> <p>Article 6 of the Research Reports Provisions requires a securities company or a securities investment consulting agency that publishes securities research reports to establish a special research department or subsidiary, establish a sound business management system and exercise central management of the activities and staff relating to the publication of research reports. Where a senior manager of the firm manages both the research reports business and other securities business of the firm concurrently, the firm must take measures to prevent conflicts of interest and furnish evidence that sufficiently demonstrates the effectiveness of the measures.</p> <p>Under Article 21 of the SAC's Professional Standards on the Release of Securities Research Reports, securities companies and securities investment consulting agencies must establish a reasonable performance evaluation and incentive mechanism for personnel responsible for the publication of securities research reports in order to maintain the independence of the reports. A variety of factors should be taken into account in developing the standards for evaluations and incentives, including the quality of the research, client's feedback and the amount of work involved. The standards of compensation for personnel responsible for the publication of the research report must not be coupled directly and exclusively with external media's evaluation. Departments in conflict of interest with the publication of securities research reports are not permitted to participate in the evaluation of personnel responsible for the publication of research reports. Where a securities analyst crosses the Chinese wall to engage in underwriting, sponsoring, financial consulting or other similar services, his or her personal compensation cannot be directly linked with the business income of the relevant projects.</p> <p>Article 5 of the Analysts Code requires analysts to maintain their independence and not be influenced by any request from any internal department of their firm, issuer, listed company, fund company, asset management company or any other interested parties.</p> <p>Firm's compliance systems</p> <p>Under Article 12 of the Research Reports Provisions, securities companies and securities investment consulting agencies must establish effective mechanisms for the prevention of conflicts of interest related to the publication of securities research reports that clearly specify conflicts management procedures, conflicts disclosure items and operational requirements, so as to prevent effectively conflicts of interest between the publication of those reports and the firm's other securities business.</p> <p>Outside influence</p> <p>Article 7 of the Research Reports Provisions requires securities companies and securities investment consulting agencies to take effective measures to ensure that the production and release of securities research reports are free from the interference and influence by the securities issuers, listed companies, fund management companies, asset management</p>
--	---

	<p>companies and other parties of interest.</p> <p>Clarity, specificity and prominence of disclosure</p> <p>Article 12 further provides that if a security company or a securities investment consulting agency issues a research report containing a valuation or rating of a specific stock and the securities company or securities investment consulting agency holds more than 1% of the issued shares of the relevant listed company, the holding must be disclosed in the research report.</p> <p>The Analysts Code further provides in Article 15 that where an analyst's spouse, child or parent is a director, supervisor or senior manager of a listed company, the analyst should recuse his/herself from covering that company or disclose the family member's position in the research report.</p> <p>Integrity and ethical behavior</p> <p>Under Article 3 of the Research Reports Provisions, when publishing securities research reports, securities companies and securities investment consulting agencies must follow the principle of independence, objectivity, fairness and prudence, effectively prevent conflicts of interest and treat the receivers of reports fairly, must not spread false, untrue or misleading information, and must not be engaged or participate in insider trading or manipulation of the securities market.</p> <p>A securities analyst who signs off on a securities research report must comply with regulations, be objective, professional and take due care when preparing the report in accordance with Article 9 of the Research Reports Provisions. The analyst must ensure that there is reasonable basis for his analysis and conclusions and must take responsibility for the contents and the views expressed in the report.</p> <p>Under Article 11 of the Research Reports Provisions, a securities company or securities investment consulting agency must treat the receivers of securities research reports fairly, and must not provide the contents of or views expressed in the securities research reports to any internal department or personnel of the company, or to particular receivers, in priority over other receivers.</p> <p>Regulation of futures analysts</p> <p>Firms and individual analysts who provide futures research reports are required to comply with the Investment Consultancy Measures and the Futures Consultancy Measures.</p> <p>In addition to the obligations applicable futures consultancy firms under the Investment Consultancy Measures, Article 23 of the Futures Consultancy Measures requires a futures company to implement a management system aimed at preventing conflicts of interest between its futures investment consulting business and other futures business, establish and improve information barriers, and keep the office space and office equipment relatively independent. Further, where conflicts of interests may occur between its futures investment advisory business activities, a futures company must make the necessary job independence, information isolation and personnel recusal and other work arrangements.</p> <p>In addition, under Article 17 of the Futures Consultancy Measures, futures companies are required to take effective measures to ensure that their research analysts form research and analysis opinions and conclusions independently. Such provision also requires them to prevent their research analysts and other personnel within the company from using research reports or information to seek improper benefits for themselves or their related parties.</p>
--	---

	<p>Under Article 18 of the Futures Consultancy Measures, analysts are responsible for the contents and opinions of the research report, and must ensure that the source of information for the report is legal, that the research methodology is professional and prudent, and the conclusion of the analysis is reasonable.</p> <p>Supervision</p> <p>Most firms that are licensed to carry out research analysis are securities companies and futures companies. As such, the supervision of the research business of these firms is subsumed under CSRC's ongoing supervision of the firms as securities firms or futures firms and on-site inspections are carried out under the CSRC's supervisory program for securities firms or futures firms. Participants confirmed that research analysis has been a topic included in their inspections.</p>
Assessment	Fully Implemented
Comments	<p>The current rules related to futures research reports are high level and do not contain the same level of specificity than those applicable to securities analysts. That said, the assessors acknowledge the existence of other provisions of the regulatory regime that address some conflict risks that KQ 3 is directed towards, notably the total prohibition on futures brokerage firms and futures consultancy firms and their analysts from dealing in futures contracts. Further, the nature of the futures markets means there are not the same opportunities for conflicts. The firm does not represent issuers of futures contracts (the concept doesn't really even apply) nor do analysts' reports have the potential to affect prices of the contracts. In this context, the concept of "sell side" analysts is not fully applicable to futures activity. However, as the authorities have recognized, the independence and reliability of futures analysis is an important issue, especially given the increased importance of futures markets. They should continue monitoring the quality of such reports and be alert to the need for more detailed rules, if appropriate.</p> <p>In addition, the current rules for securities analysts refer to two specific cases where disclosure of conflict of interest is required. More guidance on specific conflict situations where public disclosure should be made would be helpful to the firms and in promoting consistency in firms' disclosure practices. Some conflict situations where public disclosure could be required are:</p> <ul style="list-style-type: none"> • Where the issuer or other third party provided any compensation or other benefit in connection with a research report; • If the firm has a significant financial interest in the issuer (beyond the requirement to disclose equity holdings prescribed in article 12); • If individuals employed by or associated with the firm serve as officers, directors, or members of the supervisory board of an issuer that its analysts review; • If the analysts have investment positions or otherwise have financial interests in issuers that the analysts review. <p>Finally, the assessors encouraged the CSRC to monitor whether, as in other large jurisdictions, compensation remains an issue of concern in terms of the potential for misalignment of incentives.</p>

Principles for Collective Investment Schemes	
Principle 24	The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.
Description	<p><u>Regime for MFs under CSRC</u></p> <p>Background</p> <p>Under the legal and regulatory framework, a threshold of 200 investors defines the line between publicly offered funds (mutual funds) and private funds. This is the same threshold that applies to the public and private offerings of securities. For private funds a minimum of 1 million RMB investment exists.</p> <p>There are two kinds of managers of mutual funds (CIS) in China: fund management companies authorized under the <i>Fund Law</i>, and other organizations licensed to manage public funds. These other organizations include securities companies, futures companies and insurance asset management companies.</p> <p>Until recently, securities companies were authorized to manage mutual funds under the <i>Securities Law</i> and according to a different regulatory framework for collective fund business. As of the time of the assessment, the frameworks have been unified. In addition, there is a pilot program under which banks are allowed to establish fund management companies.</p> <p>At the end of June 2016, there were 117 mutual fund managers, managing 3,115 mutual funds, with AUM of RMB 7.95 trillion. The total AUM of fund management companies and subsidiaries that provide asset management services for specific clients was RMB 15.3 trillion. There are approximately 238 million mutual fund investors in China. Individual investors account for 99.96 per cent of all investors, and 46 per cent of net value.</p> <p>As of June 2016, there were 366 entities authorized to distribute funds: 131 commercial banks, 99 securities companies, 18 futures companies, 9 insurance institutions, 6 securities investment advisory agencies and 103 independent fund distributors. Increasing use is being made of on-line distribution of fund products.</p> <p>Marketing and operating a CIS</p> <p><u>Marketing</u></p> <p>Article 54 of the <i>Measures for the Administration of the Sales Activities of Securities Investment Funds</i> provides that any institution that engages in sales of funds or related businesses and charges a commission based on fund transactions (including account opening) against the fund distributors must be registered with or verified by the CSRC.</p> <p>Under Article 8 of these <i>Measures</i>, commercial banks, securities companies, futures companies, insurance institutions, securities investment advisory agencies, independent fund distributors and other agencies approved by the CSRC can apply to the CSRC for the qualification of fund distribution. Articles 9 to 17 set out detailed requirements for institutions that apply for the qualification of fund distribution.</p> <p><u>Operating a CIS</u></p> <p>Articles 12 and 13 of the <i>Fund Law</i> require fund managers of public funds to be approved by the CSRC and set out the conditions that must be met for CSRC approval of an application. Detailed eligibility standards are set out in <i>Measures for the Administration of</i></p>

Securities Investment Fund Management Companies; Measures for the Administration of Operations of Publicly Offered Securities Investment Funds; and the Official Reply of the State Council on Issues concerning Fund Management Companies Managing Publicly Offered Funds. The licensing application process for asset managers applying to manage mutual funds is set out in the *Interim Provisions Regarding the Management of Public Securities Investment Funds by Asset Management Institutions.*

Eligibility criteria

Integrity, competence and organizational requirements.

Article 6 of the Measures for the Administration of Securities Investment Fund Management Companies provides that, to establish a fund management company, detailed conditions must be met. These include conditions relating to shareholders, the articles of association of the company, proposed senior managers and other personnel (including that it has at least 15 proposed senior managers and business personnel licensed to practice in the fund industry), premises, security facilities and other business-related facilities. A fund manager must also have an organizational structure with reasonable division of duties and clear definition of responsibilities, and internal control systems, such as supervision, audit and risk control, that comply with the regulations of the CSRC.

Article 6 mentioned above sets out the factors that disqualify a fund manager from applying to operate a fund. These include having been subject to administrative or criminal penalties, being under current investigation, or any other material matter that has caused or would have an adverse effect on the operation of the fund. In addition, there must be no material operational risk such as unsound corporate governance, disorderly operation or management, ineffective implementation of internal control or risk control systems, or deteriorating finances. See also Article 5 of the *Interim Provisions Regarding the Management of Public Securities Investment Funds by Asset Management Institutions.*

The CSRC has issued a large number of *Measures* and *Guidelines* containing requirements for, among other things, the operation of branches and subsidiaries, supervision and management systems, governance structures, internal control systems, investment management systems human resources management systems (including rules on incentive arrangements), and sales management and the promotion of funds.

Financial capacity

Article 13 of the *Fund Law* requires the minimum registered and paid up capital of a fund management company to be no less than RMB 100 million. A securities company authorized to carry on an asset management business, including collective asset management, must have minimum registered capital of RMB 100 million (Article 127 of the *Securities Law*). Articles 7 of the *Interim Provisions Regarding the Management of Public Securities Investment Funds by Asset Management Institutions* provide that an insurance asset management company that applies for the operation of a fund management business must have net assets as of the end of the last quarter of no less than RMB 500 million and have at least RMB 20 billion of assets under management.

Authorization process

Pursuant to Article 50 of the Fund Law, an application for a fund management license must be accompanied by a set of documents, in particular: an application report; a draft fund contract; a draft fund custody agreement; a draft prospectus; a legal opinion issued by a law firm; and any other documents required by the CSRC

Licensing of fund management companies is carried out by the CSRC's central office. The CSRC deals with applications for authorization of a fund management company in two stages. In the first stage, it reviews the written material provided in the application.

If these meet requirements, it provides the applicant with a first response, and indicates that the applicant should make preparations for the operation of the business. When the applicant has done so, it applies to the CSRC for an on-site inspection. In this second stage, the CSRC conduct an on-site inspection to ensure that all requirements are met in practice. At the end of this stage, the CSRC makes a formal decision to issue or refuse a license. CSRC staff indicated that during 2013-2014 there were very few request for authorization, but this has changed for the last two years. Banks under the pilot program need to first have approval of the CBRC and then their application is to be reviewed by the CSRC.

For the registration of a fund, the process varies according to whether the fund can use the simplified procedures or the normal procedures. General equity funds, hybrid funds, bond funds, money market funds and a number of other fund types are eligible for the simplified procedures. The CSRC's processes include

- the CSRC accepting the application after a review of whether it is complete and the fund manager and custodian meet registration requirements;
- the CSRC providing feedback based on a more detailed analysis of documents such as the fund contract and custody agreement, disclosure documents, with a focus on the adequacy of information disclosure and investor appropriateness;
- the applicant revising its application materials; and
- the CSRC making a decision on registration.

The normal procedures also include a review meeting with the applicant after the CSRC has accepted the application.

Record-keeping and reporting

Record-keeping

Article 19 of the *Fund Law* requires fund managers to keep records, books, statements and other materials relating to fund assets management activities; Article 36 requires fund custodians to keep records, books, statements and other materials relating to fund assets custody activities.

Reporting

Articles 19 to 21 of the *Measures for the Administration of Information Disclosure by Securities Investment Funds* provide that a fund must make available to investors an annual report, a semi-annual report and quarterly report. Article 22 provides that these reports must also be filed with the CSRC. Article 23 of these *Measures* lists 28 types of events that would affect the interest of the fund unit holders or would have a material impact on the value of fund units. These require ad hoc information disclosure to investors, and a report to be filed with the CSRC.

Article 58 of the *Measures for the Administration of Securities Investment Fund Management Companies* requires a fund management company to establish rules on emergency response to incidents to appropriately handle emergencies that may seriously affect the interests of fund shareholders, may result in systematic risks, or seriously affect social stability. If any such emergency occurs, the fund management company must immediately

	<p>report it to the CSRC and the local office of the CSRC.</p> <p><u>Changes in shareholders, management and operations</u></p> <p>The CSRC's approval is required for any:</p> <ul style="list-style-type: none"> • change of any shareholder of the fund manager who holds 5 per cent of shares or more; • change of any shareholder who holds less than 5 percent of shares but nevertheless has a material effect on the governance of the fund manager; • change in the shareholdings of those who hold more than 5 per cent of shares; • amendment to any material provision of the articles of association; and • other major matters prescribed by the CSRC. <p>See Article 17 of <i>Measures for the Administration of Securities Investment Fund Management Companies</i>.</p> <p>Article 65 of the <i>Measures</i> requires fund management companies to report to the CSRC within 5 days on a range of matters. These include changes in non-major shareholders; amendment to non-material provisions of the articles of association; criminal or administrative penalties imposed on the company and its directors, senior managers and portfolio managers; any material adverse change to the company's financial status; or any other matters having a material effect on the company's operations. For some of these items (such as penalties), the fund management company must also give a written notice to all shareholders.</p> <p>Conduct of business</p> <p>Primacy of investor interests</p> <p>Article 19 of the <i>Fund Law</i> sets out the duties of fund management companies. Article 10 of the <i>Interim Provisions Regarding the Management of Public Securities Investment Funds by Asset Management Institutions</i> requires fund management companies to comply with laws and regulations, and to abide by the principles of honesty, good faith, prudence and due diligence, faithfully perform its duties, and manage and use the fund assets for the interest of the holders of fund units.</p> <p>Article 4 of the <i>Fund Law</i> provides that activities relating to securities investment funds must observe the principles of voluntariness, fairness, honesty and good faith, and must not impair the national or public interest. Article 73 provides that fund assets must not be used for:</p> <ul style="list-style-type: none"> • underwriting of securities; • providing loans or guarantees to others in violation of applicable rules; • engaging in investment with unlimited liability; • buying or selling units of other funds unless the CSRC has provided otherwise; • making capital contribution to the fund manager or fund custodian;
--	--

- insider trading, manipulation of securities price, or other illegitimate securities dealings; and
- other activities prohibited by laws, administrative regulations or the CSRC.

Article 73 of the *Fund Law* also contains provisions dealing with related party transactions (see below).

The CSRC's *Code of Corporate Governance for Securities Investment Fund Management Companies* (Tentative) requires the governance of fund management companies to adhere to the basic principle of giving priority to the interests of fund unit holders. The development of articles of association, rules and regulations, work processes and rules of procedure, the performance of duties and exercise of powers by all levels in the company and the practices of the company's employees must focus on protecting the interests of fund unit holders. The Code also requires fund managers to have appropriate checks and balances, decision making processes to be independent and efficient, and obliges directors and managers to treat all unit holder fairly and treat different funds and assets under its management fairly.

CSRC's *Guiding Opinions for the Fair Trading System of Securities Investment Fund Management Companies* prohibits the illegal transfer of interests between different investment portfolios directly or through transaction arrangements with a third party.

Best execution

Some securities trading for funds is carried out directly by the fund manager, via the renting of trading seats from securities companies. CSRC has enacted a series of rules aimed at ensuring proper management of conflict arisen from the use of rent seat by the fund managers to conduct the trading on behalf of the funds they manage. The CSRC's *Circular on Relevant Issues Concerning Improving the Trading Seat System of Securities Investment Funds* requires a fund manager to rent dedicated trading seats from securities companies that have a sound financial condition, good compliance in operations and strong research capacity. Different funds may share a same trading seat. Annual trading commissions received by a fund manager through securities trading at the trading seat of a securities company must not exceed 30 per cent of the total commission of securities trading by the fund in the year. A fund management company must not connect the seat with the sale of the securities company's fund, nor make any commitment to the securities company on the seat's trading volume of any fund. A fund manager must disclose its standards and procedures for selection of securities companies, the securities trading conducted through trading seats for the funds and related information in fund disclosure documents. A fund manager must also ensure that the interests of different fund unit holders are treated fairly. The fund manager must report to the CSRC annual securities transactions of its funds through the securities company within 30 working days after the end of each year. Finally, pursuant to article 36 of the *Securities Fund Law* the fund custodian must oversee the investment operations of the fund manager. If the fund manager discovers that any investment violates the law, regulations or relevant provisions of the fund contract, it must refuse to execute the order and report immediately to the CSRC. If the fund discovers that an order executed is in breach of the law, regulations or relevant provisions of the fund contract it must also notify the CSRC.

Appropriate trading and allocation of trades

Article 20 of the *Measures for the Administration of Information Disclosure by Securities Investment Funds* requires the fund manager to publish a quarterly report of the fund

within 15 working days after the end of each quarter. The report must include an explanation on whether the investments of the fund during the quarter comply with the fund contract. The CSRC mainly relies on custodian banks for oversight of appropriate trading by requiring custodian banks to report to the CSRC in a timely manner any breaches of the fund contract regarding appropriate trading.

The CSRC's *Guiding Opinions for the Fair Trading System of Securities Investment Fund Management Companies* contain detailed provisions designed to improve the fair trading system of securities investment fund management companies, ensure fair treatment of different portfolios managed by the same company and protect the interests of investors. Article 23 requires a company to do a quarterly and annual analysis of the relative differences in overall investment income rate, the income rate of each type of investment (such as stocks and bonds) and the difference of trading price between trades of same direction during different time windows within four continuous quarters for different investment portfolios under the company's management. Article 24 provides that the regular reports for each investment portfolio must make a specific statement on the implementation of the fair trading system and any abnormal trading activities. Article 25 requires that an accounting firm must assess the adequacy and implementation of the fair trading system in the annual internal control assessment report prepared by the company.

Churning

Fund managers must comply with the CSRC's *Circular on Relevant Issues Concerning Improving the Trading Seat System of Securities Investment Funds* and relevant rules concerning trading, and must not conduct excessive buying and selling of securities via brokers' accounts for the purpose of generating commissions, without regard to the investment objectives of customers. To avoid concentrated allocation of trading to affiliated brokers, Article 2 of the *Circular on Relevant Issues Concerning Improving the Trading Seat System of Securities Investment Funds* require that the commissions allocated to one broker by a fund manager must not exceed 30 per cent of the total commissions. Fund managers are also prohibited from linking trading volume with fund sales by securities companies. Regulations require that a fund must disclose in its semi-annual and annual reports details of transactions executed through rented trading seats, particularly transactions executed through the trading seat of affiliated brokers. Turnover rates and other data relating to the investment of funds are updated in the CSRC's regulatory authority monitoring system on a daily basis.

Due diligence

Article 50 of the *Measures for the Administration of Securities Investment Fund Management Companies* provides that fund management companies must establish an investment management system comprising authorization, research, decision-making, execution and evaluation, and must treat fairly different fund assets and customers' assets under its management. Article 17 of the *Guiding Opinions on the Administration of Investment Management Personnel of Fund Management Companies* provides that a fund management company must implement an investment analysis mechanism, strengthen research to make it better support investment decision-making, and prevent arbitrariness in investment decision-making.

Fees and commissions

Article 36 of the *Measures for the Administration of Operations of Publicly Offered Securities Investment Funds* provides that the following costs and expenses relating to the fund may be paid out of the fund assets: (1) administration cost of the fund manager; (2) custody cost of the fund custodian; (3) costs of accountant and legal counsel incurred after the

fund contract becomes effective; (4) costs of fund unit holders' meeting; (5) security trading costs of the fund; and (6) other costs and expenses that are permitted in accordance with the regulations and the fund contract. Costs and expenses relating to the fund must be stipulated in the fund contract, custodian agreement, and prospectus, and must not be changed without the CSRC's permission.

Conflicts of interest

Article 2 of the *Code of Corporate Governance for Securities Investment Fund Management Companies (Tentative)* provides that corporate governance must follow the basic principle of giving priority to the interest of fund unit holders. If conflict of interests arises between the company, its shareholders, employees and the fund unit holders, the interest of fund unit holders must always prevail. The CSRC requires companies to minimize conflict of interests and give priority to the interest of fund unit holders when conflicts of interest arise.

Related party transactions

There are extensive provisions dealing with related party transactions.

Article 73 of the Securities Investment Fund Law requires that a public fund shall strictly manage material related party transactions, including the use of fund assets for purchase and sale of securities issued by the fund manager, the fund custodian and their controlling shareholder, actual controller or other materially interested companies, or securities underwritten in the underwriting period. Or if the fund engages in other material related party transactions, emphasis must be put on the strict observance of the principle of prioritizing the interests of fund unit holders to prevent conflict of interest and perform the obligation of information disclosure.

Article 33 of the Measures for Administration of the Operation of Publicly-Offered Securities Investment Funds further requires that while using fund's assets to buy/sell securities that are issued by the fund managers, the fund custodians or their controlling shareholders, de facto controllers and any other company that the fund manager has big stakes in, or engage in other related party transactions, the transactions must be conducted in line with the investment objective and strategy. The fund manager must put first the interest of unit holders, prevent conflict, establish an internal approval and valuation mechanism and execute at fair and appropriate market prices. Such transactions must be approved in advance by the fund custodian and disclose according to laws and regulations. Material related party transactions must be submitted to the board of directors of the fund manager for deliberation and shall be approved by more than two thirds of independent directors. When deliberating major related-party transactions, the board of directors can appoint an intermediary to opine on their fairness and legitimacy. When voting on related-party transactions, directors who have interests in such transactions must abstain from voting. The board of directors of the fund manager must review related party transactions at least once every six months. Further, a report on related party transactions must be submitted to the CSRC on a semi-annual basis for its review.

Article 23 of the Measures for the Administration of Information Disclosure by Securities Investment Funds provides that after the occurrence of material related party transactions, an ad hoc announcement must be released to the public within two days. Such transactions must also be disclosed in the annual reports. Finally, pursuant to the current rules, related party transactions must be disclosed in the footnotes of the financial statements, with an indication of the type, value, pricing policies of transactions and a statement that the transactions are agreed based on normal commercial terms in normal business.

	<p>Delegation</p> <p>The <i>Fund Law</i> and its supporting regulations do not prohibit business outsourcing. In practice, however, domestic investment is not outsourced except for some small amount of sales and registration services.</p> <p>Under Articles 65 of the <i>Fund Law</i>, the subscription, redemption and registration of the units of an open-end fund must be handled either by a fund manager or its delegated fund service institution. Under Article 101 a fund manager may delegate to fund service institutions functions such as unit registration, accounting, valuation, and investment advice; and a fund custodian may delegate functions such as accounting, valuation and review. Articles 20 and 21 of the <i>Standards for Contents and Formats of Information Disclosure by Securities Investment Funds (No. 6) – Contents and Formats of the Fund Contract</i> provide that, unless otherwise provided in the <i>Fund Law</i>, the fund contract or other applicable regulations, a manager must not appoint a third party to manage fund assets, and a custodian must not appoint a third party for custody of fund assets. There is an exception for the use of overseas investment advisers and custodians in relation to QDII business.</p> <p>Under the general laws governing principal-agent relationships, (Article 63 of the <i>General Principles of the Civil Law</i> and Article 396 of the <i>Contract Law</i>), a fund manager is responsible for any action or omission of any of its authorized parties, as though the action or omission was committed by the manager. The delegations permitted by Article 101 of the <i>Fund Law</i> do not relieve the fund manager or fund custodian from liability.</p> <p>The current regulatory framework requires the operator to monitor the activities of its agents. Where a QDII delegates functions under Articles 14 and 15 of the <i>Tentative Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institutional Investors</i>, the QDII bears the fiduciary responsibility and must perform due diligence when selecting the investment advisor. Article 17 provides that where a QDII authorizes an investment advisor to make investment decisions, it must expressly stipulate in the agreement that the investment advisor is liable for any asset loss incurred due to its fault, negligence or failure to perform its duties.</p> <p>Under Articles 408 and 409 of the <i>Contract Law</i>, the operator may terminate the delegation and make alternative arrangements for the performance of the delegated function.</p> <p>Delegation arrangements and the identity of agents must be disclosed in a fund's prospectus (Article 24 of the <i>Standards for Contents and Formats of Information Disclosure by Securities Investment Funds (No. 5) – Contents and Formats of the Prospectus</i>).</p> <p>Those who carry out delegated functions on behalf of fund management companies and custodians are regulated as fund service providers under Chapter XI of the <i>Fund Law</i>. This provides a regulatory framework and also ensures that all the CSRC's powers of inquiry and inspection apply to these providers.</p> <p>Ongoing monitoring and inspections</p> <p>Article 113 of the <i>Fund Law</i> gives the CSRC power to conduct on-site inspections on fund management companies, custodians and service institutions; require them to report relevant business data; question the parties concerned; seal and seize relevant documents; and take other measures. When investigating any major irregularity, upon the approval of a principal person-in-charge of the CSRC, the CSRC can restrict the securities transactions of the parties involved. On-site inspections can be regular or ad hoc (Article 50 of the <i>Measures for the Administration of Operations of Publicly Offered Securities Investment Funds</i>).</p>
--	---

Article 62 of the Measures for the Administration of Securities Investment Fund Management Companies requires the CSRC to conduct off-site and on-site inspections on corporate governance, internal control, business operations, risk profile and related business activities of the fund management companies.

The CSRC central office has a total of 55 approved staff, and a number of secondees, for the supervision of compliance by fund management institutions. These resources are supplemented by staff in regional offices, who conduct day to day supervision of the fund managers and funds. In practice the fund business is concentrated in seven regional offices.

CSRC staff reviews all quarterly, semi-annual and annual reports of public funds. This review is conducted by the CSRC's central office.

The CSRC central office plans national inspections of public funds managers. In the planning and carrying out of these programs, the central office meets twice yearly with regional office staff: once at the beginning of the planning cycle to identify priorities, and once midway through the cycle.

National inspections are typically thematic, looking at a type of fund (such as money market funds or bond funds), or specific compliance issues (such as internal controls or internal supervision). In some cases the central office provides direction to the regions as to the fund managers to inspect as part of a thematic inspection (based on their reviews of periodic reports, the complaints they have received and more generally their knowledge of the firms), in other cases this is left to the regional offices

Two approaches are used for carrying out of centrally planned on-site inspections. In the first, the central office identifies the priorities for inspections and the relevant regional offices' staff then carries out the inspections. In the second, staff members from regional offices are seconded to the central office and a task force is formed to carry out the inspections. The results of these centrally planned inspections are reported to the central office. For inspections carried out by regional offices, any resulting regulatory actions or administrative actions are taken by the relevant regional office.

In addition to the centrally planned inspections that they must carry out, the regional offices also develop their own annual on-site inspection plans. The regional offices use several sources to determine the inspections that will be undertaken including the time gap since the last inspection, the existence of breaches by the fund manager and negative coverage in the press. The central office reviews these actions to ensure consistency across regions.

In 2014, CSRC regional offices completed 357 on-site inspections; targets included fund management companies and their subsidiaries, fund custodians, fund distributors, and fund sales payment processors. In 2015, CSRC's Beijing, Shanghai, Guangdong, and Shenzhen offices organized a combined 389 on-site inspections, covering fund management companies and their subsidiaries, fund distributors, and fund sales payment processors.

The CSRC indicated that as a result of these activities, all regulated fund management entities have been subject to inspection, and on average each entity is subject to one inspection per year.

Number of on-site inspections of fund managers and distributors			
	2013	2014	2015

	2013	2014	2015

Fund managers	142	162	189
Distributors	250	195	200
Total	392	357	389

Source: CSRC.

The CSRC has made use of its sanctions powers to impose penalties on fund managers as a result of its off-site monitoring and on-site inspections. Sanctions imposed include fines, disgorgement and market bars. For example, in 2016, the CSRC imposed more than 70 enforcement actions on fund managers and their senior executives, including 5 administrative penalties, 5 fund managers were barred from market access, and a number of cases were transferred to the criminal authorities. Significant fines have been imposed, including a fine of RMB 1.6 billion in 2014 on a fund manager, and a fine of RMB 28 million and a disgorgement order of RMB 28 million against a fund manager in 2016.

International cooperation

The need for international co-operation is specifically recognized in two contexts: for foreign shareholders of securities investment management companies; and where a QDII proposes to engage an overseas investment consultant. In each case, there is a requirement that the regulator in the foreign jurisdiction has signed a memorandum of understanding on securities regulatory cooperation and maintains effective regulatory cooperation with the CSRC. See Article 9 of the Measures for the Administration of Securities Investment Fund Management Companies and Articles 14 and 19 of the Tentative Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institutional Investors. Where a QDII intends to engage an overseas assets custodian for overseas assets, the overseas assets custodian must be regulated by the local government, finance or securities regulatory authority.

Conversely, there are limits on the investment that can be made where regulatory cooperation arrangements are not in place. Article 4 of Part V of the Circular on the Issues Relating to Tentative Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institutional Investors provides that a single fund's holding of securities listed on the market of a country or region that has not entered into a bilateral memorandum of understanding on regulatory cooperation must not exceed 10 per cent of the net value of the fund; and that total securities held in any country or region must not exceed 3 per cent of the net value of the fund.

There are arrangements for the mutual recognition of funds between the Chinese Mainland and Hong Kong. In May 2015, the CSRC and the Securities & Futures Commission of Hong Kong (HKSF) signed a memorandum of understanding on regulatory cooperation and issued the Interim Provisions for the Management of Mutually Recognized Funds of Hong Kong, which permit public funds from Hong Kong to be registered and sold in the Chinese Mainland. To be publicly sold in the Chinese Mainland, a mutual recognized fund from Hong Kong must satisfy the following conditions and be registered with the CSRC: (1) the fund is established and operated in Hong Kong under the laws of Hong Kong, approved by the HKSF to be publicly sold, and subject to regulation by the HKSF; (2) the manager is registered and operating in Hong Kong, holds an asset management license in Hong Kong, and has not delegated its function of investment management to any institution in any other country or region, and has not had any major penalty imposed on it by the HKSF in last 3 years or since its establishment; (3) if it adopts the custodian system, the trustee and

the custodian must meet the qualifications and conditions specified by the HKSF; (4) the type of fund is a regular stock fund, hybrid fund, bond fund or index fund (including exchange traded open-end index funds); (5) where the fund has been established for more than 1 year, its AUM must be no less than RMB 200 million (or equivalent in foreign currency), the fund is not mainly invested in the market of the Chinese Mainland, and the amount of sales in the Chinese Mainland is no more than 50 per cent of the assets of the fund. Under these arrangements, mainland funds can also be distributed in Hong Kong.

Regime for WMPs under the CBRC

Background - banks' wealth management products (WMPs)

At the end of June 2016, there were 454 banking institutions offering WMPs. There were a total of 68,961 products and the total value of WMPs was RMB 26.28 trillion. There are two broad types of WMPs: those that involve a guarantee of the principal (and in some cases also of return) and non-guaranteed funds.

At June 2016, 23.2 per cent of the total value of WMPs was in principal-guaranteed products (including 8.5 percent in products that guarantee both principal and return). Principal-guaranteed WMPs are on the balance sheets of the issuing bank and are treated as deposits, including coverage under the bank's deposit insurance. Because of these characteristics, they are not CIS for the purposes of the IOSCO Principles or Methodology.

Non-guaranteed products themselves fall into two types: "targeted" products that offer individual portfolio management services to single investors; and collective products that involve managing a pool of assets for multiple clients. Collective products are categorized by reference to the type of clients involved. Some products are available only to qualified investors (private banking clients with net assets of at least RMB 6 million and high net worth individuals⁶⁶). Other products are available to retail clients. For the purposes of this assessment, collective WMPs available to retail clients are treated as CIS. Approximately RMB 8 trillion of assets is held in WMPs of this type.

Of the retail WMPs that are CIS, products are either closed end (redeemable only at the termination of the WMP), or open-end (redeemable during the life of the product). Some open-end products are redeemable on demand (sometimes with a time lag of, for example, 2 days to reflect the settlement period for the sale of assets); some are closed to redemption for a specified period and then redeemable on demand; and others can be redeemed at specified intervals through redemption "windows", which can be monthly, quarterly, six monthly or longer.

Asset composition for all WMPs (including principal guaranteed and non-guaranteed products) at June 2016 was as follows: bonds 40 percent; cash and deposits 18 per cent; nonstandard debt assets 17 percent; and money market instruments 16 percent. Of the nonstandard debt assets, one third are investment receivables (repackaged assets) and trust loans and entrusted (company-to-company) loans are another thirty percent.

Marketing and operating a WMP

Marketing a WMP

WMPs can be distributed only through banks. To offer WMPs banks require the authorization of the CBRC. Authorization requirements are the same than those required to

⁶⁶ High net worth individuals are investors who invest at least RMB 1 million; have financial assets of at least RMB 1 million; annual income of at least RMB 200,000 or annual family income of at least RMB 300,000 in each of the last 3 years.

	<p>conduct wealth management services, as described below. Detailed rules for their marketing are set out in the <i>Administrative Rules for the Sales of Wealth Management Products by Commercial Banks (Sales Rules)</i> (CBRC [2011] No. 5). These rules apply to banks that market their own WMPs, and, under Article 47, to banks that act as agents to market WMPs issued by other banks or financial institutions.</p> <p>Where a bank is involved in selling another financial institution's investment products, it must conduct a due diligence review of the product provider and the product (Articles 12, 13, 18 and 19 of the <i>Notice of the CBRC on Regulating the Agency sales Business of Commercial Banks</i>). In addition, the bank must disclose to investors whether the WMP it sells are its own or a third party's. Banks must have a specific/separate department for selling/distributing of WMPs. Current regulations require that the whole distribution process be recorded.</p> <p><u>Operating a WMP business</u></p> <p>A bank requires authorization from the CBRC to undertake WMPs business. Pursuant to Article 77 of the <i>Licensing Manual for Chinese Commercial Banks</i>, banks must meet the following criteria: (a) sound corporate governance, organizational structure and rules and regulations commensurate with its business development, and adequate and effective internal rules and risk management and accountability mechanisms; (b) no conflicts with current laws and regulations; (c) the supervisory requirements relating to main prudential and regulatory indicators; (d) in line with its strategic orientation and development; (e) an approval from its board of directors with a written consent; (f) technical and managerial staff required for business operations, with multi-layer authorization management comprehensively implemented; (g) business venues and facilities commensurate with its business operations; (h) necessary, safe and compliant information technology systems to support its operations, and technologies and measures to ensure the effective and safe operation of the information technology systems; (i) no serious violations of laws and regulations nor involvement in any major cases resulting from internal management problems in the last three years; and (j) other prudent conditions as specified by the rules of CBRC. See more detail on minimum organization requirements, including for human resources, risk management systems and internal controls below.</p> <p>Article 5 of the Licensing Manual provides that an applicant must submit application documents in accordance with the Catalogue and Format Requirements on License Application Documents of the CBRC. Such documents include: (a) an application letter, with contents including but not limited to: general information about the applicant, state of operation and major risk indicators; (b) feasibility study report including but not limited to: general information, definition of the products and services to be launched, risk features and preventive measures, cost and benefit projections, managerial and business staffing, plans for supporting system and business development and implementation; (c) information about the applicant's severe noncompliance and material cases arising from internal management deficiencies in the last three years; (d) the rules, policies, procedures and internal control rules applicable to the products and services to be launched; (e) a written consent issued by the board of directors; (f) compliance opinions prepared by the applicant's internal control department; (g) contact person, telephone, fax, email address and correspondence address (zip code) of the applicant; and (h) other documents required by CBRC according to prudential principles. Pursuant to article 76 of the Licensing Manual provides that CBRC must, within 3 months after the acceptance of the application, make a written decision on whether approval is granted.</p> <p>Eligibility criteria</p>
--	--

Integrity and competence

Article 54 of the *Interim Rules* sets out requirements for the wealth management staff of banks. These include requirements for knowledge and understanding of regulatory requirements, product knowledge, education and experience, and appropriate industry qualifications. See also Article 7(d) of the *Notice on Improving the System for Organization and Management of Banks' Wealth Management Business* (CBRC [2014] No 35).

Financial capacity

Banks offering WMPs must comply with the capital standards that apply to their banking business (Basel capital standards).

Organizational requirements

The *Guidelines on Risk Management of Individual Wealth Management Services of Commercial Banks (Risk Management Guidelines)* (Yin Jian Fa [2005] No 63) contain detailed rules on the management of WMP businesses, including requirements for:

- separation of customer assets (Article 9);
- record keeping (Article 10);
- internal supervision and audit (Article 12);
- qualifications of staff (Articles 13 and 19);
- segregation of consulting and sales staff (Article 20);
- risk management (Chapter III), including provisions dealing with the monitoring and auditing of internal risks (Article 33); risk limitation management rules (Articles 40-45); and requirements for the segregation of duties (Article 47-49);
- new product development (Articles 58-60).

Article 7 of the *Notice on Improving the System for Organization and Management of Banks' Wealth Management Business* (CBRC [2014] No 35) requires banks to have sound supervision systems, good IT systems, and monitoring indicators and risk limits for their wealth management business. The bank's conduct of its WMP business must also adhere to standards of conduct for marketing, investment management and operations (Article 4). The bank must have a separate department responsible for all aspects of the wealth management business (Article 5) – see also the segregation requirements described under Principle 25.

Authorization of WMPs

Banks' WMPs are not generally subject to ex-ante approval. In most cases, a bank intending to sell a WMP just must submit documentation to the CBRC and register the product information 10 days prior to the sale of the product (Article 52 of the *Interim Rules for Individual Wealth Management Business of Banks (Interim Rules)* and Article 69 of the *Sales Rules*).

An exception to this general rule is that CBRC approval is required to offer WMPs involving guaranteed income or guaranteed returns, or any other WMP where approval is stated to be required (Article 46 of the *Interim Rules*). Market participants indicated that CBRC approval is required for new products that involve risks other than standard risks, for

	<p>example those that may present non-standard liquidity risks.</p> <p>Article 2 of the <i>Notice on Further Regulating the Administration of the Reporting of the Personal Financial Management</i> (CBRC [2009] No 172) and Article 69 of the <i>Sales Rules</i> set out the information about a WMP that a bank must provide to the CBRC at least ten days before offering the WMP for sale. This includes:</p> <ul style="list-style-type: none"> • a feasibility report on the WMP, including the basic characteristics of the product, the target customer group, the timetable and size of the planned offering, regions in which the product is to be sold, the investment mandate, the portfolio structuring, the capital cost and return estimate, the expected profitability of the financial plan to measure the income and measurement basis, product risk assessment and control measures; • relevant internal audit documents; • the bank's due diligence documents on the investment managers, custodians, investment consultants and other relevant parties; • legal documents signed by the bank and related parties such as investment managers, custodians and investment advisers; • the WMP's sales documents, including the product agreement, the sales agreement, the prospectus and risk disclosure statement, the customer evaluation and other documents that the bank will require the customer to sign; and • promotional materials for the WMP <p>This information is entered into CBRC's registry system and is available to all relevant departments of the CBRC. CBRC staff indicated that during the ten-day period prior to sales starting, CBRC staff review the documents and if necessary require changes to them or stop an issue if the documents are found to be non-compliant.</p> <p>Record-keeping and reporting</p> <p><u>Record-keeping</u></p> <p>Article 10 of the <i>Risk Management Guidelines</i> requires a bank to keep complete records of its WMP activity, Article 37 of the <i>Interim Rules</i> requires banks to keep records of customer information and assessments and their consultancy services. Banks must also keep records (including documents and sound recordings) relating to the sales process of WMPS (Article 65 of the <i>Sales Rules</i>).</p> <p><u>Reporting to the regulator</u></p> <p>Article 73 of the <i>Sales Rules</i> requires a commercial bank to prepare statistical information on its sales of WMPs on a monthly, quarterly and annual basis and provide these reports to the CBRC.</p> <p>Monthly reports provide aggregate information on distribution channels, volumes, funds subscribed, and the number and value of the bank's WMPs.</p> <p>Quarterly reports provide detailed information for each WMP, including portfolio composition and holdings.</p> <p>A bank must prepare an annual development report of its wealth management business by the end of each fiscal year, and submit it to the CBRC before the end of February in the</p>
--	---

following year. At minimum the development report must include information about sales and investment, distribution of returns and client complaints. (See also Articles 57 to 60 of the *Interim Rules*.)

Article 72 of the *Sales Rules* requires a commercial bank to promptly report to the CBRC if any of the following circumstances occurs to its wealth management business:

- material events such as mass events or significant complaints;
- misappropriation of clients' funds or assets;
- serious credit default on the part of the counterparty of investment or any other related party of credit, which may incur significant loss to the wealth management product;
- significant loss of the wealth management product; or
- other serious malpractices or non-compliances arising out of the sales activities.

Article 3 of the *Notice on Adjusting the Relevant Provisions on the Administration of Personal Financial Services* (CBRC [2007 No 241]) requires banks to provide timely reports to the CBRC on major fluctuations in earnings, abnormal risk events, major product redemptions, unexpected early termination and customer complaints relating to a WMP. After a WMP expires, banks must carry out a post-evaluation analysis on the product's earnings, risk outcomes and customer satisfaction, and report the results of this evaluation to the CBRC.

Changes in shareholders, management and operations

Changes in bank shareholders and management are required to be reported to the CBRC in its capacity as the banking regulator. Changes to the investment strategy and fees of a WMP must be reported to investors, who are given the opportunity to withdraw (see further under Principle 26).

Conduct of business

Primacy of investor interests

In providing WMPs, banks have a general obligation of due care and diligence, and to observe the principle of meeting clients' interests (Article 4 of the *Interim Rules*), and to follow the principle of integrity, diligence and honest disclosure (Article 5 of the *Sales Rules*). The legislative and regulatory framework does not contain detailed rules on issues such as best execution rules or rules on appropriate trading or the allocation of trades.

For the selling of WMPs, there are comprehensive suitability rules (described in more detail under Principle 31) giving effect to the principle that only suitable products are to be sold to suitable customers.

Conflicts of interest

Article 47 of the *Risk Management Guidelines* requires banks to take sufficient measures to keep separate different departments so as to avoid damaging the interests of customers through conflicts of interest. The segregation rules described under Principle 25 (which require the complete segregation of WMP business from a bank's other business lines and the separate management of each WMP) are designed to assist with the management of potential conflicts of interest.

	<p><i>Related party transactions</i></p> <p>Pursuant to Article 3 of the <i>Notice of the CBRC on Issues Concerning Improving the Organizational Management System for the Wealth Management Business of Banks</i>, a bank's WMP is not permitted to invest in bank's own products or assets.</p> <p>The CBRC's 2004 <i>Rules for the Regulation of Internal Trading, Transactions with Shareholders and Internal Staff</i> sets out requirements for transactions between WMPs and related parties. Under these rules, transactions must be carried out honestly and at fair valuation, and at no better than usual business practice; transactions above specified limits require the approval of the bank's board.</p> <p>Delegation</p> <p>Article 8 of <i>Notice on Further Regulating the Investments of Individual Wealth Management Business of Commercial Banks</i> (Yin Jian Fa [2009] No. 65) permits a bank to delegate investment management of WMPs to other financial institutions approved by the CBRC. A bank doing so must undertake due diligence on the qualifications and credit status of the delegate, and such a delegation must have the approval of the bank's senior management. CBRC senior staff highlighted that in the case of delegation the bank keeps the responsibility.</p> <p>Ongoing monitoring and inspections</p> <p>As indicated above, all WMPs must be registered with the national banking industry wealth management information registry system. Banks must register information on the WMPs through their life cycle including WMPs' issue information, fund raising information, duration, asset valuation, assets, trading, liquidation, etc. Thus through this system the CBRC is able to monitor WMPs and the relevant risks in real time. In addition, as stated above, the CBRC receives a series of periodic reports on the WMPs. All these information is incorporated by the CBRC into its analysis of the banks for purposes of determining the intensity of supervision.</p> <p>In this regard, the CBRC aims to allocate supervisory resources and identify supervisory scopes according to bank risk profiles and potential negative impacts on the financial system. The risk assessment mainly focuses on inherent risks within bank businesses, risk management and internal control framework, and the effectiveness of oversight and governance structures. The impact assessment mainly focuses on potential impacts that a bank may have in time of crisis on the financial system and the real economy. Based on the assessments, CBRC defines the supervisory cycle (normally a calendar year) and develops supervisory plans, and allocates resources for on-site and off-site supervisions.</p> <p>For systemic issues, the CBRC conducts thematic on-site inspections on multiple institutions simultaneously, with consideration of the risk profile of individual banks and the banking industry, and focus on key risks and important areas. For example, in recent years, the CBRC organized multiple thematic inspections on the asset management business of banks. In particular, in the last three years thematic inspections were undertaken as follows:</p> <ul style="list-style-type: none"> • In 2014, with a focus on WMPs' risk ratings, liquidity management, corporate bond management, statistics etc.; • In 2015, with a focus on internal controls and supervision to prevent non-compliant and illegal conduct; and • In 2016, with a focus on checking that appropriate steps had been taken to
--	--

	<p>implement changes required as a result of the 2014 examinations.</p> <p>Since 2013, the CBRC has carried out 1,272 on-site inspections of the wealth management business activities of banks, including 618 in 2016. As a result of the inspections, during 2013-2015 201 sanctions were imposed with monetary penalties amounting to RMB 56 million; 148 rectification orders were made; business suspensions imposed in 14 cases; 3 cases were referred to judicial authorities; and the qualifications of 17 executives were cancelled. Market participants commented that these inspections were thorough and that the CBRC had required a number of changes to be made to their business operations as a result. These included changes to sales and marketing practices.</p> <p>International cooperation</p> <p>There is no need for international cooperation in relation to WMPs as they are only offered by Chinese banks and available to Chinese investors.</p>
Assessment	Broadly Implemented
Comments	<p>Regime for MFs under CSRC</p> <p>KQ 8 and 9 of the Methodology requires that a system of on-going monitoring be in place, and that the regulatory authority proactively perform investigative activities. In the context of China, CIS fund managers are subject to a comprehensive regime, requiring authorization, and compliance with detailed rules for the management of funds and the treatment of investors. The authorization process for fund managers is robust, as is the process for fund registration. They are subject to ongoing supervision by the CSRC. Periodic and ad hoc reports are all examined by the CSRC. Although a formal risk rating process is not used, the process used to determine priorities for on-site inspections draws on the extensive information the CSRC holds about fund managers and their activities, as well as records of previous compliance issues and complaints or publicly disclosed information. The combination of centrally mandated inspections and the on-site inspections carried out at the initiative of regional offices leads to a significant number of inspections being conducted on an annual basis. In this regard, the assessors note that overall all fund managers are subject to some level of on-site inspection on an annual basis. This is consistent with the opinions expressed by market participants, who informed the assessors that they were conscious of the likelihood that they may be subject to on-site inspections at any time. The assessors also note that, as well as being subject to CSRC inspections, regulated entities are also subject to on-site inspections by the SROs. Although the focus of SRO inspections is on compliance with SRO rules, these rules often reflect legislative or CSRC rules in a more granular form, and so SRO inspections add to the overall intensity of supervision.</p> <p>In this context it is key to ensure that the basis used to decide on themes and areas to inspect is robust. To this end the assessors recommend that the CSRC review whether a more structured process for themes identification should be implemented, potentially linked to the process to identify emerging and systemic risk. In addition, as the industry continues to grow, it may be desirable for the CSRC to move to a more systematic assessment of fund management companies' compliance risks, for example by adopting a formal risk rating system like the one it uses for other intermediaries (see under Principle 31). Finally, similar to the case of listed companies, the key concern relates to the effectiveness of enforcement, and whether sufficiently vigorous enforcement measures are being taken to affect the behavior of market participants. These issues have been discussed</p>

	<p>in Principle 12.</p> <p>Given the growth of mutual funds, a critical area for focus in ongoing supervision will continue to be compliance with investor suitability rules, especially in the distribution process. The assessors are aware that this is already an area of focus of the CSRC. On-line distribution of funds is increasing and it is important that compliance with suitability and disclosure rules is monitored throughout the distribution chain. Actions taken by the CSRC in recent years demonstrate that it is aware of the risks of such platforms. These issues have been considered under Principle 31.</p> <p>Finally the assessors note that under the current regulatory framework fund managers are authorized to trade, through rent seats, on behalf of the funds they manage. This is not common in other large jurisdictions, and it could potentially give rise to certain conflict of interest. However as indicated above the regulatory framework as developed by the CSRC contains several provisions aimed at managing such conflicts.</p> <p>Regime for WMPs under CBRC</p> <p>As indicated above, KQ 8 and 9 of the Methodology requires that a system of on-going monitoring be in place, and that the regulatory authority proactively perform investigative activities. As indicated in the description, there is evidence that the CBRC has in place a supervisory program for WMPs activities of banks that includes conducting on-site inspections followed by enforcement actions. Further, market participants indicated that such program, and in particular on-site inspections have become stricter over the last few years.</p> <p>The key question is whether the intensity of the supervision program is sufficient. In this regard, the high level regulatory framework for WMPs relies heavily on the effectiveness of the systems and processes adopted by banks to comply with regulatory requirements. This approach in turn requires banks' to have a systematic and sophisticated approach to the design and implementation of compliance and supervision arrangements. While some larger institutions may have the necessary resources and understanding to develop and implement appropriate measures, smaller or less sophisticated banks may lack the resources, knowledge or organizational culture to achieve this. These factors, combined with a still evolving practice concerning private and public enforcement, seem to require a greater use of on-site inspections by the CBRC than may be necessary in other large jurisdictions.</p>
Principle 25	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p><u>Regime for MFs under CSRC</u></p> <p>Legal form and investors' rights</p> <p>The rights and obligations of fund managers, fund custodians and fund unit holders must be specified in a fund contract (Article 3 of the <i>Fund Law</i>). Fund managers and fund custodians must carry out their responsibilities as trustees pursuant to the <i>Fund Law</i> and the fund contract, and unit holders of publicly offered funds are to share returns and bear risks in proportion to the number of fund units they hold. Articles 5 to 7 provide that fund assets are trust assets in nature, and must be segregated from the assets owned by the fund manager or the fund custodian. The proceeds and income obtained from the use of the fund assets become fund assets.</p>

	<p><i>Disclosure</i></p> <p>As further described in Principle 26, a fund's prospectus must contain a summary of the fund contract (Article 52 of the <i>Fund Law</i>). Article 53 of the <i>Fund Law</i> requires that a series of information be included in the fund contract, including the obligations of different parties (fund manager, fund custodian) and the rights of fund holders. The fund manager must publish the prospectus, fund contract and other relevant documents three days before the offering of fund shares (Article 56 of the <i>Fund Law</i>). The fund contract must specify the type of the fund as closed-end or open-end fund (Article 52).</p> <p><i>Responsibility for monitoring compliance with form and structure requirements.</i></p> <p>Articles 37 and 38 of the <i>Fund Law</i> make the custodian responsible for monitoring the fund manager's compliance with laws and regulations and with the fund contract. If it detects violations, it must refuse to act and notify the fund manager and the CSRC.</p> <p><i>Investment and borrowing restrictions</i></p> <p>Article 72 of the <i>Fund Law</i> lists the types of investment that can be made with fund assets. These are stocks and bonds traded on stock exchanges and other securities and derivatives specified by the CSRC. Article 73 prohibits the assets of a fund being used in specified types of transactions, including underwriting of securities, providing loans or guarantees to others in violation of applicable rules, and buying or selling units of other funds unless the CSRC has provided otherwise.</p> <p>Article 32 of the <i>Measures for the Administration of Operations of Publicly Offered Securities Investment Fund</i> specifies concentration limits for funds. For example, a fund must not invest more than 10 per cent of the net asset value of a fund in the securities of a single company; and all the funds managed by the same fund manager must not hold more than 10 per cent of any class of securities issued by a company. There are also rules relating to investment in securities-based derivatives.</p> <p>The CSRC has the power to ensure that any restrictions on type or level of investment or borrowing are complied with.</p> <p>Changes to investors' rights</p> <p>Significant matters concerning the rights of investors require the approval of a general meeting of fund unit holders (Article 47 of the <i>Fund Law</i>). These matters include the issuance of additional fund units; extension of the term of the fund contract; modification of key provisions of the fund contract; early termination of the fund contract; replacement of the fund manager or fund custodian; adjustment of the compensation standards of fund manager or fund custodian or adjustment of their other powers or functions previously agreed in the fund contract. A general meeting of fund unit holders can be held only when fund unit holders representing 50 per cent or more of the fund units are present (Article 86).</p> <p>The actions adopted at a general meeting of fund unit holders must be reported to the CSRC and made public within five days of their adoption.</p> <p>For a non-material matter that does not require the approval of a general meeting, the fund management company must publicly release a provisional report on the matter and update the prospectus every 6 months to reflect any material changes in the equity interests of investors. All the information released by a fund, including the prospectus and provisional information disclosure documents, is available on the websites of the fund management company and the newspapers designated by the CSRC.</p>
--	--

Separation of assets/safekeeping

Article 5 of the Fund Law provides that fund assets must be independent from a fund management institution's or a fund custodian's own assets. The fund management institution or fund custodian must not incorporate any fund assets into its own assets. All property and income obtained by the fund management institution or fund custodian from managing, utilizing or otherwise disposing of fund assets must be incorporated into fund assets. Where the fund management institution or fund custodian is liquidated for being dissolved, administratively dissolved or declared bankrupt in accordance with law or any other reason, fund assets are not liquidating property. In addition, Article 6 of the *Fund Law* provides that the creditors of the fund manager or the custodian cannot assert rights against fund assets, and that the assets of one fund cannot be used to offset debts of another. Article 7 provides that compulsory measures against a fund' assets can only be taken for debts incurred by the fund.

Pursuant to the legal framework, the capital raised by a fund through public issuance of fund units must be placed into the custody of fund custodians that are commercial banks or other duly established financial institutions (Articles 32, 35 and 50 of the *Fund Law*). The requirements for entities applying to become fund custodians are set out in Article 8 of the Measures for the Administration of Securities Investment Fund Custody Business (for commercial banks) and Article 5 of the Interim Provisions on the Securities Investment Fund Custody Business of Non-Bank Financial Institutions. They include requirements for minimum net assets, the qualifications and experience of managers and custody personnel, and monitoring and risk control systems.

Pursuant to article 36 of the *Fund Law* custodians have four main functions: (i) safekeeping of assets, (ii) overseen of clearing and settlement, (iii) overseeing the investment operations of the fund management company, and (iv) reviewing the net asset value and subscription and redemption prices of the fund

A fund custodian and a fund manager must not be the same entity and they must not contribute capital to each other or hold the shares of each other (Article 35). Fund assets must not be used as capital contributions to the fund manager or the fund custodian (Article 73 of the *Fund Law*). However, custodians can (and in practice some are) part of the same financial group. As indicated under Principle 24 there are provisions that seek to manage potential conflicts of interest. The CSRC is currently considering further improvement of relevant regulatory rules on related party transactions to prevent conflict of interest.

In addition, as part of its annual auditing, the audit firm must conduct a comprehensive yet targeted audit on possible conflicts of interest, so as to safeguard the interests of fund unit holders.

Winding up

Article 80 of the *Fund Law* sets out the circumstances in which a fund contract is to be terminated. These are when: the fund contract has expired; a general meeting of fund unit holders has decided to terminate the contract; the fund manager or fund custodian are terminated and their duties are not assumed by a new fund manager or fund custodian within six months; and in any other circumstances prescribed in the fund contract.

Article 81 provides that upon termination of the fund contract, the fund manager must organize a liquidation team to liquidate the fund assets. The liquidation team consists of the fund manager, fund custodian and related intermediaries. After the liquidation report

prepared by the liquidation team is audited by an accounting firm and a legal opinion on the liquidation report is provided by a law firm, the report must be submitted to the CSRC and made public.

Article 82 provides that the fund assets remaining after paying all liabilities of the fund shall be distributed among holders of fund units in proportion to the number of units they hold.

In addition, article 26 of the Fund Law stipulates that where a fund manager of a publicly offered fund engages in any illegal business operation or has incurred material risk seriously disturbing the order of securities market or infringing upon the interest of fund unit holders, the CSRC may take regulatory actions against the fund manager such as ordering it to cease business or rectification, designating a custodial or receivership institution for it or disqualifying it for fund management and administratively dissolving it. Article 30 establishes that if the function of a fund manager terminates, then the assembly of unit holders must appoint another manager within six months. While such designation takes place the CSRC must designate a temporary fund manager.

There has been experience with the winding up of funds, mainly related to cases where the fund was too small or its operation was not financially viable. In those cases fund managers initiated winding up in accordance with the procedures stated above (by consulting investors in general assembly of unit holders). Among those cases terminated fund assets were liquidated and distributed prorata to unit holders by their holdings. There have not been lawsuits arising from the termination of funds.

Regime for WMPs under CBRC

Legal form and investors' rights

Banks' WMPs are contractually based, and the rights of investors and the responsibilities of product providers are set out in the contract.

Pursuant to Article 2 of the *Notice on Further Standardizing Issues relating to Investment Operations of Wealth Management Business of Commercial Banks* (CBRC [2013] No 8), each WMP must be managed separately, its assets separately identified, and must have its own financial statement. In addition, under Interpretation No. 8 of the Accounting Standards for Business Enterprises of the MoF of 2015, each WMP is to be a separate accounting entity and maintain separate books and records in accordance with accounting standards.

Article 4 of the *Notice on Issues Concerning Further Regulating the Personal Financial Management Business* (CBRC [2008] No 47) requires that when entering into contracts for wealth management services, banks must clearly stipulate the methods to be used to communicate with customers and how information is to be provided so as to ensure that customers can obtain information in a timely way.

Disclosure

The legal rights and obligations of banks and investors regarding WMPs are agreed through contracts. Investors can request banks information on WMPs, including regarding legal structure and bankruptcy remoteness.

Responsibility for monitoring compliance with form and structure requirements.

Article 35 the *Risk Management Guidelines* requires a bank to have rules and a process for auditing investments to ensure that they conform to the stipulations agreed with customers. Article 9 of the *Notice on Further Strengthening Risk Management of Banks'*

	<p><i>Wealth Management Business</i> (Yin Jian Fa [2011] No. 91) requires a bank to conduct a comprehensive audit on at least one WMP every quarter. The CBRC has responsibility for monitoring compliance with these obligations.</p> <p><i>Investment and borrowing restrictions</i></p> <p><i>The Notice on Further Regulating the Investments of Individual Wealth Management Business of Commercial Banks</i> (Yin Jian Fa [2009] No. 65) requires banks to adhere to prudent principles of investment management.</p> <p><i>The Notice on Relevant Matters concerning Further Regulating the Investment Management of the Individual Wealth Management Business of Commercial Banks</i> provides that WMPs may be invested in: (a) fixed income financial products with underlying assets' being rated above investment-grade (Article 11); (b) financial derivatives or structured products, when the commercial bank or its commissioned domestic investment manager has the qualification for trading derivatives issued by financial institutions and appropriate risk management capability (Article 16); and c) stocks on the secondary markets or equities of non-listed companies but this only for WMPs offered to high net-worth clients, private banking clients and institutional clients (Articles 18, 19 and 20). Pursuant to such Notice WMPs may not be invested in non-financial assets, including real estate and other immovable properties.</p> <p>Fixed income assets are required to have an investment grade rating. Regarding fixed income assets, up to 35 per cent of a WMP's portfolio may be invested in "non-standardized debt assets" (debt assets not traded in the inter-bank market or on stock exchange markets). Investments of this kind are governed by the <i>Notice on Further Standardizing Issues relating to Investment Operations of Wealth Management Business of Commercial Banks</i> (CRBR [2013] No 8). The <i>Notice</i> requires specific disclosure to be made about assets of this kind (Article 3); due diligence and risk analysis before investment in such assets (Article 4); and prohibits banks from providing any explicit or implicit guarantee or repurchase commitment for the financing of assets of this kind (Article 8). CBRC senior staff indicated that currently about 75% is invested in simple assets, while the current share of non-standardized (less liquid) assets corresponds to about 15%.</p> <p>The disclosure documents provided to prospective investors must contain information about the type of assets a fund will hold and the asset allocation (see under Principle 26).</p> <p>Changes to investors' rights</p> <p>Article 20 of the <i>Sales Rules</i> allows a bank to adjust the investment mandate of a WMP according to market conditions provided that the information is disclosed to investors in advance. If an investor does not agree with the adjustment, they are entitled to redeem their interest early.</p> <p>Article 21 of the <i>Sales Rules</i> provides that a bank can adjust WMP fees stipulated in the contract only after disclosing its intention to do so. Investors who do not agree with the change are entitled to early redemption.</p> <p>Separation of assets/safekeeping</p> <p>There are no specific legal provisions that provide bankruptcy remoteness to the assets of the WMPs in case of insolvency of the banks. However, the CBRC requires the custody of WMPs to be conducted in compliance with the same provisions applicable to the custody of securities investment funds explained above. Further, as indicated above, regulations of the CBRC and MoF have required strict separation and accounting of such assets. CSRC senior staff indicated also that there have not been cases of banks</p>
--	---

	<p>becoming insolvent, leading to problems with WMPs. In any event, the CBRC is currently drafting provisions on bankruptcy remoteness for WMP assets to address the legal uncertainty.</p> <p>In addition to the rules about the custody of assets, other segregation rules apply to a bank's WMP business including:</p> <ul style="list-style-type: none"> • the WMP activity of a bank must be segregated from its proprietary banking business; • WMP activity must be segregated from a bank's other asset management business; • each WMP must be segregated from other WMPs; and • the assets of WMP clients must be segregated from banking assets. <p>See Article 3 of the <i>Notice on Improving the System for Organization and Management of Banks' Wealth Management Business</i> (CBRC [2014] No 35).</p> <p>The assets of a WMP must be held by a custodian bank. Custodian banks must be licensed by both by the CBRC and the CSRC (see Article 10 of the Notice on Further Regulating the Investments of Individual Wealth Management Business of Commercial Banks (Yin Jian Fa [2009] No. 65) for the CBRC). Custodian banks must meet a series of requirements, regarding capital, their organization and their human resources. There are currently 27 such banks in China. A bank that has a custodian license is permitted to have custody of the assets of WMPs it issues, but these must be held as custody assets (in the bank's Custody Department) and the assets of each WMP must be separately accounted for.</p> <p>Securities assets of a WMP are held by the CSDC in the name of the WMP and are therefore readily identifiable as the assets of the relevant WMP.</p> <p>Winding up</p> <p>There are no specific provisions in the regulatory regime dealing with the winding up of a WMP (i.e. in case of their liquidation prior to the conditions established in the prospectus) Current regulations do require that the banks prepare a report of the WMP upon liquidation (i.e. once they mature).</p>
Assessment	Partly Implemented
Comments	<p>Regime for MFs under CSRC</p> <p>There are challenges concerning KQ 8b) of the Methodology. Although cross shareholding between a fund manager and a custodian is prohibited, both can be members of the same corporate group, and the assessors understand that this happens in practice. Key Question 8(b) of the IOSCO Methodology requires that, in these circumstances, there should be special legal or regulatory safeguards in place.</p> <p>There appear to be some additional safeguards in the system that operates in China. In particular, securities of a mutual fund must be held separately in the name of the mutual fund at the CSDC and are fully protected in the event of the insolvency of the fund manager, the custodian or both.</p>

	<p>However, in China's regulatory system custodians play an active role in the supervision the fund manager's compliance with its obligations. For example, as indicated above they oversee the manager's compliance with a fund's investment mandate and with valuation rules. In these circumstances, there is a potential for conflicts of interests where fund managers and custodians are related entities. Thus additional safeguards should be explored, for example, by the CSRC treating related party custodians as a special risk category when planning and carrying out supervision activity such as on-site inspections</p> <p>Regime for WMPs under CBRC</p> <p>The key concerns relate to KQ8 (a) and (b) in relation to custody and KQ 8(c) in relation to bankruptcy remoteness.</p> <p>The assessors acknowledge that WMP assets must be held by a custodian bank; however as per the current regulations they could be in self-custody if the bank that issues the WMPs is itself a custodian bank. While self-custody is permitted by the Principles and Methodology, the Methodology requires that in such cases additional safeguards be in place to protect investors' interests. Thus, the assessors recommend the authorities to consider the imposition of a requirement for independent custody. Alternatively additional safeguards should be implemented as required by the Principles.</p> <p>As for bankruptcy remoteness, the assessors understand that there is legal uncertainty regarding the treatment of WMP assets in the event of the bankruptcy of the issuing bank; although the obligations to segregate assets (which in the case of securities are held in the name of the WMPs in the CSDC), and to hold them in custody provide a layer of protection. In the long run it is critical that this issue be clarified, if needed via a legal reform.</p>
Principle 26	<p>Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p>
Description	<p><u>Regime for MFs under CSRC</u></p> <p>The fund manager is primarily responsible for information disclosure relating to a fund. Article 76 of the Fund Law requires the following information to be publicly disclosed:</p> <ul style="list-style-type: none"> • the fund prospectus, fund contract, and fund custody agreement; • the fund offering information; • the announcement on the listing and trading of fund shares; • the net asset value of a fund and the net asset value per share; • the subscription and redemption prices for fund shares; • quarterly portfolio reports on fund assets, financial accounting reports and semi-annual and annual fund reports; • ad hoc reports; • resolutions of fund shareholders' meetings; • any major personnel changes in the specialized fund custody department of the

	<p>fund manager or the fund custodian;</p> <ul style="list-style-type: none"> • any legal proceedings or arbitration involving fund assets, the fund management business or the fund custody business; and • any other information required by the CSRC. <p>Disclosure documents are available on the fund manager's website, relevant securities newspapers and the CSRC's website.</p> <p>To make released information easier to understand, the CSRC developed the <i>Standards for Contents and Formats of the Annual Report of Fund Management Companies</i>, the <i>Standards for Contents and Formats of Information Disclosure by Securities Investment Funds (No. 1 – No. 7)</i> ("Fund Disclosure Standards") and the <i>Rules for Preparation and Reporting of Information Disclosure by Securities Investment Funds (No. 1 – No. 5)</i>.</p> <p>The CSRC also gives investors access to information about funds. It has adopted eXtensible Business Reporting Language (XBRL) standards for information disclosure of funds. Using these standards, funds submit daily net asset value reports, regular reports, ad hoc announcements and all other fund reports. The CSRC has also established a website for electronic disclosure of information on funds, giving investors a central platform for accessing information.</p> <p>Disclosure to investors</p> <p>Fund contract</p> <p>Pursuant Article 52 of the Fund Law, a fund contract for a publicly offered fund must include: the objectives and name of the fund offered; the names and domiciles of the fund management institution and fund custodian; the operating mode of the fund; the total fund shares and the term of the fund contract in the case of a closed-end fund or the minimum total shares offered in the case of an open-end fund; the principles for determining the offer date of fund shares and the fund share prices and fees; the rights and obligations of the fund shareholders, fund management institution and fund custodian; the procedures and rules for convening the fund share holders' meeting and the deliberation and voting at the fund share holders' meeting; the procedures, time and place for the fund share offering, trading, subscription and redemption, the calculation method for fees, and the time and method for paying the redemption amount; the principles and execution methods for fund income distributions; the methods for drawing and paying remuneration for the fund management institution and fund custodian and the proportion; the methods for drawing and paying other fees and expenses related to the management and utilization of fund assets; the investment directions and restrictions for fund assets; the calculation and publication methods for the net asset value of the fund; the handling methods when the fund offered fails to satisfy the statutory requirements; the causes and procedures for the rescission and termination of the fund contract and the liquidation methods for fund assets; the dispute resolution methods; and other matters as agreed upon by the parties.</p> <p>Prospectus</p> <p>Pursuant to Article 53 of the Fund law the prospectus of a publicly offered fund must include: the title of the registration approval document for the fund offering application and the date of registration; the basic information on the fund management institution and fund custodian; the summaries of the fund contract and fund custody agreement; the fund share offer date, prices, fees and duration; the methods for offering fund shares and the</p>
--	--

names of the offering institution and registration institution; the names and domiciles of the law firm issuing legal opinions and the accounting firm auditing fund assets; the methods for drawing and paying remuneration for the fund management institution and fund custodian and other relevant fees and expenses and the proportion; the risk alerts; and any other information prescribed by the CSRC.

The CSRC's *Fund Disclosure Standards No. 5 – Prospectus Standards* provides more detail on content requirements for prospectuses. Article 4 requires all information that will have a significant influence on the decision of investors to invest in the fund, and in particular the risks of investing, to be fully disclosed in the prospectus. In addition, any other information that may help investors make that decision, whether or not required under the *Standards*, must be disclosed. Detailed disclosure requirements are also set out for other information required to be in the prospectus, including risk factors, information about the custodian, the investment strategy and policies of the fund, and fees and charges. Article 31 requires disclosure of all relevant risk factors such as market, liquidity and management risk.

The fund prospectus and fund contract must contain detailed descriptions of the rights of investors: see Article 52 and 53 of the *Fund Law* and Article 23 of the *Fund Disclosure Standards No. 6 – Fund Contract*.

Article 56 of the *Fund Law* requires the fund manager to publish the prospectus, fund contract and other relevant documents three days before the offering of fund shares.

The procedures for the listing of funds are set out in Articles 61-64 of *Fund Law*. CSRC staff reviews all fund documents, including the prospectus, during the fund registration process.

Periodic reports

Article 5 of the *Measures for the Administration of Information Disclosure by Securities Investment Funds* requires a fund manager to issue an annual report, a semi-annual report and a quarterly report on the fund. The CSRC's *Fund Disclosure Standards* contain detailed provisions about the content and formats of these reports. Annual reports must be issued within 90 days of year-end; semi-annual reports within 16 days of the period end; and quarterly reports within 15 days of the close of the quarter.

CSRC staff review all quarterly, semi-annual and annual reports.

Material event reporting

Article 23 of the *Measures for the Administration of Information Disclosure by Securities Investment Funds* provides that upon the occurrence of any material events relating to the fund, the fund manager must prepare and publish an *ad hoc* report within two days, and, on the date of disclosure, file it with the CSRC. Material events are those that may have a significant impact on the interest of fund unit holders or on the price of the fund units.

Regulator's powers

The CSRC has power under Article 54 of the *Fund Law* to refuse to register a fund. If application documents for fund registration contain false records, misleading statements or material omissions, the CSRC will refuse to accept the application; if an application has already been accepted, the CSRC will refuse to register it; if a fund is already registered but not yet offered, the CSRC will cancel its decision on registration and suspend acceptance of any application for fund registration from the fund manager in the following year. The CSRC may also take administrative regulatory actions against the fund manager and staff members directly in charge or directly responsible for the violation. If the circumstances are serious, CSRC will issue a warning, impose a fine of a maximum of RMB 30,000, or both. If registration and offering have already been completed, sanctions can be imposed in

	<p>accordance with Article 132 of the <i>Fund Law</i>.</p> <p>If the application documents for fund registration submitted by a fund manager contain contradictory information or contain inconsistent wording that conveys substantially different information about the same facts, the CSRC will suspend its review and will not accept any application for fund registration filed by the fund manager in the following six months (Article 53 of the <i>Measures for the Administration of Operations of Publicly Offered Securities Investment Funds</i>).</p> <p>Advertising</p> <p>Regulation of advertising and promotional material is governed by the <i>Measures for the Administration of the Sales Activities of Securities Investment Funds</i>. Article 32 defines the advertising material outside of the offering documents in broad terms to include all promotional material and activity. Article 35 provides that publicity and promotional materials must be truthful and accurate, and conform to the fund contract and fund prospectus; and prohibits misleading statements and omissions. Specific provisions prohibit promises of profitability, and caution against the misuse of promotional terms such as “guaranteed”, “high returns” and “risk-free”. Prediction of the performance of securities invested in by the fund is prohibited. The CSRC has also issued <i>Supplementary Provisions on the Supervision of Promotional Materials of Securities Investment Fund</i> that provides further guidance on the misuse of promotional terms. For example, unsubstantiated claims about fund performance are prohibited, as are expressions likely to blind investors to risk.</p> <p>Updating offering documents</p> <p>Article 12 of the <i>Measures for the Administration of Information Disclosure by Securities Investment Funds</i> and Article 2 of the <i>Fund Disclosure Standards No. 5 – Prospectus</i> require that, a fund manager must, within 45 days after the end of each 6 months, update the fund’s prospectus, publish it on the website, and publish a summary in a designated newspaper. The fund manager must submit the updated prospectus to the CSRC with a written explanation on the updated contents 15 days prior to the announcement.</p> <p>Ongoing developments concerning disclosure</p> <p>The CSRC is currently evaluating and revising the Measures for the Administration of Information Disclosure by Securities Investment Funds to improve relevant regulatory rules. First, the CSRC intends to add the principle of “simple and easily available” information disclosure into the basic principles of information disclosure for securities investment funds. Second, the CSRC aims to introduce a “product information summary” during the fund issuance and distribution process similar to the practice in other jurisdictions, so as to show investors material fund information in a simple and easily available way. Third, the CSRC intends to improve the update frequency of material information. Drawing upon practices of sophisticated overseas markets, the CSRC plans to require fund managers to timely update the prospectus and “product information summary” in the event of material changes.</p> <p>Accounting standards</p> <p>The CSRC has required securities investment funds to adopt the Accounting Standards for Business Enterprises (ASBE) since 2007. These accounting standards have achieved substantial convergence with the internationally accepted accounting standards. See further under Principle 18.</p> <p>Ensuring compliance with investment policies</p>
--	---

As noted above, the custodian has an obligation to ensure that operation of the fund complies with the terms of the fund contract, including investment policies.

The CSRC has power to intervene if the stated investment policy or trading strategy, the authorized investments that the CIS is permitted to undertake, or any policy required by regulation, is not being complied with.

Regime for WMPs under CBRC

Disclosure to investors

The CBRC requires banks to continuously disclose information related to WMPs and make sure customers have sufficient knowledge of the information about the products they invest in. In this regard, article 3 of the *Notice on Relevant Matters Concerning Further Strengthening the Management of Risks Associated with Wealth Management Business of Commercial Banks* provides that relevant information prior to, during and post the sales of wealth management products offered to individual customers shall be fully disclosed on the website of the banks' headquarters. In addition, article 3 of the *Notice on Relevant Matters Concerning Improving the Organization and Management Systems* provides that banks shall ensure sufficient information disclosure throughout the lifecycle of wealth management products and strengthen continuous disclosure prior to, during and post the sales.

Offering documents

The *Sales Rules* provide that, when selling wealth management products, banks must provide customers with "sales documentation" including a sales agreement, a prospectus, a risk disclosure statement and a notice about clients' rights and interests. This documentation must include information about:

- risks including a risk warning, information about the type of product type, the product's risk rating, scope of suitable clients, examples illustrating worst-case scenario and results, rating of client risk tolerance, and a risk acknowledgement statement which must be signed by the investor (Article 18);
- the rights and interests of clients, which at least covers the sales process and the methods, channels and frequency of information disclosure (Article 19);
- the investment portfolio including the classes and proportions of assets to be invested (Article 20);
- fees to be charged (Article 21); and
- complaints procedures (Article 19).

Sales documentation must disclose risks in a prominent position at the beginning of the document (Article 3 of the *Notice on Issues Concerning Further Regulating the Personal Financial Management Business* (CBRC [2008] No 47)) and must be in plain language (Article 6 of *Notice on Further Regulating the Administration of the Reporting of the Personal Financial Management* (CBRC [2009] No 172). Where investments are to be made in non-standardized debt assets, there are requirements for disclosure of specific details about those assets (Article 3 of the *Notice on Further Standardizing Issues relating to Investment Operations of Wealth Management Business of Commercial Banks* (CBRC [2013] No 8)). There are no specific regulatory requirements for the sales documentation to provide disclosure about the methodology for valuing assets, redemption and pricing of interests, custodial arrangements or financial information about the WMP.

Periodic reports

Article 28 of the Interim Measures for the Administration of Commercial Banks' Personal Wealth Management Services provides that until a WMP matures, the commercial bank must provide its customers with the statements of account for all relevant assets held by them and such statements must list the changes in assets, incomes and expenses, as well as closing asset valuation, etc. Such statements must be provided for at least two times and at least on a monthly basis.

Banks must make available to clients quarterly information about their WMPs, covering financial statements of various investment vehicles, performance and related information, as well as the investment portfolio, types and proportions of the portfolio. See Article 29 of the *Interim Rules*; Article 6 of the *Notice on Further Regulating the Investments of Individual Wealth Management Business of Commercial Banks* (Yin Jian Fa [2009] No. 65); Article 3 of the *Notice on Further Strengthening Risk Management of Banks' Wealth Management Business* (Yin Jian Fa [2011] No. 91); and Article 3 of the *Notice on Further Standardizing the Matters relating to Investment Operations of Wealth Management Business of Commercial Banks* (Yin Jian Fa [2013] No. 8)). On termination of a WMP, or upon payment of investment proceeds, a bank must provide holders with detailed information on the WMP investments and corresponding proceeds. Information to be disclosed when a product expires or is terminated includes the types of asset invested in, investment portfolio, proportion thereof, sales fees, custodian fees, investment management fees, and proceeds attributable to customers. (Article 30 of the *Interim Rules*; Article 22 of the *Sales Rules*.)

Material event reporting

Banks are required to disclose the following events to clients:

- In cases where significant market events have led to investment composition to deviate beyond the floating margin agreed in the sales document with clients, potentially impacting client earnings significantly, such events must be communicated to clients timely;
- In cases where a bank needs to adjust the scope of investment or related fees due to market conditions or regulatory changes, such adjustments must only be processed after information disclosures have been made according to related regulations. The bank must allow early WMP redemptions according to agreement in the sales document if such adjustments are rejected by bank clients;
- In case where illiquid assets or their risk conditions in bank WMPs have experienced material changes during the depository period, banks must disclose it to clients within 5 days.

See Article 6 of the *Notice on Further Regulating the Investments of Individual Wealth Management Business of Banks* (Yin Jian Fa [2009] No. 65); Article 3 of the *Notice on Further Standardizing the Matters relating to Investment Operations of Wealth Management Business of Commercial Banks* (Yin Jian Fa [2013] No. 8); and Article 20 and 21 of the *Sales Rules*.

Regulator's powers

As noted under Principle 24, the CBRC receives disclosure documents at least 10 days before a product can be offered, and has the power to stop the offering if, among other things, the disclosure documents do not comply with requirements.

	<p>Advertising</p> <p>Articles 39 to 42 of the <i>Sales Rules</i> deal with advertising and promotion of WMPs. Provisions include:</p> <p>a prohibition on promoting any specific WMPs through TV or radio channels; and on promoting products by telephone, fax, SMS or email if clients explicitly disagree with promotion of wealth management products in this way (Article 39);</p> <p>requirements that, when WMPs are sold through its online banking website, or by telephone, there must be evaluation of the potential client's risk tolerance before a sale is made and clients must confirm their understanding of risks (Articles 40 and 41);</p> <p>a requirement that WMPs with a risk rating of level-4 or higher must be sold face-to-face through its outlets unless otherwise agreed with the client in writing (Article 42).</p> <p>Article 2 of the <i>Notice on Issues Concerning Further Regulating the Personal Financial Management Business</i> (CBRC [2008] No 47) requires customer suitability assessments to be done face-to-face.</p> <p>Material used in the promotion of WMPs must be authorized by the issuing bank's head office, be truthful, accurate and clear, avoid misleading representations and material omissions, and avoid exaggerated expressions (such as "safe" or "guaranteed") and exaggerated expressions about past performance. There are explicit rules about the use of past performance data (Articles 12 to 14 of the <i>Sales Rules</i>), and rules requiring a warning that WMPs are not comparable to bank deposits (Article 17). Banks are permitted to provide information about estimated returns in promotional material and sales documentation, but there must be a prominent warning that estimated returns do not represent actual returns, and any estimations must be reasonably based (Article 16).</p> <p>Updating offering documents</p> <p>There are no express provisions dealing with the need to update or replace sales documentation (including prospectuses) when information in them becomes out-of-date or inaccurate. However, as indicated above CBRC rules require banks to ensure sufficient information disclosure throughout the lifecycle of wealth management products and to strengthen continuous disclosure prior to, during and post the sales. In addition, there are obligations to give notice of material changes that may have a material impact on their investments (see above).</p> <p>Accounting standards</p> <p>Under Interpretation Rule 8 WMPs must comply with accounting standards (ASBE).</p> <p>Ensuring compliance with investment policies</p> <p>As noted above, Article 35 the <i>Risk Management Guidelines</i> requires a bank to have rules and a process for auditing investments to ensure that they conform to the stipulations agreed with customers.</p>
Assessment	Broadly Implemented
Comments	<p>The grade is mainly a result of challenges in the regulation of WMPs as detailed below.</p> <p>Regime for MFs under CSRC</p> <p>There is a comprehensive disclosure regime, requiring full disclosure to investors at the</p>

	<p>time they invest in a fund and on an ongoing basis. One issue that the assessors have considered is whether the obligations to update prospectuses every 6 months are adequate if there have been substantial changes to the operation of a fund since the last update. Existing investors may have been kept informed of changes through ad hoc disclosures and participation in decisions to approve major changes. The position of a new investor may be different: an investor making a decision on the basis only of the prospectus may be relying on material that is significantly out of date. Some jurisdictions deal with this issue by requiring the fund manager to produce a supplementary prospectus, or issue a new prospectus, where information in the existing prospectus cannot be relied on to make a fully informed investment decision. The assessors recommend the authorities implement this improvement.</p> <p>In addition, the authorities are encouraged to consider whether requiring a summary information document along with the prospectus could improve the usefulness of the prospectus vis-à-vis investors. This issue has not been considered for the grade.</p> <p>Regime for WMPs under CBRC</p> <p>The key concerns relate to KQ1 and 5 of the Methodology. The assessors appreciate that there are strong rules concerning sales and distribution obligations. However, the framework for disclosure about a WMP and a number of its key characteristics is high level and does not address many of the issues contained in the Methodology. Furthermore, the review of some prospectuses shows that in practice disclosure is very basic. Permitting the use of expected returns, even if accompanied elsewhere by statements that the product is an investment product and subject to investment risk, has the potential to mislead investors about the nature and risks of the product. This combination of factors, has the potential to affect investors' ability to fully understand the nature of the product that they are investing in. Thus, in the short term the assessors recommend that the CBRC prohibits banks from using expected returns in the prospectus and marketing the WMPs based on expected returns. In the medium term the CBRC should work towards enhancing disclosure of key operational aspects of the WMPs. In this context the assessors also recommend that the CBRC reviews whether a stronger framework for material events disclosure is required.</p>
Principle 27	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>Regime for MFs under CSRC</p> <p>Asset valuation</p> <p><u>Principles for valuation</u></p> <p>Pursuant to CSRC regulations funds must apply ASBE. CSRC has issued detailed rules regarding fund valuation, especially the determination and measurement of the fair value of various financial instruments. The CSRC requires fund managers and fund custodians to implement all the provisions of the relevant accounting standards (ABSE) and not to selectively employ them. As required by the standards, fund managers must choose appropriate fair value measurement models and establish internal control systems for determining fair values.</p> <p><u>Where market prices not available</u></p> <p>The CSRC's <i>Guiding Opinions on Further Regulating the Valuation Business of Securities Investment Funds</i> contains detailed provisions dealing with the valuation of investment</p>

products for which there are no market prices on the valuation date, and investment products without an active market. Fund managers must have sound and effective valuation policies and procedures, including valuation models, assumptions, parameters and verification mechanisms. These must be implemented with the approval of senior management. Custodians must review valuations and the calculation of net asset values, and must be informed about any changes in valuation principles. Where the fund manager changes from valuation based on market prices to an alternative methodology and the result is a material change in net asset value (defined as a change of more than 0.25 percent), the fund manager must engage an accounting firm to conduct an audit. The accounting firm must provide audit opinions and issue a report on the appropriateness of the related valuation models, assumptions, and parameters adopted.

Valuation policies and any changes to them must be disclosed in periodic reports.

Timing

The CSRC requires open-end funds to make valuations on each trading day and announce the NAV per fund unit on the next day. Closed-end funds must disclose the fund NAV and NAV per fund unit at least on a weekly basis but also to make valuations on each trading day. QDII funds are required to calculate the NAV per fund unit at least once a week and disclose it within two working days after the valuation date; if QDII funds invest in derivatives, calculation and disclosure must be made on each working day.

Independent audit

Annual financial reports of funds must be audited by an independent auditor. For investment products for which market quotations are readily available, the auditor should verify independently all quotations used by the fund at the date of balance sheet. For products carried at fair value without readily available market prices, the auditor must review all information considered by the fund manager and assess the fund manager's valuation procedures. The independent auditor must also obtain a sufficient understanding of internal control over the valuation process to plan and conduct the audit. See Article 5 of the *Guidance on Further Regulating the Valuation Process of Securities Investment Funds* (CSRC Announcement [2008] No. 38); Article 18 under Chapter IV of the *Measures for the Administration of Information Disclosure by Securities Investment Funds* (CSRC Order No. 19); and Article 8 of the *Standards for Contents and Formats of the Annual Report of Fund Management Companies* (CSRC Announcement [2008] No. 4).

In addition, one of the functions of a custodian is to check the fund NAV and the purchase and redemption price of fund units calculated by the fund manager (Article 36 of the *Fund Law*).

Pricing and redemption of interests

Requirement

The purchase and redemption price of units of publicly offered funds must be calculated on the basis of the per-unit NAV on the day of purchase or redemption after adjusting for relevant fees. See Article 69 of the *Fund Law* and also Article 17 of the *Measures for the Administration of Operations of Publicly Offered Securities Investment Funds*.

Money market funds

The first rules for MMFs were promulgated in 2003. Given that most investment products were not actively traded and did not have a readily available fair value at the inception of MMFs, the MMF industry adopted amortized cost method for valuation. Such method is still accepted under conditions that have been strengthened overtime through changes to

the corresponding rules as detailed below. The last changes took place in 2015.

Article 11 of the *Measures for the Supervision and Administration of Money Market Funds (MMFs)* provides that money market funds must adopt sound and appropriate accounting and valuation methods. On condition that the NAV fairly reflects the value of the portfolios it holds, a MMF is permitted to use the amortized cost method to value its portfolios, provided that the accounting method and its potential impact on the fluctuation of the fund NAV have been disclosed in the fund contract and prospectus. Article 12 requires that, if a fund adopts the amortized costs method, it must create a "shadow price" (i.e. the price using market value) as a risk control measure in evaluating the fairness of the NAV calculated by reference to amortized cost.

The Regulations also prescribe measures to be taken if there are material variances between the NAVs calculated under each method. Under these measures, where the fund NAV calculated by shadow pricing is 0.25 per cent below that calculated by the amortized cost method, the fund manager must adjust the absolute value of the negative deviation to within 0.25 per cent in five trading days. Thus, this operates as an early warning threshold. Failing to do so will subject the manager to regulatory measures. Where the absolute value of a negative deviation reaches 0.5 per cent the fund manager must draw upon its risk reserve or proprietary funds to compensate for potential losses and limit the absolute value of negative deviation to within 0.5 per cent. Where the absolute value of negative deviation exceeds 0.5 per cent for two consecutive trading days, the fund manager must either revalue portfolios using the fair value method, or take action such as suspending the acceptance of all redemption applications, terminating the fund contract and starting to liquidate assets. Where the shadow NAV is 0.5 per cent more than the NAV calculated by the amortized cost method, the fund manager must suspend acceptance of unit purchase requests and adjust the absolute value of the positive deviation to within 0.5 per cent in five trading days. In addition, there are also limits on:

- the types of investments that can be made: For example, there must be no investment in bonds or debt-financing instruments of non-financial enterprises rated less than AA+, or in equity securities, and bank deposits must have a maturity of less than one year;
- portfolio composition: Investments must have an average day to maturity of not more than 120 days and an average life of no more than 240 days;
- Liquidity: At least 5 per cent of the portfolio must be invested in liquid assets, which include cash and interbank notes; at least 10 per cent of the fund securities must be in securities with a 5 day maturity; and instruments with constrained liquidity should be no more than 30% of the assets.
- concentration: Bonds issued by one single entity can comprise no more than 10% of the portfolio.

The rules also permit the fund to charge an exit fee of 1 per cent in extreme situations. In addition, if redemption by one investor amounts to more than 10% of the fund, the fund can suspend redemptions.

CSRC senior staff indicated that in practice the average deviation between the actual NAV and the NAV based on the amortized method has been less than 0.1 percent. They also indicated that in cases of extreme volatility, fund managers have used the risk reserve mechanisms that all managers must keep (10% of management fees) to make up for

deviations and pull back the NAV to an acceptable level (less than a deviation of 0.5%). However they also emphasized that fund managers do not have unlimited responsibility to keep the stable NAV; i.e. once the deviation goes beyond 0.5 percent then the fund manager must switch to fair value.

CSRC staff also emphasized that they closely monitor MMFs and are considering changes to the regulations in light of changes in market structure. In the past MMFs used to be dominated by retail investors, but now the proportion of institutional investors is larger. These changes in structure require a rethinking on different aspects including valuation, redemption and liquidity management. In this context, one possibility being explored is to classify MMFs based on the investors to which they cater, and require those for institutional investors to be valued at fair value. For those marketed to retail investors, stable NAV would still be permitted; but potentially there might be requirements to hold a higher percentage of high quality, highly rated securities and shorter duration of the portfolio.

Finally, on August 31, 2017 the CSRC released a new rule for the liquidity risk management of open-ended securities investment funds, following public consultation. The new rule, effective in October 1st 2017, proposes revisions to the valuation methods of MMFs and liquidity management tools under circumstances of substantial redemptions.

Disclosure

Article 52 of the *Fund Law* provides that, the fund contract for a publicly offered fund must include information about the procedures, time, place of the offering, trading, purchase and redemption of fund units, how fees are calculated, and the time and method of payment from unit redemptions. Article 17 of the *Measures for the Administration of Operations of Public Securities Investment Funds* supplements Article 69 of the *Fund Law* by requiring that the detailed calculation method of the purchase and redemption price of open-end fund units must be set out in the fund contract and prospectus. Article 30 of the *Standards for Contents and Formats of Information Disclosure by Securities Investment Funds (No. 5) – Contents and Formats of the Prospectus* sets out detailed requirements for prospectus disclosure of purchase and redemption processes.

Pricing errors

Article 70 of the *Fund Law* provides that where there is an error in the calculation of per unit NAV, the fund manager must promptly correct it and take reasonable steps to prevent further losses. If the error in the calculation of the price reaches 0.5 per cent of per unit NAV, the fund manager must make a public announcement and make a report to the CSRC. Where fund unit holders suffer losses as result of an error in the calculation of per unit NAV, they are entitled to claim compensation from the fund manager and fund custodian. The fund manager's risk reserve (10% of the management fees) can be used for compensation purposes.

Suspension/deferral of redemptions

Article 67 of the *Fund Law* requires a fund manager to make redemption payments on time except where:

- the fund manager is unable to pay for the redemption due to force majeure;
- the relevant stock exchanges have temporarily closed the market and as a result, the fund manager is unable to calculate the NAV of the fund for that day; or

- other special circumstances specified in the fund contract.

Under any of these circumstances, the fund manager must file a written report to the CSRC on the same day. Redemptions must be resumed as soon as the circumstances no longer exist.

Article 23 of the *Measures for the Administration of Operations of Publicly Offered Securities Investment Funds* provides that, if an open-end fund faces redemption requests for a large amount on a single day, the fund manager must redeem at least 10 per cent of the total units of the fund, but may defer remaining redemption applications. Article 26 of the *Measures* provides that, if high demands for redemptions occur continuously, the fund manager is permitted to temporarily suspend the acceptance of redemption applications. The persons subject to disclosure obligations must prepare and publish an *ad hoc* report within two days and file the report with the CSRC.

Article 90 of the *Measures for the Administration of the Sales Activities of Securities Investment Funds* provides that if a fund manager or distributor ceases the offering of fund units or refuses the purchase or redemption request of investors without authorization, the CSRC is to order the fund manager or distributor to rectify the situation, and issue a warning and impose a fine up to RMB 30,000, or both. The persons directly in charge or directly responsible for the violation are to be given a warning, be fined up to RMB 30,000, or both.

Regime for WMPs under CBRC

Asset valuation

Principles for valuation

Interpretation No. 8 of the Accounting Standards for Business Enterprises of the MoF of 2015 sets forth specific requirements on the accounting treatment of banks' WMPs, including: how shall commercial banks and their subsidiaries determine whether they have control over the WMPs issued in accordance with appropriate regulations of the CBRC; and how shall commercial banks account for WMPs they have issued.

Pursuant to such Interpretation, ASBE must be used for valuing WMP assets and in calculating investors' entitlement on redemption of their interests. There are no exceptions to this obligation.

The CBRC has issued Supervisory Guidelines on the Fair Value Valuation of Financial Instruments of Commercial Banks, which are applicable to WMPs. The Guidelines provide general rules for ensuring the reliability and comparability of the fair value valuation of financial instruments of commercial banks and the transparency of information disclosure.

In particular the Guidelines require that:

- The board of directors establish a sound internal control system for the fair value valuation of financial instruments, and assume the ultimate responsibility for its adequacy and efficacy (article 5); and
- The banks conduct an internal audit on the internal control system for fair value valuation on a regular basis (Article 10).

Where market prices are not available

The Guidelines establish principles for banks to follow to determine the fair value of instruments. In particular, article 14 provides for the use of mark to market whenever prices can be directly obtained from the market. Otherwise, banks may determine the fair value of

	<p>the financial instrument by marking to model or by using a third party valuation entity. Article 15 requires also cross-checking mechanisms for complex instruments or instruments with poor liquidity. When using models banks must have an independent validation team and regularly assess the reliability of the model used.</p> <p><u>Timing</u></p> <p>There are no specific regulatory requirements as to the timing of the valuation a WMP's assets and the timing of such valuations will, at a minimum, depend on the type of redemptions offered by a WMP.</p> <p><u>Independent audit</u></p> <p>Article 9 of the CBRC's <i>Notice on Further Strengthening the Risk Management of Financial Management of Commercial Banks</i> requires banks to conduct comprehensive quarterly internal audits of at least one WMP selected on a random basis.</p> <p>In addition, the WMP activities of banks are subject to external auditing, as part of the auditing of banks annual reports. The Guidelines on the Audit of Commercial Banks issued by the Chinese Institute of Certified Public Accountants sets forth the scope, audit requirement and methods applicable to the audit of commercial banks' financial statements and internal control audit. Chapter 7 "Audit of Intermediary Business Processes" of the Guidelines requires the audit of commissioned wealth management activities to include the following items: development and sales of wealth management products; investment management; internal transactions; reconciliation and valuation; recognition and allocation of revenues from intermediary business; as well as dividends, redemption, payment upon maturity and information disclosure of the WMPs.</p> <p>In practice, certified public accountants audit banks' wealth management activities pursuant to the Auditing Standards for Chinese Certified Public Accountants, the Guidelines on the Audit of Commercial Banks, the Internal Audit Guidelines for Enterprises, and other appropriate regulations. The contents and scope of the audit include but are not limited to:</p> <ul style="list-style-type: none"> • The judgment on the treatment of WMPs as on- or off-balance-sheet activities: based on an overall understanding of the WMP's performance, i.e. whether the bank has substantively assumed risks associated with the WMP, e.g. whether the bank has provided funding, guarantee, liquidity support for or enjoyed significant variable compensation, whereby has control over the WMP, and whether it has complied with the "consolidation" requirements set forth in the accounting standards, the auditors determine whether it is appropriate for the bank to treat the WMPs as on-balance-sheet or off-balance-sheet activities in its accounting practice. • Internal control and risk management: The auditors audit whether the bank has put in place internal control rules and the risk management system for its wealth management business and whether key business processes and internal controls are effective. • Connected transactions: The auditors audit whether the bank has effective internal control over connected transactions between WMPs and the bank itself, whether the transaction prices are fair, and whether the bank has disclosed the information about its off-balance-sheet wealth management products in a correct and sufficient manner.
--	--

- **Product valuation:** The auditors audit whether the valuation policy for the wealth management business is appropriate, reasonable and complete, and whether the financial assets or liabilities held by wealth management products have been classified and measured appropriately and impairment provisions have been set aside in accordance with the requirements on the recognition of financial instruments and measurement of fair value set forth in the enterprise accounting standards.
- **Recognition of revenues from intermediary business relating to wealth management products:** The auditors comprehensively assess whether the revenues from intermediary business relating to wealth management products are recognized accurately and whether the information disclosure is appropriate and complete by looking at the size of investment in off-balance-sheet wealth management products, investment varieties, liquidity management, and changes in income and yields.

Pricing and redemption of interests

Requirement

There are no specific regulatory requirements dealing with the way in which purchase and redemption prices are to be calculated. However banks have general obligations to set up internal rules and procedures for their WMP business; as a result they are required to set up rules concerning these issues.

WMPs offering on-demand redemptions (money market like funds)

The regulatory regime does not require WMPs that offer on-demand redemption to comply with specific minimum liquidity standards but the CBRC does require banks to set overall liquidity limits for WMPs. How this is achieved is left to the discretion of the bank that issues the WMP, to manage in accordance with its general obligations to have adequate internal controls and risk management systems. In addition, the *Notice on Improving the System for Organization and Management of Banks' Wealth Management Business* (CBRC [2014] No 35) requires banks to fully assess liquidity risk and have contingency plans for its management.

However, WMPs that offer on-demand redemption are required to value assets using ASBE and are not permitted to offer a stable NAV.

Disclosure

As indicated earlier, pursuant to article 3 of the *Notice on Relevant Matters Concerning Further Strengthening the Management of Risks Associated with Wealth Management Business of Commercial Banks* pre-sale, sale and after-sale information about all WMPs products offered to individual customers must be fully disclosed on the website of the bank's head office. As a result, banks are required to post on their websites information about the timing, and frequency of redemptions and the redemption price.

Pricing errors

There are no specific provisions dealing with pricing errors or mechanisms to provide redress to investors who have suffered losses as the result of pricing errors. The CBRC requires banks to have internal measures to deal with pricing errors.

Suspension/deferral of redemptions

There are no specific rules concerning suspensions/deferrals of redemptions, i.e. gates.

	<p>However, as indicated above, banks have general obligations to set up internal rules and procedures for their WMP business; as a result they must establish this type of rule. CBRC senior staff indicated that banks must establish the conditions for gates to apply, which in turn must be described in the sales documentation. Market participants indicated that for WMPs that are used for cash management, it is common to see gates, such as establishing the ability of the WMP to suspend redemptions if it exceeds a specified percentage (such as 10 percent) within one day. There are no provisions in the regulatory regime requiring the use of such mechanisms to be reported to the CBRC.</p> <p>Market participants indicated that in practice, during the bond market volatility events in late 2016, some WMPs did receive large redemption requests. They managed these requests by using redemption gates to suspend redemptions for short periods of time.</p>
Assessment	Partly Implemented
Comments	<p>The grade stems mainly from challenges in the framework for WMPs, although the assessors have some concerns regarding valuation of MMFs.</p> <p>Regime for MFs under the CSRC</p> <p>KQ 2(b) requires that MFs are valued according to high quality standards which are applied consistently. In this regard, the valuation and redemption rules comply with the standards set by the IOSCO Methodology. However, the regulations allow MMFs to value their portfolios at amortized cost and keep a stable NAV. The assessors acknowledge that while the IOSCO recommendations for MMFs highly encourage the use of market to market and floating NAV for MMFs, they accept the use of amortized cost and stable NAV under limited circumstances. The issue then is whether the current framework is restrictive enough to consider that the potential risks arising from a stable NAV are being adequately managed. The assessors take note that the CSRC has kept the regulatory framework for MMFs under scrutiny and that at different points in time reforms have been introduced to address challenges identified, the most recent reforms in 2015. That said, the opinion of the assessors is that, as per current regulations, MMFs could still face important credit and market risks given current rules on portfolio composition and duration. This could also impact MMFs ability to meet redemption obligations. Furthermore, in practice the linkage of some MMFs with payment mechanisms (credit cards for example) exacerbates the perception of MMFs as “deposits”. That, combined with the fact that MMFs are a very significant component of China’s mutual fund market, accounting for almost 55 per cent of the AUM of all open-end funds, leads the assessors to recommend that the CSRC further review and tighten the framework for MMFs. As indicated in the description, the assessors note that the CSRC is already reviewing such regulations.</p> <p>Regime for WMPs under CBRC</p> <p>The key concerns relate to KQs 5(b), 8, 9 and 11 of the Methodology. As indicated in the description, the assessors acknowledge the existence of a framework for valuation that requires all WMPs to follow prudent rules for valuation. However, the guidelines do not include provisions for some of the key operational aspects required by IOSCO, such as minimum standards for subscription and redemption pricing, pricing errors and suspension or deferral of redemptions. Many of these elements have an important impact on investors’ rights and that is why the Methodology emphasizes the need for the regulatory regime to explicitly address them, to ensure clarity and consistency in their treatment. In the case of WMPs these issues are left to the discretion of issuing banks, to be dealt with through the</p>

	contracts and prospectus. As a result there could be significant variations in standards, or these issues may not be addressed at all. Thus, the assessors recommend that the CBRC strengthens the current regime by establishing explicit guidance for all of the issues required by the Methodology in this Principle.
Principle 28.	Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.
Description	<p>Definition of HFs</p> <p>There is no definition of hedge funds in the Chinese securities legislation. However, Chapter X of the <i>Fund Law</i> and related Measures contain detailed provisions relating to “non-publicly offered funds”. In addition to such Chapter, the provisions of the Fund Law apply to private fund managers (i.e. managers of non-publicly offered funds) unless they are expressly said to apply only to public funds and public fund managers.</p> <p>Before 2014, private equity funds were regulated by the NDRC. In 2014, the rules for these types of funds were unified in the <i>Interim Measures for the Supervision and Administration of Private Investment Funds (Measures for Private Investment Funds)</i>, and supervision responsibilities for both types given to the CSRC.</p> <p>Private funds are offered only to qualified investors, and each fund is limited to 200 such investors. Funds set up as limited partnerships or limited liability companies are limited to 50 such investors each. A qualified investor is a person or entity that:</p> <ul style="list-style-type: none"> • meets minimum asset holdings or income levels specified by the CSRC (for institutions net assets of at least RMB 10 million; and for individuals financial assets of at least RMB 3 million, or personal income of at least RMB 500,000 in the 3 preceding years – see Article 12 of the <i>Measures for Private Investment Funds</i>); • has the necessary capacity to identify and bear risks; and • will invest at least RMB 1 million in a single private fund. <p>The permitted investments of funds of this kind include publicly offered shares of joint-stock companies, bonds, fund shares, and other securities and their derivatives prescribed by the CSRC (Article 94 of the <i>Fund Law</i> and guidelines issued by the CSRC).</p> <p>Under Article 91 of the <i>Fund Law</i> and Chapter 3 of the <i>Measures for Private Investment Funds</i> non-publicly offered funds must not raise capital from any entity or individual other than qualified investors and they must not be publicized or promoted to investors generally.</p> <p>As of the end of December 2016, AMAC had a total of 17,433 private fund managers on its register, and was keeping records on 46,505 private funds with a combined paid-in AUM of RMB 7.89 trillion including:</p> <ul style="list-style-type: none"> • 7,781 managers managing 27,015 private securities investment funds with a combined paid-in AUM of RMB 2.77 trillion; • 7,988 managers managing 15,789 private equity funds with a combined paid-in AUM of RMB 4.32 trillion; • 1,218 managers managing 2,143 venture capital funds with a combined paid-in

	<p>AUM of RMB 0.36 trillion; and</p> <ul style="list-style-type: none"> • 446 fund managers managing 1,558 funds of other types with a combined paid-in AUM of RMB 0.44 trillion. <p>The largest of these funds is a private equity fund with AUM of about RMB 137.509 billion. The largest securities fund has an AUM of RMB 117.119 billion. Of the securities funds, equity funds account for more than 51 per cent of the total, with bond funds accounting for 13 per cent, fund of funds 12.1 per cent, and hybrid funds 11.7 per cent. (based on data as of June 2016) Among the registered private funds, 133 have a paid-in AUM of 10 billion RMB or above.</p> <p>Registration and reporting</p> <p><i>Registration of fund managers</i></p> <p>Article 89 of the <i>Fund Law</i> requires managers of private funds to register and provide information to AMAC. No entity or individual is permitted to use the words "fund", "fund management" or any similar name unless they are registered in this way (Article 90).</p> <p>Pursuant to Article 7 of the <i>Measures for Private Investment Funds</i> to apply for registration with the AMAC fund managers must submit the following information:</p> <ul style="list-style-type: none"> • copies of the industrial and commercial registration record and the original and duplicate of business license; • the articles of association or the partnership agreement; • a list of major shareholders or partners; • basic information on senior managers; and • other information required by AMAC. <p>In addition, AMAC has issued its own rules (<i>Measures for the Registration of Private Fund Managers and Record Filing for Private Funds (Tentative)</i>) relating to the registration process. Article 6 of these <i>Measures</i> provides that when registering a private fund, the fund manager must submit, through the private fund registration and record-filing system, basic information about itself, its senior managers and other employees, its shareholders or partners, and the funds it will manage. AMAC's function is to enter information about the fund manager on its register. Information on the register is available to the CSRC.</p> <p>The CSRC has issued high level rules (<i>Measures for the Supervision of Private Funds</i>) on internal controls and risk management for private funds requiring, for example, fund managers to comply with their obligations and that funds have specialized and professional management. The CSRC rules are supplemented by detailed requirements contained in AMAC's <i>Guidelines on Internal Control of Managers of Private Investment Funds</i>. These <i>Guidelines</i> require fund managers to have institutional arrangements, organizational structures and control measures aimed at identifying, assessing and managing risks in operations, taking into account their external and internal environment. These arrangements must be adequate to prevent and mitigate risks, ensure the legality and compliance of all of their business lines, and achieve their business objectives. Private fund managers must establish sound internal control mechanisms, define internal control responsibilities, improve internal control measures, enhance internal control safeguards, and perform ongoing internal control evaluation and supervision. Before registration, a</p>
--	--

fund must obtain an opinion from a law firm verifying that the fund complies with the *Guidelines*.

Fund registration

At the conclusion of the offering process for a private fund, the fund manager must file with AMAC:

- information about the fund's main investment areas and the type of fund;
- the fund contract, either the articles of association or the partnership agreement, and the fund prospectus if it was provided to investors during the fund offering process;
- the asset management agreement if management of the fund is entrusted to a third party;
- the custodian agreement if fund assets are kept under the custody of a custodian; and
- any other information required by AMAC.

As well as making this information available to the CSRC, AMAC also publishes the names and basic information about registered funds on its website.

Ongoing reporting requirements

Private fund managers are required under Article 25 of the *Measures for Private Investment Funds* to provide timely reports to AMAC on themselves and their employees, and on the funds they manage.

AMAC has published *Measures for the Administration of Information Disclosure by Private Investment Funds*, which establish reporting obligations towards AMAC and disclosure obligations towards investors.

Regarding reporting to AMAC, private funds must provide quarterly reports. In times of market stress, weekly reports may be required. Fund managers must also report to AMAC the identity of major investors in a fund. Fund managers are also required to report material events to AMAC within 10 days of the event occurring, and audited annual financial reports within 4 months of year end.

Information on a fund's holdings of securities is also available through the CSDC, which has a different account for each fund.

AMAC has also promulgated rules on leverage: a fund's maximum leverage ratio must not be more than 2:1.

Disclosure to investors

Pursuant to Article 24 of the *Measures for Private Investment Funds*, managers and custodians (if any) of private funds must disclose to investors the investments, assets and liabilities, distribution of investment return, expenses, and performance-based compensation of the fund, potential conflict of interests, and other significant information that may affect the lawful rights and interests of investors. Detailed disclosure requirements are set out in the *Measures for the Administration of Information Disclosure by Private Investment Funds* issued by AMAC. CSRC staff explained that in cases where the fund is offer to a very limited number of qualified investors, the standard practice is to

provide disclosure in the way specified in the contract. In funds that are offered to a larger number of investors, a prospectus is usually prepared. A single private securities investment fund, if its AUM reaches more than RMB 50 million, has to disclose the NAV to investors within five working days after the end of every month.

Recordkeeping requirements

Private funds managers are required to keep records, including records on investment decision-making, transactions and investor suitability management. These records must be retained for 10 years (Article 26 of the *Measures for Private Investment Funds*).

Fund custody

The *Fund Law* and the *Measures for Private Investment Funds* require private securities investment funds to have a custodian, except as otherwise provided in the contract of the fund. CSRC staff indicated that funds that invest in securities are usually set up as a trust. Trust-type funds do not have independent status and their assets must be held in custody. Private equity and venture capital funds usually use the corporate or partnership structure and hold assets independently, so separate custody is not required if mechanisms are in place to safeguard the security of fund assets.

Oversight authority

As indicated, the approval of the CSRC is not required to establish a private fund management institution (such as a HF manager) and to offer private funds. AMAC is responsible for the *ex post* registration and filing of private fund managers and the private funds they offer. AMAC has a rule book that applies specifically to managers of private funds. It is responsible for registration, filing and self-regulation, and is obliged to report any breaches of the legislative and regulatory framework to the CSRC.

However, the CSRC has overall regulatory responsibility for private funds (Article 5 of the *Measures for Private Investment Funds*) and has explicit obligations relating to these funds. For example, it is required to:

- conduct statistical monitoring and inspection on the operations of private fund businesses by private fund managers, custodians, distributors and other private fund service providers (Article 31 of the *Measures for Private Funds*); and
- record integrity information on fund managers and other entities involved in the private fund industry in its Integrity Database for Securities and Futures Markets (Article 32).

The *Fund Law* gives the CSRC broad powers to supervise fund managers and fund, such as the power to require information and to carry out on-site inspections.

Enforcement authority

The CSRC has power to take action against fund managers and other industry participants that violate the legislation, regulations or measures (Article 33 of the *Measures for Private Investment Funds*). It also has broad powers under the *Fund Law* to take action for violations. Moreover, AMAC has power to exercise self-regulatory supervision.

Sharing of information

The CSRC has access to all the information AMAC holds about private fund managers and private funds. Under the arrangements described in Principles 13-15, it can share this information with other domestic authorities and foreign regulators.

	<p>Supervision of private funds managers</p> <p>The CSRC carries out on-site inspections of private fund managers. The CSRC has specific internal <i>Guidelines for On-Site Inspections of Private Investment Funds (Tentative)</i>. Generally speaking, the CSRC uses random selection together with a risk-based approach to determine the fund managers to inspect. On one hand, fund managers are selected at a percentage, which varies for funds of different sizes. On the other hand, the focus is on larger funds that have been the target of complaints and negative media reports (those with AUM of over 10 billion).</p> <p>In 2014, the CSRC carried out on-site inspections of 100 fund products offered by 9 fund managers; and in 2015 it inspected 140 private fund managers and distributors and a further 40 for suspected illegal activities.</p> <p>In 2016, the CSRC carried out targeted inspections of private fund managers, and mapping exercise on risks arising from private funds via the internet. These and other inspections covered a total of nearly 500 private fund managers. As a result of these inspections, the CSRC took administrative regulatory measures against 132 private fund managers, imposed administrative sanctions on 7 private fund managers, initiated formal investigations of 11 private fund managers, referred over 20 clues on suspected criminal offences to local governments or the public security authorities, and referred 271 private fund managers who are off radar to AMAC for handling. In addition, the CSRC made public through press conferences the names of 73 private fund managers subject to penalties during the targeted inspections.</p> <p>AMAC carries out off-site monitoring of private funds based on the information it receives in regular reports. In its review of this information, it places particular emphasis on the leverage of the funds it monitors.</p> <p>AMAC also conducts on-site inspections. It may decide to conduct an on-site inspection as a result of complaints received, information in the media, or information contained in regular reports. AMAC carried out on-site inspections of 10 private fund managers in 2014, 34 in 2015 and 20 in 2016. These inspections resulted in the registration of 20 fund managers being cancelled, 3 fund managers being reported to the CSRC for administrative action, and 2 law firms being barred from giving legal opinions relating to funds. In these inspections, AMAC uses outside experts (such as accountants and lawyers) as well as its own staff. As its resources increase, AMAC plans to carry out a larger number of inspections. AMAC has also investigated and sanctioned more than 900 individuals for violations of rules relating to the qualifying examination for fund practitioners.</p>
Assessment	Fully Implemented
Comments	<p>The IOSCO Methodology notes that assessors should consider the regulatory framework in the context of the risks that hedge funds (individually and collectively) pose, and the emphasis of the Methodology is on systemic risk.</p> <p>Based on conversations with market participants, there appear to be very few funds currently operating in China that should be categorized as HFs for the purpose of the IOSCO Methodology. In this regard, the majority of funds do not have an investment policy that meets the characteristics of what is traditionally considered a HF in terms of their use of leverage, derivatives and/or complex investment strategies. In addition, most funds are small scale. Thus, the potential for systemic risk problems arising from the HF industry</p>

	<p>seems to be limited, at least at this stage.</p> <p>The current regulatory framework establishes a set of information that hedge fund managers need to provide for purposes of their registration.</p> <p>There are reporting obligations in connection with the fund themselves vis-à-vis the CSRC and AMAC and disclosure obligations vis-à-vis investors. Such disclosure obligations are in line with the type of investors to which the funds can be offered. Through periodic reporting both AMAC and the CSRC can monitor the growth of such funds and critical aspects from a financial stability perspective such as their portfolio composition and leverage. Furthermore the detailed portfolio composition can be accessed through the CSDC. In addition, as indicated, there are rules that limit the leverage of the funds. That said, the assessors recommend the authorities to review and shorten the deadlines for material events reporting.</p> <p>The assessors note the limited resources available for the on-site monitoring of private funds and their managers; however as indicated the current number of HFs is very limited and the potential for systemic risk arising from them appears limited too. Thus from a financial stability perspective, the current supervisory approach for HFs, mainly based on off-site monitoring and complemented with limited on-site inspections appears reasonable at this point in time.</p> <p>Nonetheless the CSRC should continue to provide guidance for AMAC to monitor the HF industry to ensure that it develops in a healthy manner. If large, potentially systemically important, funds emerge, it may be necessary to take a differentiated approach to the regulation of such funds. In such an approach, the CSRC might consider a transfer of the registration of such managers and funds to the CSRC, as well as additional reporting obligations and more intense on-site supervision.</p> <p>From a broader perspective, the rapid growth of private funds should be closely monitored by the CSRC because it is possible that a consolidation of the industry takes place and if that occurs, it would be important that it be done in an orderly manner. In this context, monitoring of compliance with the qualification of investors would also be key.</p> <p>Finally, the assessors note the existence of other CIS offered to non-retail investors, such as WMPs. At the time of this assessment they do not appear to meet the characteristics of HFs. However, given the rapid evolution of the markets, it is important that the authorities keep an eye on these products to ensure that their regulation and supervision remain commensurate to the risk they pose to the system.</p>
<p>Principles for Market Intermediaries</p>	
<p>Principle 29</p>	<p>Regulation should provide for minimum entry standards for market intermediaries.</p>
<p>Description</p>	<p>Background</p> <p>There are four separate categories of intermediary licenses issued by the CSRC:</p> <ul style="list-style-type: none"> • Securities companies (of which there are 127 approved firms). • Fund management companies (of which there are 117 approved firms); • Futures companies (of which there are 149 approved firms); and

- Investment consultancy businesses (of which there are 84 firms approved on a stand-alone basis).

Under the legislation, securities companies and futures companies can, if authorized to do so under their license, provide asset management services, including services to individual clients and to clients collectively (funds management). However, as noted under Principle 24, the CSRC requires entities wishing to provide management of mutual funds to seek authorization as asset management companies under the *Fund Law*. Securities and futures companies can also provide investment consultancy services if their license authorizes them to do so. Insurance asset management companies can also provide fund management services, subject to licensing by the CSRC. Finally, as stated in Principle 24, there is currently a pilot whereby banks are being authorized to provide fund management services.

Authorization

The discussion below addresses the first three categories of firms. The discussion of the requirements applicable to consultancy business has been included at the end of this Principle.

Basic requirement

Securities companies

The establishment and operation of a securities company requires the approval of the CSRC and no entity or individual may engage in any securities business without this approval (Articles 122 and 125 of the *Securities Law*).

CSRC staff indicated that there has been an evolution in the activities in which securities companies were authorized to engage. Until recently they were only authorized to conduct brokerage activities. Currently, a securities company licensed by the CSRC is permitted under Article 125 to operate any or all of the following businesses:

- securities brokerage;
- securities investment consultation (investment advice);
- financial consultation relating to securities trading and securities investment activities (corporate advisory work);
- securities underwriting and sponsorship;
- securities proprietary business;
- securities asset management; and
- other securities businesses.

These activities can be provided over the exchanges and the OTC markets (including NEEQ and the regional platforms).

Fund management companies

The approval of the CSRC is required to engage in securities investment fund management business (Article 2 of *Measures for the Administration of Securities Investment Fund Management Companies*). A license is required for both the management of publicly

offered funds (Article 12 of the *Fund Law*) and the provision of specific (individual) customer asset management services (Article 10 of the *Trial Measures for Asset Management Services for Specific Clients of Fund Management Companies*). A manager of private funds does not require a CSRC license, but must be registered with AMAC (see under Principle 28).

Futures companies

The establishment and operation of futures companies requires the approval of the CSRC and no entity or individual can engage in futures business without this approval (Articles 15 and 17 of the *Regulations on the Administration of Futures Trading*). Article 13 of the *Measures for the Supervision and Administration of Futures Companies* creates categories of registration for:

- commodity futures brokerage;
- financial futures brokerage;
- overseas futures brokerage;
- futures investment consultancy;
- asset management activities; and
- other businesses.

Future companies are not authorized to conduct proprietary trading.

Integrity and competence

Securities companies

Directors and managers of securities companies are subject to requirements as to their integrity (Part IV of the *Measures for the Supervision and Administration of the Professional Qualifications of Directors, Supervisors and Senior Managers of Securities Companies*) and there are detailed requirements for their professional qualifications and experience (Part II). A company's major shareholders must have sustainable profitability and good credibility, have no record of material illegal or non-compliant activities in the last three years, and each have net assets of no less than RMB 200 million (Article 124 of the *Securities Law*). There are rules relating to the qualifications of overseas shareholders in joint venture securities companies similar than those described below for futures companies.

Fund management companies

The *Measures for the Administration of Securities Investment Fund Management Companies* impose requirements for the integrity and directors and managers of fund management companies, and for the professional qualifications and experience of senior managers and other staff. The *Measures* also set out minimum net asset requirements for both principal and other shareholders, and require that shareholders must have no record of material illegal or non-compliant activities in the last three years. If principal shareholders are natural persons, they must have at least 10 years' experience in asset management. There are also rules relating to the qualifications of overseas shareholders in joint venture management companies similar to those described below in connection with futures companies.

Futures companies

A futures company's directors, supervisors and senior managers must be qualified for their positions, and it must have employees qualified as futures practitioners (Article 16 of the *Regulations on the Administration of Futures Trading*). Article 14 of the *Measures* provides that senior managers must not have been subject in the last two years to any criminal, administrative or regulatory penalty, or be under investigation; and that the applicant company must not have been subject to any criminal or administrative penalty due to violation of any law or regulation in last two years. A futures company must also have at least 15 employees qualified for practicing futures business; and must have at least three senior managers, all of whom must be qualified for their positions (Article 6 of the *Measures*). Shareholders holding more than 5 per cent and any *de facto* controller are subject to integrity and minimum net asset requirements. Additional rules for foreign shareholders are set out in Article 9 of the *Measures*, including rules requiring a foreign shareholder holding a more than 5 per cent interest to be a financial institution regulated in a foreign jurisdiction with a sound regulatory system, the foreign regulator to have a co-operation MoU with the CSRC, and the shareholder to have met the regulatory requirements in the foreign jurisdiction for at least the last 3 years.

Capital requirement

Securities companies

Article 124 of the *Securities Law* provides that to establish a securities company, the company must have registered capital that complies with the provisions of the *Securities Law*, which include a minimum capital and a net capital requirement. The capital requirements vary according to the nature of the company's business. See under Principle 30.

Fund management companies

The registered capital of a fund management company must be at least RMB 100 million, and must be fully paid up (Article 13 of the *Fund Law* and Article 6 of the *Measures for the Administration of Securities Investment Fund Management Companies*).

Futures companies

Article 16 of the *Regulations on the Administration of Futures Trading* provides that to establish a futures company the registered capital must be at least RMB 30 million, and futures companies are also subject to a net capital requirement (see under Principle 30). The net assets or financial assets of any natural person who is a controlling shareholder must be at least RMB 30 million.

Article 6 of the *Trial Measures for the Futures Investment Consulting Business of Futures Companies* provides that a futures investment consulting business must have registered capital of no less than RMB 100 million, and its net capital must be no less than RMB 80 million.

Internal controls and risk management

Securities companies

Article 124 of the *Securities Law* provides that to establish a securities company, the company must have in place sound risk management and internal control systems, and qualified business premises and facilities.

Article 12 of the *Regulations on the Supervision and Administration of Securities Companies* provides that, when a securities company is established, its scope of business must be commensurate with its financial conditions, internal control system, compliance system and

	<p>human resources. The CSRC has set out specific requirements for these matters in the <i>Measures for the Administration of Risk Control Indicators of Securities Companies</i>, the <i>Trial Provisions for the Compliance Management of Securities Companies</i>, the <i>Provisional Code of Corporate Governance for Securities Companies</i> and the <i>Guidelines on Internal Control for Securities Companies</i>,</p> <p><i>Fund management companies</i></p> <p>To establish a fund management company, the applicant must have sound internal auditing and monitoring systems and risk control systems (Article 13 of the <i>Fund Law</i> and Article 6 of the <i>Measures for the Administration of Securities Investment Fund Management Companies</i>). In addition, the CSRC's <i>Guidelines on Internal Control of Securities Investment Fund Management Companies</i> contain detailed provisions on internal control systems required for fund management companies.</p> <p><i>Futures companies</i></p> <p>Article 16 of the <i>Regulations on the Administration of Futures Trading</i> provides that a futures company must have sound risk management and internal control systems.</p> <p>Article 14 of the <i>Measures for the Supervision and Administration of Futures Companies</i> provides that a futures company applying to operate a futures brokerage business must have risk control indicators that meet regulatory standards; have in place and effectively implement sound corporate governance, risk management system and internal control systems; and have business facilities and technical systems that comply with technical codes and are in good operation.</p> <p>Authority of regulator</p> <p>The CSRC is responsible for authorization of securities companies, fund management companies, futures companies and stand-alone investment consultancy companies. SAC and CFA establish and administer arrangements for the professional qualifications of individual securities and futures practitioners, but play no other role in the licensing process. Under Article 128 of the <i>Securities Law</i>, Article 14 of the <i>Fund Law</i> and Article 16 of the <i>Regulations on the Administration of Futures Trading</i>, the CSRC must make a decision on an application for a license within 6 months. It can approve or disapprove the application. If it disapproves it must explain reasons for the rejection. In accordance with the <i>Administrative Licensing Law</i>, where an application does not meet the statutory requirements or standards, the CSRC must not grant the license. If the CSRC refuses an application, the applicant has a right to apply for administrative reconsideration or to file an administrative lawsuit.</p> <p><u>Licensing process</u></p> <p>The licensing of intermediaries is done by the CSRC's central office.</p> <p><i>Securities companies and fund management companies</i></p> <p>The CSRC deals with applications for licensing of a securities company or a fund management company in two stages. In the first stage, it reviews the written material provided in the application. If these meet requirements, it provides the applicant with a written response and indicates that the recipient of such written response should make preparations for the operation of the business. When the applicant has done so, it applies to the CSRC for an on-site inspection. In this second stage, the CSRC conducts an on-site inspection to ensure that all requirements are met in practice. At the end of this stage, the CSRC makes a formal decision whether to issue the business operation license.</p>
--	--

As part of the authorization process for reviewing applications from securities companies, the CSRC requires shareholders having more than 5 per cent of the applicant and *de facto* controllers to provide undertakings based on a review carried out by legal counsel. Counsel must carry out a due diligence investigation, give an opinion on whether the shareholders and *de facto* controllers meet the qualifications and conditions and give specific comments on their credit standing. The CSRC has also established a credit file of senior managers, and a manager's previous record of bad credit is a factor considered in approval of the person's appointment at a new company.

Futures companies

The current regulations do not require on-site examinations for the licensing of futures companies. However, CSRC staff indicated that in practice, there have been no new applications for licensing as a futures company for the last 15 years.

License revocation and other regulatory action

The CSRC has extensive powers to deal with licensees who fail to comply with their obligations.

For securities companies, Articles 150 and 153 of the *Securities Law* gives the CSRC the power to impose a variety of measures if a securities company's capital or other risk control indicators do not meet requirements, if the company engages in illegal conduct, or its activities threaten the order of the securities market or injure the interest of investors.

Among other things, the CSRC has power to:

- impose restrictions on the company's business activities;
- suspend part of its businesses;
- withhold approval for new branches;
- impose restrictions on profit distribution, or on the payment of compensation or benefits to directors, supervisors or senior managers;
- impose restrictions on the disposal of the company's property;
- order the company to replace its directors, supervisors or senior managers, or to impose restrictions on their rights;
- order controlling shareholders to divest their shares or impose restrictions on their shareholder rights;
- order another company to assume operation of the business; and
- revoke the company's license.

Article 151 of the *Securities Law* also empowers the CSRC to take action against a shareholder of a securities company who has made a false capital contribution or withdraws registered capital. The CSRC can, among other things, order the shareholder to transfer shares held, or restrict the person's shareholder rights.

Article 26 of the *Fund Law* gives the CSRC power to deal with a fund management company where its non-compliant operations or any related major risk seriously disturbs the order of the securities market or injures the interests of the fund unit holders. The

CSRC can a variety of regulatory measures similar to those available against securities companies. It can also designate another institution to assume trusteeship for the business or take it over, cancel its fund management qualification or revoke its license.

Article 58 of the *Regulations on the Administration of Futures Trading* provides that, if a futures company fails to implement a rectification order and if its actions severely endanger its stable and sound operation and impairs the legitimate rights and interests of its clients, or if it is being investigated by the CSRC for suspected serious violations, CSRC can take a variety of measures, including:

- limiting or suspending some of its futures businesses;
- stopping the approval of any new business or new branch;
- restricting the distribution of bonuses, payment of remuneration or provision of welfare to the directors, supervisors and senior managers;
- limiting the transfer of property or setting any other right to property;
- ordering the futures company to change its directors, supervisors, senior managers or the persons-in-charge of the relevant business departments or to limiting their rights;
- restricting the allocation, transfer and utilization of the futures company's own funds or risk reserve; and
- ordering the controlling shareholders to transfer their stock rights or to impose restrictions on the relevant shareholders' exercise of their shareholder rights.

Articles 67, 68 and 69 of the *Regulations on the Administration of Futures Trading* provide that when a futures company commits material illegal conduct or misconduct, a material fraudulent act against its customers, or obtains a futures business license by fraudulent means, the CSRC can order it to suspend its business for rectification or revoke its futures business license.

Action against individuals

As indicated in Principle 11, the CSRC has the power to bar a person who has committed a serious violation of the legislation or regulations, or CSRC rules, from entering into the securities market (Article 233 of the *Securities Law*). If barred in this way, the person must not undertake any securities practice or be a director, supervisor or senior manager of a listed company for a prescribed term or for life. If an individual director, supervisor or senior manager of a securities company fails to discharge his duties diligently, resulting in the company's material violation of laws or regulations or exposing the company to any material risk, the CSRC can disqualify the person from the post and order the company to replace him (Article 152 of the *Securities Law*). The *Securities Law* and the *Measures for the Administration of Qualifications of Directors, Supervisors and Senior Managers of Securities Companies* set out the circumstances where a person can be prohibited from serving as director, supervisor or senior manager. The CSRC and SAC can also cancel a person's practitioner qualification for violation of laws or regulations.

Directors, supervisors, senior managers and practitioners of investment fund managers and of fund custodians can also be barred from entry into the securities market for serious violations of relevant laws and regulations.

If a futures company commits serious violations of the legislation, the CSRC can suspend or revoke the qualifications to act in the positions of the directly liable person-in-charge and any other directly liable persons, and revoke their futures practitioners' qualifications (Articles 68 and 69 of the *Regulations on the Administration of Futures Trading*).

Ongoing requirements

CSRC approval is required for significant changes in the ownership or operation of licensees. These include changes in business scope, changes in registered capital, material changes in shareholding structure, changes of any shareholder who holds more than 5 per cent of shares in the company's capital or of the *de facto* controller, mergers or split-ups, discontinuation of business, dissolution or bankruptcy (see for example Article 129 of the *Securities Law*; Article 17 of the *Measures for the Administration of Securities Investment Fund Management Companies*; and Article 19 of the *Regulations on the Administration of Futures Trading*).

Public disclosure of licensed intermediaries

Licensees have obligations under legislation to disclose information publicly about their licensing status (see Article 66 of the *Regulations on the Supervision and Administration of Securities*; Article 16 of the *Measures for the Administration of Securities Investment Fund Management Companies*; and Article 16 of the *Measures for the Administration of Securities Investment Fund Management Companies*).

In addition to providing information on their websites, information about licensees is made available on the websites of the relevant SROs (SAC, AMAC, CFA and, for securities companies, the stock exchanges.)

For securities companies, the information available through these mechanisms includes basic information about securities companies (serial number of securities business license, qualifications obtained for conducting relevant securities business); branches in operation; class of business license; products; senior managers; the qualifications of managers and staff; and the company's history, organizational structure and business scope.

For fund management companies, information about the fund managers, key personnel, and governance arrangements must be included in each funds' prospectus.

The *Provisions on the Administration of Information Release by Futures Companies* require a futures company to disclose on the CFA's website its business scope and information about its senior managers and employees.

In addition, information on the firms licensed by the CSRC can be found on the CSRC website.

Investment consultancy firms

As explained in Principle 23, there are two forms of investment consultancy businesses: businesses involving the management of assets on behalf of clients (asset management businesses); and those involving only the provision of investment advice to clients (investment consulting businesses).

Asset management businesses can be carried on by securities companies, futures companies and by fund management companies if the terms of their licenses permit them to do so.

Investment consulting businesses can be carried on by a securities company or futures company whose license permits it do so, or by a separately licensed investment consulting entity. An entity licensed only as an investment consultancy business is not permitted to

	<p>deal on behalf of clients or hold client assets (Article 171 of the <i>Securities Law</i> and Article 24 of the <i>Interim Procedures on Administration of Securities and Futures Investment Consultancy</i>).</p> <p><u>Asset management businesses</u></p> <p>The <i>Securities Law</i> requires that, where a securities company engages in securities asset management business, its minimum registered capital must be RMB 100 million. The <i>Measures for the Administration of Client Asset Management Business of Securities Companies</i> require securities companies engaging in customer asset management to have a sound risk control and compliance management system, to take effective measures to manage the customer asset management business separately from other businesses of the company, to prevent the improper use or transfer of sensitive information, and avoid insider transactions and conflicts of interest.</p> <p>Fund management companies must have registered capital of more than RMB 100 million. The obligations that apply to the public fund (CIS) business of a fund management company also apply to the asset management business. These include detailed disclosure obligations (see under Principle 26), provisions relating conflicts of interest, and record keeping.</p> <p>The <i>Trial Measures for the Asset Management Business of Futures Companies</i> require that, for a futures company to conduct an asset management business, it must satisfy detailed requirements. These include requirements for: net capital of at least RMB 500 million; risk control indicators that have continuously met regulatory requirements in last six months; regulatory rating by CSRC that have met specified levels for the last two ratings cycles; a feasible asset management business implementation plan; senior managers and employees to have appropriate expertise; and a sound asset management business management system. A futures company conducting asset management business must also comply with all its obligations as futures company in relation to risk management, internal controls, and the protection of client assets (see under Principle 31).</p> <p>The <i>Trial Measures for the Asset Management Business of Futures Companies</i> also require a futures company to make full disclosure to the customers about the risks of the asset management business, to explain the investment strategies and contractual provisions, and to have a risk disclosure statement signed by the customers. A futures company must also properly maintain implementation plans, investment strategies, customer commitments, risk disclosure statements, contracts, accounts, records of transactions, records of monitoring and other business data and information with respect to the asset management business.</p> <p>On 29 Oct. 2014, the CSRC released <i>Administrative Measures for the Supervision of Futures Companies</i>, which changed the approval procedure for the asset management business of futures companies from administrative licensing to registration and filing. In accordance with the <i>Trial Measures for the Asset Management Service of Futures Companies</i> (CFA [2014] No. 100), futures companies or their subsidiaries engaging in asset management business must register at CFA. Futures companies must meet the below requirements in order to register for asset management business:</p> <ol style="list-style-type: none"> (1) Its net capital is not less than 100 million yuan. (2) Its risk indicators have met the regulatory requirements for six consecutive months before the date of application. (3) It is not lower than Grade C of Category C in the last rating for futures company
--	--

differentiate supervision.

(4) It has not received any administrative, criminal punishment, regulatory measures or SRO disciplinary sanctions in the last year for any violation of law or regulation in business operations and is not under investigation by competent authorities for any suspicious violation of law or regulation.

(5) It has at a minimum five personnel who hold professional qualifications for securities, futures or fund business; the senior manager shall have corresponding qualifications; None of the above-mentioned senior managers and personnel has any bad credit record or subject to any administrative, criminal punishment, regulatory measures or SRO disciplinary sanctions in the last three years or is under investigation by competent authorities for any suspicious violation of law or regulation.

(6) It has business premises which has met the requirements, and infrastructure and operating capacity necessary for the asset management business.

(7) It has sound internal governance rules, risk management rules and internal control rules.

(8) It meets other conditions as set forth by the CSRC and CFA under the principle of prudential supervision.

Investment consulting business

The *Interim Provisions Regarding Securities Investment Consulting Business* contain detailed rules relating to the conduct of an investment consulting business. These include rules relating to:

- processes to be followed in promoting the business, agreement with customers the provision of services, and the settlement of complaints;
- recordkeeping obligations, including for the content, form and basis of the investment advice provided to the customers. These records must be kept for at least five years from the date of the agreement;
- disclosure of information to clients;
- obligations not to impair the interests of any customer for the benefits of any securities investment consultant; and
- not give any false, untrue or misleading marketing statement about its service capacity or past performance, or give any promise or guarantee of return on investment.

Article 10 of the *Trial Measures for the Futures Investment Consulting Business of Futures Companies* requires a futures company and its employees to provide futures investment consulting services to customers with professional skills and in a prudent, diligent and responsible manner, protect the trade secrets of the customers, and safeguard the legitimate rights and interests of the customers. The futures company and its employees must not make false or misleading representation about its capacity of futures investment consulting service, and must not defraud or mislead customers. Article 13 of the *Trial Measures* contains specific prohibitions, including that the company and employees must not promise profit to the customers, stipulate the profit sharing or risk allocation, provide the service based on any false information, market rumor or inside information, when providing a futures investment consulting service, staff of the licensee must not accept

	authorization to engage in futures trading from a customer.
Assessment	Fully Implemented
Comments	<p>The legislative framework for the regulation of intermediaries is comprehensive and covers all forms of securities and futures intermediary activity that can be carried out in China. The licensing process for securities companies is a rigorous, two-stage process, with the second stage including an on-site inspection. There have been no new futures companies licensed for some time.</p> <p>The CSRC retains control of the scope of securities and futures intermediaries' business activities by licensing them for specific activities, and requiring re-authorization for new types of activity. This control will be important as securities companies develop new business models and move toward full service investment banking models rather than, as now, relying largely on brokerage activity. The CSRC indicated its wish to see the industry develop in this way, but will need to ensure that key components of securities companies' structural and governance arrangements – such as risk management and internal controls – remain adequate for this expanded range of activities. The assessors are aware that the CSRC is placing particular attention to this issue in their on-site inspection program.</p> <p>The CSRC has powers to take action when the ownership of a licensee changes, or where it no longer meets the standards for holding a license. Licensees are required to report material changes in their circumstances. Information about licensees is readily available to the public.</p> <p>Investment advisers are either securities or futures companies whose license permits them to provide advice services, or separately licensed investment consulting businesses. Pure investment advisers are not permitted to deal for clients or hold client assets.</p>
Principle 30	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>Capital requirement – securities companies</p> <p>There are initial and ongoing minimum capital requirements for securities companies, and the CSRC has the right to increase minimum capital requirements according to the risk levels of different securities businesses.</p> <p>Until October 2016, the CSRC required securities companies to comply with a net capital regime. It has now adapted that regime by reference to some features of Basel requirements, for example by redefining net capital as the sum of core net capital and subsidiary net capital, and introducing a risk coverage ratio, a capital leverage ratio and two liquidity ratios. The new rules also permit security companies to use internal models method to calculate risk capital reserves in accordance with requirements formulated by the CSRC. The CSRC is in the process of developing rules for the use of models. Securities companies are now reporting under the new regime, which took effect in October 2016.</p> <p>The CSRC anticipates that moving to the new capital regime will result in securities companies having to hold more capital and in increases in risk reserves. This is because, under the new regime off balance sheet assets are now included, and more risk exposures are taken into account in the calculation of capital requirements.</p>

Minimum capital

The minimum registered capital requirements for securities businesses are set out in Article 127 of the *Securities Law*. The minimum required varies according to the category of the securities business:

- minimum registered capital of RMB 50 million for a securities company engaging in securities brokerage, securities investment consultancy, financial advising on securities trading or securities investment;
- minimum registered capital RMB 100 million for a securities company engaging in any one of securities underwriting and sponsorship, proprietary trading and securities asset management or any other securities business (together “higher risk businesses”);
- minimum registered capital of RMB 500 million for a securities company engaging in two or more of the higher risk businesses.

In all case the registered capital must be the paid-in capital.

Net capital requirements

The *Measures for the Administration of Risk Control Indicators of Securities Companies* set out detailed requirements for net capital levels. The requirement varies according to the nature of the business undertaken so that minimum net capital must be:

- RMB 20 million for a securities company engaging in securities brokerage business;
- RMB 50 million for a securities company engaging in any one of the higher risk businesses;
- RMB 100 million for a securities company engaging in securities brokerage and any one of the higher risk businesses;
- RMB 200 million for a securities company engaging in two or more of the higher risk businesses.

Core net capital is calculated, as in other jurisdictions, by reference to a company's balance sheet, deducting illiquid assets from total assets, applying haircuts to financial assets, and adjusting the resulting figure for contingent liabilities. Subsidiary net capital consists of a specified proportion of subordinated debt, with the proportion allowable based on the term-to-maturity of the debt (100 per cent of debt with a maturity of more than 3 years, 70 percent of debt with a maturity of 2 years, and 50 per cent of debt with a maturity of 1 year).

Securities companies must also maintain risk capital reserves. The risk capital reserves for a securities company engaging in securities brokerage business must be calculated in accordance with the total amount of clients' transaction and settlement funds; for a securities company engaging in securities underwriting and sponsorship, proprietary trading, securities assets management or margin trading and securities financing reserves must be calculated in accordance with the scale of the business or businesses engaged in. Where a securities company has set up branches or outlets, risk capital reserves for these branches must be calculated based upon the total operational costs of the previous year.

	<p>The CSRC has issued detailed instructions on how calculations are to be carried out for net capital and risk capital reserves for different types of assets.</p> <p>As well as meeting minimum requirements, the net capital of a securities company must not fall below specified ratios:</p> <ul style="list-style-type: none"> • the ratio of net capital to the sum of risk capital reserves must be not less than 100 per cent; • the ratio of net capital to net assets must be not less than 40 per cent; • the ratio of core net capital to on- and off-balance sheet liabilities must be not less than 8 per cent;⁶⁷ and • the ratio of net assets to liabilities must be not less than 20 per cent. <p><i>Liquidity requirements</i></p> <p>The CSRC has adopted liquidity requirements that were initially developed by SAC. These require securities companies to report on two control indicators for liquidity risk: a Liquidity Coverage Ratio (requiring companies to have adequate high quality liquid assets to survive stressed liquidity conditions over a 30 day period) and a Net Stable Funding Ratio (focused on longer term liquidity). The <i>Measures for the Administration of Risk Control Indicators of Securities Companies</i> have been amended to require companies to comply with and report against these ratios.</p> <p>Capital requirement – fund management companies</p> <p>Fund management companies are required to have a minimum registered and paid up capital of RMB 100 million.</p> <p>Capital requirement – futures companies</p> <p>The CSRC has initial and ongoing minimum capital requirements and prudential requirements for futures companies. It has not applied the new regime for securities companies to futures companies.</p> <p><i>Minimum capital</i></p> <p>The minimum registered and paid-in capital of a futures company must be not less than RMB 30 million (Article 16 of the <i>Regulations on the Administration of Futures Trading</i>).</p> <p><i>Net capital requirement</i></p> <p>Futures companies are subject to the CSRC's net-capital-based risk supervision. Entities licensed as futures companies are not permitted to engage in own-account trading.</p> <p>Article 18 of the <i>Measures for the Administration of Risk Control Indicators of Futures Companies</i> states that a futures company must consistently meet standards for ongoing risk supervision:</p> <ul style="list-style-type: none"> • the net capital must be not be less than RMB 15 million and not less than 6 per cent of the total equity of clients;
--	--

⁶⁷ This brings securities companies' off-balance sheet activities such as asset management and securities derivatives under the regulatory regime for leverage ratios.

	<ul style="list-style-type: none"> • the average net capital per business branch must be not less than RMB 3 million; • the ratio of net capital to net assets must be not less than 40 per cent; • the liabilities to net assets ratio must be not more than 150 per cent⁶⁸; and • the futures company must meet requirements for minimum settlement reserves. <p>Different capital requirements have been set for futures companies engaging in different types of business such as entities engaging in transaction clearing and settlement services; and entities engaging in comprehensive clearing and settlement services.</p> <p><i>Liquidity requirements</i></p> <p>The liquidity of futures companies is primarily managed through the CSRC's risk control indicators. The net capital indicator is the core indicator for liquidity management. In addition, the <i>Measures for the Administration of Risk Control Indicators of Futures Companies</i> require that a futures company's coverage ratio (net capital to risk capital reserves) must not be less than 100 per cent, and the ratio of its current assets to current liabilities must not be less than 100 per cent.</p> <p>Risk-sensitivity of capital requirements</p> <p><i>Securities companies</i></p> <p>The <i>Measures for the Administration of Risk Control Indicators of Securities Companies</i> require a risk control system based on net capital with two levels of risk control indicators: the net capital requirement which is designed to ensure that capital adequacy is commensurate with the scope of the business; and requirements for risk reserves which are designed to ensure that each business line is under proper control and risks are appropriately managed. These requirements are intended to cover a wide range of potential risks, including market, credit, liquidity, operational and legal and reputational risks.</p> <p>Standards are set that limit the scale of any type of business relative to net capital, and include requirements dealing with concentration risk. For example, for a securities company's proprietary business:</p> <ul style="list-style-type: none"> • the total amount of proprietary equity securities and derivatives must not exceed 100 per cent of net capital; • the total amount of proprietary fixed income securities must not exceed 500 per cent of net capital; • the value of a single line of equity securities must not exceed 30 per cent of net capital; and • the ratio of the market value of a single line of equity securities to the total market value of all equity securities held must not be more than 5 per cent. <p>The CSRC classifies and rates securities companies according to their risk management capabilities, competitiveness and ongoing compliance status (see further under Principle</p>
--	--

⁶⁸ CSRC staff indicate that futures companies do not have any off-balance sheet liabilities (in its general sense) with respect to their present businesses

	<p>31). The CSRC may, based on the corporate governance, internal controls and risk controls of a securities company, adjust the standards for its risk control indicators and risk reserves levels.</p> <p>The CSRC and its regional offices may require a securities company to provide a detailed explanatory report on the adequacy and reasonableness of its assets impairment reserves.</p> <p>A securities company must, in the notes to its net capital statement, fully disclose contingencies (such as pending litigation, pending arbitration, external guarantees) with regard to their nature, amounts involved, causes and progress, expected losses and the accounting treatment for expected losses. Contingencies likely to result in outflows must be recognized as accrued liabilities; for others, a proportion must be deducted in the calculation of net capital.</p> <p>Securities companies are also required to conduct sensitivity analyses of their risk control indicators and conduct stress testing.</p> <p><i>Futures companies</i></p> <p>The <i>Measures for the Administration of Risk Control Indicators of Futures Companies</i> require a futures company to apply haircuts to its assets based on the assets' classification, liquidity, age, and recoverability.</p> <p>CSRC senior staff indicated that the CSRC is in the process of updating the <i>Measures for the Administration of Risk Control Indicators of Futures Companies</i>. The updated version will prescribe leverage ratios for futures companies. In particular, the ratio of its current assets to current liabilities must not be lower than 100 per cent; and the ratio of its liabilities to net assets shall not be higher than 150 per cent.</p> <p>A futures company must, in the notes to its net capital statement, fully disclose contingencies (such as pending litigation, pending arbitration, external guarantees) having regard to their nature, amounts involved, causes and progress, expected losses and the accounting treatment for the expected losses. It must deduct a proportion of the liabilities in the calculation of net capital.</p> <p>Reporting</p> <p><i>Securities companies</i></p> <p>Securities companies must establish monitoring and other mechanisms for risk control indicators to ensure that net capital and other risk control indicators satisfy the required standards at any point in time. Under the <i>Measures for the Administration of Risk Control Indicators of Securities Companies</i>, a securities company must calculate its net capital, accrue risk capital reserves and prepare statements on net capital, risk capital reserves and monitor risk control indicators daily. In practice, the systems used by securities companies to comply with these obligations are open to the CSRC for monitoring purposes.</p> <p>A securities company must submit monthly monitoring reports which include financial statements through the CSRC's Comprehensive Intermediaries Supervision Platform (CISP). The CSRC verifies these monitoring reports in their day-to-day supervision. Securities companies must also submit an annual report which includes audited financial statements within four months of year end, and an ad hoc report if any event has impacted or may impact its operations and management, financial status, risk control indicators or the safety of client assets. The directors and senior managers of a securities company must sign and provide opinions on the annual reports and managers in charge must sign and provide opinions on monthly reports.</p>
--	--

Failure to stay above 120 per cent of a specified minimum level or failure to stay below 80 per cent of a specified maximum level triggers an early warning reporting requirement. An early warning report must be given to the CSRC and its regional office within 3 working days. The report must include measures to address the problem and a timeline for its resolution. In addition, if net capital or other risk control indicators change by more than 20 per cent from one month to another, a securities company must submit a written report to the CSRC within 3 working days.

CSRC senior staff emphasized that in these two cases reaching the thresholds does not mean that the company is in breach of its capital and prudential requirements. Further, the firm is required to address the situation from the moment it reaches the threshold; even though the reporting takes place within 3 days. In contrast, if risk control indicators show non-compliance with capital rules, then the securities firm must report to the CSRC in 1 working day, with proposals for remediation. The differences in deadlines reflect the different regulatory status of a company that is in compliance versus a company that fails to meet the statutory standard.

At least once every six months, a securities company must provide all directors with a written report, signed and confirmed by the principal, on the status of its risk control indicators including net capital. Also, the board must report to shareholders every six months on the same matters. If the net capital levels change by more than 30% from one month to another, or fail to meet relevant standards, the securities company must issue a written report to all the directors within 5 working days and all shareholders within 10 working days.

Fund management companies

The CSRC requires fund management companies to submit financial reports on a monthly basis, quarterly compliance audit reports within 15 days of quarter end, and an annual compliance audit report within 30 days of year-end. A company's annual report, audited financial reports and an annual evaluation report must be submitted to the CSRC within 3 months of year-end.

A fund management company that has deteriorating financial position or is otherwise exposed to material operational risks is not permitted to apply for a fund offering (Article 6 of the *Measures for the Administration of Operations of Publicly Offered Securities Investment Funds*).

Under Article 76 of the *Measures for the Administration of Securities Investment Fund Management Companies*, where the net assets of a fund management company fall below RMB 40 million or its available current assets fall below RMB 20 million and are lower than its operating expenses in the preceding year, the CSRC can temporarily suspend the acceptance and review of its applications for offering fund products or for any other business, and require it to raise its financial liquidity within a designated time limit. If the company's financial situation further deteriorates, the CSRC will order the company to suspend its business operations for rectification.

Futures companies

Futures companies are required to calculate their net capital by the end of each month. Pursuant to Article 22 of the *Measures for the Administration of Risk Control Indicators of Futures Companies* they are required to submit monthly risk surveillance statement including financial statements to the CSRC regional office where they are domiciled within seven workdays after the end of each month and annual risk surveillance statement, including audited financial statements, within four months after the end of each year.

	<p>The CSRC can also require futures companies to prepare and submit risk control reports on an <i>ad hoc</i> basis. A futures company must maintain its written risk control reports, which must be signed by relevant persons-in-charge and bear the company's seal. The retention period for such reports is 5 years.</p> <p>There are early warning thresholds for risk control indicators of futures companies that operate in the same way as those for securities companies, so that when key ratios fall below 120 per cent of a minimum limit, or exceed 80 per cent of a maximum limit the futures company must provide a report to the CSRC, but in this case reporting needs to take place on the same day (Article 28 of the <i>Measures for the Administration of Risk Control Indicators of Futures Companies</i>). In addition, where the ratio of net capital to risk capital reserves changes by more than 20 per cent from one month to another, a futures company must submit a written report to the CSRC explaining the reasons for the change. A copy of the report must be given to all directors within 5 working days.</p> <p>Independent audit</p> <p><i>Securities companies</i></p> <p>The <i>Regulations on the Supervision and Administration of Securities Companies</i> specifies that the annual reports of a securities company, the financial statements, risk control statements and other special reports prescribed by the CSRC must be audited by an auditing firm licensed by the CSRC. Article 9 of the <i>Measures for the Administration of Risk Control Indicators of Securities Companies</i> requires an auditor to carry out an audit of, and issue an opinion on, the authenticity, accuracy and completeness of the regulatory statements of the risk control indicators of the securities companies. An assessment report on internal controls provided by the auditing firm must be attached to the securities company's annual report. If the accounting firm issues a qualified opinion or an unqualified opinion with an explanatory paragraph, the company must provide explanations.</p> <p><i>Futures companies</i></p> <p>Annual reports of futures companies must be audited by an auditing firm licensed by the CSRC. Pursuant to Article 5 of the <i>Measures for the Administration of Risk Control Indicators of Futures Companies</i>, a futures company must engage an accounting firm that has the qualification of securities and futures related business to audit the annual risk supervision report of the futures company. The auditor must verify the authenticity, accuracy and completeness of the report and is responsible for the legality and authenticity of the audit report.</p> <p>Monitoring by regulator</p> <p><i>Securities companies</i></p> <p>The CSRC assigns staff to review and verify the monthly and annual reports submitted securities companies and produce review reports.</p> <p>Securities companies are subject to on-site inspections (see under Principle 31). Based on the information acquired from the annual audit report and day-to-day supervision, the CSRC increases the frequency of on-site inspections on securities companies whose risk control indicators, financial status and business operations are outside normal parameters or who are ranked at low levels in classification.</p> <p><i>Futures companies</i></p> <p>The CSRC assigns staff to review monthly reports and annual reports and prepare review reports. The CSRC can carry out regular and <i>ad hoc</i> on-site inspections on futures</p>
--	---

companies and their business offices.

Regulator's powers of intervention

Securities companies

As noted under Principle 29, Article 150 of the *Securities Law* gives the CSRC extensive powers to take action if the net capital level or other risk control indicators of a securities company are not in compliance with specified levels or thresholds. In addition, the *Measures for the Administration of Risk Control Indicators of Securities Companies* provide that, if the net capital level or any other risk control indicators of reaches the early warning level, the CSRC can:

- issue a letter of concern requiring the company to account for the potential risks and control measures, and send a copy to the principal shareholders of the securities company;
- require the company to take measures to adjust its business scale and asset-liability structure to improve the net capital level;
- require the company to submit a special report at least five working days before making a major business decision to explain the impact of the decision on the company's financial position, capital requirements or other risk control thresholds; or
- order the company's compliance department to increase the frequency of inspections of risk control indicators and submit reports on the levels of risk control indicators.

Futures companies

Under Article 156 of the *Regulations on the Administration of Futures Trading*, if a futures company and its branches fail to meet the requirement for ongoing operations or are exposed to operational risks, the CSRC may take a range of administrative actions against the company. Available actions are similar to those that can be taken against securities companies under Article 150 of the *Securities Law*. Action can also be taken against the company's directors, supervisors, and senior managers.

The *Measures for the Administration of Risk Control Indicators of Futures Companies* provide that, if a futures company fails to rectify problems with its risk indicators, including net capital, within a specified time or if any of its risk control indicators still fail to meet requirements, the CSRC can take the regulatory actions provided for in Article 55 of the *Regulations on the Administration of Futures Trading* including:

- restrict or suspend part of its futures business;
- cease approving its applications for undertaking new line-of-business or creating new branches;
- restrict the distribution of dividends, and restrict the payment of compensation and provision of benefits to its directors, supervisors and senior managers;
- restrict the alienation of company property or the creation of encumbrance on such property;

	<ul style="list-style-type: none"> • order it to replace, or restrict the powers of, any of its directors, supervisors, senior managers, or the persons-in-charge of relevant business unit or branch; • restrict the transfer and use of its own funds or the risk reserves; and • order the controlling shareholder to transfer its equity or restrict the exercise of shareholder rights of relevant shareholders. <p>Risks from outside the regulated entity</p> <p>The business scope of securities companies and futures companies, including the establishment of branches or subsidiaries, requires the approval of CSRC.</p> <p>In calculating net capital, any external equity investment of a securities company must be deducted in full and not included in its net capital. For futures companies, long-term equity investments and fixed assets are fully deducted.</p> <p>Under the <i>Regulations on the Supervision and Administration of Securities Companies</i>, the CSRC has the power to require enterprises legally or de facto controlled by the securities company to provide documents and information that relate to the operation, management and financial position of the securities company.</p> <p>Where the subsidiary of a securities or futures company raises funds, a proportion (0.2 per cent) of the amount raised must be accounted for in the parent company's risk reserves as well as in the subsidiary.</p> <p>The 2016 revision of the <i>Measures for the Administration of Risk Control Indicators of Securities Companies</i> has incorporated a capital leverage ratio (core net capital/total on-and off-balance sheet assets) indicator, bringing their off-balance sheet activities such as asset management and securities derivatives under the regulatory regime for leverage ratios. CSRC staff indicated that futures companies currently do not have any off-balance sheet liabilities.</p> <p>The CSRC has selected 7 firms to participate in a pilot program for consolidated risk management supervision. A group level risk management and risk indicator system will apply from 1 January 2017, and include reporting by local and foreign subsidiaries of these firms.</p>
Assessment	Fully Implemented
Comments	<p>The IOSCO Assessment Methodology explicitly recognizes a net capital regime as one of the main alternative approaches to the setting of capital standards for intermediaries. The CSRC's net capital regime for securities companies has recently been adapted by adding to it a number of specific capital ratios, a leverage ratio and two liquidity ratios. The revised regime addresses market, credit, liquidity, concentration and operational risks, and capital requirements increase as risk increases. Futures companies are also subject to a net capital regime that, reflecting the relative less complex nature of futures brokerage business, is simpler in design than that applying to securities companies. The prohibition to conduct proprietary trading together with the strong system of margins that apply in futures trading, and the monitoring role played by the exchange CCPs and CFMMC, mean that at least in their brokerage business futures companies are not exposed to significant risks, such as market risk. That said, the assessors recommend that the CSRC reviews whether, similar to securities firms, futures companies must also be required to compute their</p>

	<p>capital daily even if it is reported only on a monthly basis.</p> <p>As for the current early warning system, the assessors note that securities companies are not required to immediately report to the CSRC when they reach the early warning thresholds; rather they have up to 3 business days to report. As highlighted by the CSRC, the assessors acknowledge that reaching the early warning thresholds does not mean that a firm is in breach of their capital and prudential requirements. Further, that while there is a three day lag for reporting the firm is required to address the situation from the moment it reaches the threshold. Finally, the thresholds have been set up "conservatively" (at 120%). That said, depending on the activities conducted by the firms and market conditions, its financial situation could deteriorate significantly in this interim, and thus a notification within three days might affect the ability of the CSRC to request prompt actions. That is why the assessors encourage the CSRC to require notification within the same day when the threshold is reached, as is the case for futures companies.</p> <p>As noted in the comments under Principle 29, the CSRC is encouraging securities companies to develop a full range of investment banking services, which could potentially involve more complex legal structures. As firms move to this new business model, it will be important for the CSRC to ensure the revised capital rules apply as intended, and to monitor closely firms' compliance with capital rules in the more complex environment of a full service firm. Further, the pilot project to apply consolidated risks indicators would provide useful insights to the CSRC to determine whether additional prudential requirements are needed for full service firms.</p> <p>The assessors note the objective of the authorities to further develop the futures markets. In such context, it is possible that there be a need for an evolution in the business models of futures companies that in turn might require strengthening of their prudential framework.</p>
<p>Principle 31</p>	<p>Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.</p>
<p>Description</p>	<p><u>Regime applicable to securities intermediaries under CSRC</u></p> <p>Management, supervision and organizational requirements</p> <p><u>Securities companies</u></p> <p>To obtain authorization, a securities company must have adequate risk management and internal control mechanisms (Article 124 of the <i>Securities Law</i>). The <i>Regulations on the Supervision and Administration of Securities Companies</i> set out more detailed requirements, including requirements to have a sound organizational structure and clearly defined functions for the bodies responsible for decision-making, execution and monitoring. Chapter IV of these <i>Regulations</i> sets out requirements for risk management and internal control systems. The CSRC's <i>Provisional Code of Corporate Governance for Securities Companies</i> and the <i>Guidelines on Internal Control for Securities Companies</i> establish specific requirements for management (including the responsibilities of board and senior managers), organizational structures and internal control mechanisms. The board bears ultimate responsibility for internal control systems.</p> <p>The <i>Guidelines on Internal Control for Securities Companies</i> contain detailed requirements for organizational structures and monitoring systems. They include a requirement for an</p>

	<p>independent supervision and inspection department to conduct overall monitoring, inspection and reporting. They also require the board of directors of a securities company to conduct a comprehensive inspection and evaluation of the company's internal controls at least once a year and document its findings in a special report.</p> <p>The <i>Trial Provisions for the Compliance Management of Securities Companies</i> make a securities company's board of directors, board of supervisors and senior managers responsible for the effectiveness of compliance management. Under the <i>Securities Law</i> and the <i>Regulations on the Supervision and Administration of Securities Companies</i> senior management can be subject to administrative liability, and in appropriate cases criminal liability, for a securities company's non-compliance or misconduct.</p> <p>The <i>Regulations on the Supervision and Administration of Securities Companies</i> require a securities company's annual report, financial statements and risk control statements to be audited by an accounting firm with qualifications for securities/futures services. An assessment report on the internal control of the company issued by the auditing firm must be attached to the annual report.</p> <p>The <i>Trial Provisions for the Compliance Management of Securities Companies</i> require a securities company either to organize an internal body or engage an external specialized institution to assess the effectiveness of its compliance management and address any compliance issues. The securities company must give the CSRC interim and annual compliance reports on the effectiveness of its compliance management, stating whether any issues have been found and corrected. Directors and senior managers must attest these reports.</p> <p><u>Fund management companies</u></p> <p>The <i>Fund Law</i> requires a fund manager of public funds to establish a sound internal governance structure and specify the functions and authority of the shareholders' meeting, board of directors, board of supervisors and senior managers, with a view to ensuring its independence in operations. Under the <i>Measures for the Administration of Securities Investment Fund Management Companies</i>, a fund management company must establish a governance structure with a sound organizational framework, a clear division of functions, effective checks and balances of supervision and appropriate incentives and restrictions.</p> <p>The CSRC's <i>Guidelines on Internal Control of Securities Investment Fund Management Companies</i> provides further detail on requirements for a fund management company's corporate structure. The <i>Guidelines</i> make a fund management company's board of directors ultimately responsible for establishing internal control systems and maintaining their effectiveness. Management is responsible for ensuring implementation and ensuring staff are informed of requirements.</p> <p>Under Article 64 of the <i>Measures for the Administration of Fund Management Companies</i>, a fund management company must submit to the CSRC an audited annual report of the fund management company; an annual evaluation report on the internal controls of the fund management company issued by the auditing firm; and quarterly and annual compliance audit reports.</p> <p><u>Futures companies</u></p> <p>The <i>Measures for the Supervision and Administration of Futures Companies</i> set out the rules for the corporate governance of futures companies, including requirements for the division of responsibilities, checks and balances, and risk management. The <i>Measures</i> require a futures company to segregate functions, create a compliance supervision department or position, and establish mechanisms for risk management, internal control and custody of</p>
--	--

futures margins.

The *Regulations on the Administration of Futures Trading* provides that in respect of any misconduct of a futures company, the manager directly in charge and other persons directly liable are accountable (for example, see Articles 67 and 68). Under the *Measures for the Supervision and Administration of Futures Companies* and the *Provisions on the Administration of Chief Risk Officers of Futures Companies (Tentative)*, a futures company must establish the position of chief risk officer, who supervises the compliance of the company's business operations and risk management.

The *Provisions on the Administration of Chief Risk Officers of Futures Companies (Tentative)* require a futures company's chief risk officer to submit quarterly working reports to the relevant CSRC regional office within ten working days from the end of each quarter; and a comprehensive annual working report for the preceding year before January 20 of each year. The reports must describe the compliance operations, risk management and internal control of the futures company; the work carried out by the chief risk officer; and any due diligence conducted, corrective actions proposed, and results of these corrective actions.

Protection of clients

Securities companies

Client funds and assets

Clients' funds for the settlement of transactions must be deposited with a commercial bank prior to trade execution and an individual account opened in the name of each client. Securities companies must not calculate or include their clients' transaction settlement funds or securities as part of their own assets. Funds held in this way are protected in the event of the security company's bankruptcy or liquidation. See Article 139 of the *Securities Law*. More detailed rules are set out in the *Regulations on the Supervision and Administration of Securities Companies*. They include a rule that the designated commercial bank must ensure that a client can enquire at any time about the balance of and changes in the transaction settlement funds. Further the SIPF is able to also see balances in customers' accounts as further described below.

The Measures for the Administration of Client Asset Management Business of Securities Companies provide rules relating to the holding of assets by securities companies. The rules vary according to the nature of the asset management business conducted:

- directed asset management business: the securities company must separate customer assets from its own assets and separate the assets of different customers; there must be different accounts for the assets of different customers, which must be accounted for and managed separately; the securities company must transfer the assets entrusted by the customers to a custodian recognized for custody by the CSRC (a commercial bank, CSDC, or a securities company authorized to provide custody);
- collective asset management business: the securities company must ensure the assets of the collective asset management plan, its own assets, assets of other customers and the assets of different collective asset management plan are independent of each other, and must set up accounts for these assets which must be accounted for and managed separately; assets of a collective asset management plan must be transferred to an asset custodian qualified to operate fund custody.

	<p>In addition, the securities company must establish a fair trading system and abnormal trading daily monitoring mechanism, treat different assets under its management fairly, monitor transactions of same direction and reverse direction between the different investment portfolios, and regularly report the transactions to the CSRC and to SAC.</p> <p><i>Investor complaints</i></p> <p>A securities company must establish an effective and efficient mechanism for resolving investor complaints. The <i>Regulations on the Supervision and Administration of Securities Companies</i>, the <i>Provisional Code of Corporate Governance for Securities Companies</i> and the <i>Guidelines on Internal Control for Securities Companies</i> set out requirements for this mechanism including by requiring securities companies to designate a special department responsible for communicating with clients and handling their complaints.</p> <p><i>Client information, know your client and suitability rules</i></p> <p>A client wishing to open an account with a securities firm must obtain an identification number from the CSDC. This number will be used for all the client's dealings in the securities market, irrespective of the number of brokerage or trading accounts the person has. CSRC staff indicated that a universal identification number applicable to both securities and futures accounts is in the process of being implemented. Article 166 of the <i>Securities Law</i> requires the investor to present documentation to CSDC to establish his identity as a Chinese citizen or his qualifications as a Chinese legal person. In practice, the CSDC delegates this function to the broker who is to act for the client.</p> <p>Article 29 of the <i>Regulations on the Supervision and Administration of Securities Companies</i> requires a securities company that engages in securities asset management, margin trading and securities financing, or distribution of securities-related financial products to follow prescribed procedures. The company must acquire sufficient knowledge of the identity, property and income status, securities investment experience and risk appetite of the client and must record and keep the information. The securities company must, based on this knowledge, recommend only suitable products or services to the client.</p> <p>Regulations require that clients of asset management services are informed of the level of the risks associated with the services, categorized according to their risk appetite and recommended products and services that are commensurate with their risk profiles.</p> <p>In December of 2016 the CSRC approved the <i>Measures for the Administration of the Suitability of Securities and Futures Investors</i> which establish a single set of suitability requirements for the securities and futures markets. The <i>Measures</i> apply to the sale of publicly and non-publicly offered securities, publicly and non-publicly raised investment funds and private equity funds (including venture capital funds), publicly and non-publicly transferred futures and other derivatives, and the provision of the relevant business services to investors. Institutions selling securities and futures products or providing securities services to investors must abide by the <i>Measures</i> and must during the sale of products and provision of services diligently perform their duties, have an all-round knowledge about investors situation, thoroughly investigate and analyze the information about products and services, make scientific and effective assessment, sufficiently disclose risks, put forward clear opinions on proper matching according to the different risk tolerance of investors and the different risk grade of products and services, sell suitable products or provide suitable services to investors and bear legal liability for any violation of these duties.</p> <p><i>Conflicts of interest</i></p> <p>A securities company must have a comprehensive system of internal controls and adopt</p>
--	---

effective partitioning measures against conflict of interests between the company and its clients and between different clients (Article 136 of the *Securities Law*). The partitioning measures include obligations to separate business lines such as brokerage business, proprietary trading, and underwriting. Further rules dealing with conflicts of interest are contained in the CSRC's *Guidelines on Internal Control for Securities Companies* and SAC rules, including detailed rules requiring the use of Chinese walls to fully separate their brokerage business from other activities.

Records

Client account opening materials, order records, transaction records and all materials relating to a securities company's internal management and business operations must be kept for not less than 20 years (Article 147 of the *Securities Law*).

Disclosure to clients

Transaction services to be provided by a securities company to its clients are required to be set out in a contract signed by both parties. The *Regulations on the Supervision and Administration of Securities Companies* provide that, before signing service contracts with the clients with respect to securities brokerage, securities asset management, margin trading and securities financing, a securities company must explain the relevant business rules and contractual terms to the clients, and give the client a risk disclosure statement for the client's signature. SAC has developed model terms of the service contract and a standard format for the risk disclosure statement.

Reports to clients

Under the *Regulations on the Supervision and Administration of Securities Companies*, a securities company engaging in securities asset management, margin trading and securities financing must send statements of account to its clients on a monthly basis. The securities company and its clients may agree on alternative timing and means of delivery for these statements.

Under Article 32 of the *Regulations on the Supervision and Administration of Securities Companies*, a securities company must establish an information inquiry system to ensure clients have access, during business hours, to entrustment and trading records and the balance of securities and funds as well as other information, including the names and professional certificates of securities brokers.

Information about remuneration

The securities transaction fee that a securities company charges its clients must comply with applicable national regulations (Article 40 of the *Regulations on the Supervision and Administration of Securities Companies*). These regulations provide for maximum and minimum fees for brokerage transactions. Securities companies must also post their fees and fee rates prominently at their business premises.

Fund management companies

Client funds and assets

The *Fund Law* and the *Trial Measures for Asset Management Services for Specific Clients of Fund Management Companies* establishes that the assets of clients of a fund management company's asset management business must be held by a custodian, and are protected in the event of the bankruptcy of the fund management company.

Investor complaints

	<p>The CSRC's <i>Guidelines on Internal Control of Distributors for Securities Investment Funds</i> require a fund distributor to establish an adequate mechanism for the handling and resolving client complaints.</p> <p><i>Client information, know your client and suitability rules</i></p> <p>The <i>Guiding Opinions on Investor Suitability in the Sales of Securities Investment Funds</i> require a fund distributor to verify the identity and eligibility of the client as part of its anti-money laundering and other legal obligations. It must also establish an investor survey system, formulate sound survey methodologies, and establish a clear and effective process for surveying and evaluating the risk tolerance of a fund investor.</p> <p><i>Conflicts of interest</i></p> <p>The <i>Measures for the Administration of Securities Investment Fund Management Companies</i> require that the corporate governance of a fund management company must prioritize the interests of fund unit holders. Where the interests of the fund management company and its shareholders and employees conflict with the interests of fund unit holders, the interests of fund unit holders shall prevail.</p> <p><i>Records</i></p> <p>The <i>Measures for the Administration of the Sales Activities of Securities Investment Funds</i> require a fund distributor to establish a sound archive management system, and preserve the account opening materials of fund unit holders and other materials associated with sales. Client identity information must be kept for no less than 15 years from the termination of business relations, and other materials associated with sales shall be kept for no less than 15 years from the beginning of business relations.</p> <p><i>Other obligations to clients</i></p> <p>For disclosure to clients, reporting to clients and fund managers' obligations to provide information about remuneration to clients, see under the relevant CIS principles.</p> <p><u>Futures companies</u></p> <p><i>Client funds and assets</i></p> <p>The <i>Regulations on the Administration of Futures Trading</i> provide that margins collected from clients by a futures company belong to the clients and are not be misappropriated. This provision is further emphasized by the <i>Measures for the Supervision and Administration of Futures Companies</i>, which provide that a client's margin and entrusted assets belong to the client and must be segregated and managed separately from the proprietary assets of the futures company. They may only be used to meet client obligations, or as provided for by laws or administrative regulations. Client assets may not become subject to sealing-up, freezing, deduction or enforcement, and are protected if the futures company goes into bankruptcy or liquidation.</p> <p>Pursuant to these provisions the margins of clients of clients need to be deposited in individual accounts in designated banks. Under the <i>Regulations on the Administration of Futures Trading</i>, the CFMMC is responsible for monitoring futures margins and carrying out daily verifications. If any irregularity is discovered, it must be promptly reported to the CSRC. In addition, clients can consult (see) their account balances directly. Thus margins are fully portable.</p> <p><i>Investor complaints</i></p> <p>The <i>Measures for the Supervision and Administration of Futures Companies</i> require a futures</p>
--	--

company to develop a sound system for the handling and resolution of client complaints and publish the handling process.

Client information, know your client and suitability rules

The *Provisions for the Management of Account Opening by Clients of the Futures Market* require a client opening an account to comply with the *Regulations on the Administration of Futures Trading* and relevant provisions of the CSRC and open the account using the client's real name. The *Provisions* require the CFMMC to create a unique account opening code for each client and link it to the client's trading code at each futures exchange. As indicated elsewhere, a universal identification number applicable to both securities and futures accounts is in the process of being implemented.

The *Measures for the Supervision and Administration of Futures Companies* provide that a futures company must fully disclose to a client the risks of futures trading, implement the principles on investor suitability and educate clients on the relevant laws and regulations, business rules, products and services.

Conflicts of interest

Under the *Measures for the Administration of Futures Practitioners*, if the interests of a futures practitioner or its related party conflict with or is likely to conflict with those of a client, the practitioner must promptly disclose the conflict to the client and put the interests of the client first in its dealings.

As required by the *Trial Measures for the Futures Investment Consulting Services of Futures Companies*, when engaging in futures investment consulting services, a futures company and its employees must treat all clients fairly from an independent and impartial perspective, and avoid conflicts of interest. A futures company must formulate rules for preventing conflicts of interest between its consulting business and other futures businesses, set up a sound information segregation mechanism, and separate the offices and office equipment of different business departments. If conflicts of interest arise between a futures company or its employees and clients, the interests of clients must prevail.

Records

Article 51 of the *Measures for the Supervision and Administration of Futures Companies*, requires a futures company to retain client materials for a minimum of 20 years.

Disclosure to clients

The *Regulations on the Administration of Futures Trading* require that, before accepting a client as brokerage client, the futures company must give the client a risk disclosure statement for the client's signature and enter into a written contract. The futures company is not permitted to trade futures products without authorization from or instructions by the client.

Under the *Trial Measures for the Futures Investment Consulting Services of Futures Companies*, a futures company must enter into service contract with its client with respect to futures investment consulting services, specifying the contents, fee rate and terms of service. Templates for the service contract and of the risk disclosure statement are provided by the CFA.

Reports to clients

Article 57 of the *Measures for the Supervision and Administration of Futures Companies* requires a futures company to provide a report on transaction settlement to its clients

	<p>following the closing of each trading day and advise them that this report can be accessed through the CFMMC.</p> <p><i>Information about remuneration</i></p> <p>Under the <i>Trial Measures for the Futures Investment Consulting Services of Futures Companies</i>, the service contract between a futures company and its client must specify the fees to be charged.</p> <p>Direct Electronic Access</p> <p>The systems of pre-trade controls that apply to trading on both stock exchanges and futures exchanges are described under Principle 33. These pre-trade controls require that before entering an order, the exchange member verifies that cash/securities are in the clients' accounts, that the order is within the price limits established, and that, in the case of future markets, it is also within the position limits established by the market. These arrangements mean that client orders do not have uncontrolled access to market trading systems.</p> <p>Supervision</p> <p><u>Securities companies</u></p> <p>To enhance supervision of securities companies, the CSRC has performed classified evaluations of securities companies based on their risk management capabilities and ongoing compliance status since 2007, with five categories and 11 levels including category A (AAA, AA, A), category B (BBB, BB, B), category C (CCC, CC, C), category D and category E. The risk rating assigned by the CSRC is based primarily on four factors:</p> <ul style="list-style-type: none"> • the company's market competitiveness. This is based on quantitative measures such as the size and complexity of its operations; • its compliance record, including whether it has been subject to any regulatory or disciplinary action by the CSRC or an SRO; • risk management capability, which captures the company's risk control indicators (including its capital position) and • social responsibility, which is a new measure the contents of which are still under discussion. <p>The ratings process takes place once a year. Companies are required to prepare a self-evaluation, which is verified by the relevant CSRC regional office. The CSRC consults with experts and then decides on the company's rating for the year. Ratings are published.</p> <p>For securities companies under different categories, the CSRC implements differentiated regulatory policies: First, companies under different categories contribute to the investor protection fund at different rates and are subject to compliance with different risk control indicators. Second, the categorization has impact both in prudential standards and the intensity of supervision. For example, the CSRC may, based on a company's corporate governance, internal control and risk control, adjust the company's standards for risk control indicators and risk reserves levels. In addition, a company's risk rating is a key element used to determine whether it should be subject to an on-site inspection, complemented by other sources such as information from complaints, media reports and from SROs such as the exchanges.</p> <p>In conducting on-site and off-site inspections of securities companies, the CSRC gives</p>
--	---

overall considerations to the risk profile of securities companies and the problems and clues discovered during daily supervision and determine inspection targets and approaches taking into account business scale, growth rate and geographical distribution. Next, priorities and methods of inspection are determined according to inspection items and relevant risk points, so as to ensure inspection quality and avoid quantity over quality.

Finally, in practice, classification in the differentiated evaluation is also regarded as one of the entry criteria for the underwriting and issuance of short-term financing bonds bills and other instruments in the inter-bank market.

Off-site review

Securities companies are required to provide regular reports to the CSRC, including monthly reports on compliance with capital and risk control indicators, an annual report and ad hoc reports.

These reports are all reviewed by CSRC staff in the regional offices.

On-site inspections

Planning for on-site inspections is carried out both centrally and regionally. The CSRC's central office plans national inspections. Similar to what was indicated for fund management companies, the central plans focus on common problems in the market (for example, in the next year one round of inspections will focus on securities firms involved in the distribution of securities products). The "themes" or areas of focus are discussed with the CSRC regions in nationwide annual meetings. Planning for these inspections (including the training of staff) is done centrally and results are reported to and analyzed by the central office. These inspections are usually carried out by staff in the CSRC's regional offices, although staff from the central office may participate in them.

In this context, to enhance the on-site inspections of securities companies, since 2012, the CSRC has implemented targeted inspections on a range of businesses, including financing, asset management, underwriting and sponsorship and bond businesses on the basis of giving overall considerations to the hot issues and risk points of the securities industry.

In addition, to the thematic inspections mandated by the central office, the plans of the regional offices incorporate:

- risk oriented inspections, for which the regions use different sources of information available to them, including the risk rating of the firms, but also the time gap since the last inspection, the existence of complaints or negative coverage in the media, the business model, etc.; and
- inspections selected on a random basis to ensure that any company may be subject to an inspection in a given year.

The CSRC expects regional offices to inspect all companies in their jurisdiction over a reasonable amount of time, but leaves the time frame for regional offices to decide. Random inspections are the means used to ensure that there will be coverage of companies not covered by national or risk-driven inspections. Typically, inspections other than for-cause inspections begin with a request for a company to carry out a "self-inspection" and report the result to the CSRC. This is used as baseline information for the CSRC inspection.

In practice, particularly for the larger regions, the theme inspections mandated by the central office constitute the bulk of their inspection plan. For example, in 2015-16 a large

	<p>regional office carried out a total of 315 inspections encompassing both securities companies and futures companies, of which 274 were part of the nationally mandated inspection programs. Another large regional office conducted a total of 267 inspections encompassing securities companies, futures companies and fund management companies, out of which 202 were at the request of the CSRC.</p> <p>SAC and the securities exchanges also carry out on-site inspections of their members to monitor compliance with SRO rules. The CSRC and the SROs co-ordinate the timing of these inspections, but generally their areas of focus differ, and inspections are not normally joint inspections, although they may take place at the same time.</p> <p>For example, in 2014 SAC cooperated with the CSRC in six inspection programs covering a total of 129 members; in 2015 it supported six CSRC on-site inspection programs covering 106 members and carried out three independent inspections covering 53 members; and in 2016 it supported two CSRC inspection programs covering 39 members and carried out three independent inspections covering 20 members.</p> <p>SSE carried out 161 on-site inspections of members in 2014; 46 in 2015; and 18 in 2016; SZSE supported the CSRC in 20 on-site inspections, and carried out 43 on-site inspections in 2015 and 23 in 2016.</p> <p><u>Futures companies</u></p> <p><i>Off-site review</i></p> <p>Futures companies provide regular reports to the CSRC, including monthly reports on compliance with capital and risk control indicators, an annual report and ad hoc reports. The CSRC's Futures Intermediary Supervision System holds consolidated information on futures companies, relating primarily to risk control standards including capital. The CFMMC also provides daily reports to the CSRC on the status of futures clients' funds and assets.</p> <p>These reports are all reviewed by CSRC staff in regional offices.</p> <p><i>On-site inspections</i></p> <p>Similar to securities firms, planning for on-site inspections is carried out both centrally and regionally. The CSRC's central office plans national inspections. These inspections also focus on common problems in the market. The "themes"/areas of focus are discussed with the CSRC regions in nationwide annual meetings.</p> <p>In addition, to the thematic inspections mandated by the central office, the plans of the regional offices incorporate:</p> <p>risk oriented inspections, for which the regions use different sources of information available to them, including the risk rating of the firms, but also the time gap since the last inspection, the existence of complaints or negative coverage in the media, the business model; and</p> <p>inspections selected on a random basis to ensure that any company may be subject to an inspection in a given year.</p> <p>Also as indicated above, in practice for some regional offices the bulk of their inspection plan is composed of the nationally driven inspections. For example, in 2015-2016 one large regional office conducted 136 inspections on fund management companies out of which 75 were part of nationally mandated inspection programs.</p> <p>Inspections have included topics such as internal controls, conflict of interest and</p>
--	--

suitability.

The CFA also carries out on-site thematic and regular inspections of futures companies. Under the CFA program, futures companies complete a self-inspection every two years and report results to the CFA. The CFA uses the report, together with information from complaints and other sources, to select 30 to 40 companies to be inspected in the next two year period. This process enables the CFA cover all futures companies over a 3 to 4 year period. In addition the futures exchanges conduct on-site inspections on their members.

The futures exchanges also carry out off-site and on-site inspections of their members. For on-site inspections, the intensity varies between exchanges. Shanghai Futures Exchange carried out on-site inspections of four members in 2014, eight members in 2015 and 17 members in 2016; Zhengzhou Commodity Exchange carried out on-site inspections of nine members in 2014, 13 in 2015 and 15 in 2016; Dalian Commodity Exchange carried out on-site inspections of 50 members in 2014, 51 members in 2015 and 50 members in 2016; and CFFEX carried out on-site inspections of 92 members in 2014, 100 in 2015 and 169 in 2016.

Number of on-site inspections conducted by the CSRC	2013	2014	2015
Securities companies	105 33	11 14 45	46 1 targeted on a firm
Futures companies	50 20	152 (themed on IT security)	40 (including subsidiaries)
Consultancy firms	89	86	19

Source: CSRC.

The following are examples of thematic inspections mandated by the CSRC's central office in 2014 and 2015.

2014

1. On-site inspection on asset management businesses

In August 2014, the Department of Fund and Intermediaries Supervision carried out a thematic inspection on six securities companies and eight subsidiaries of fund management companies with regard to their asset management business.

2. On-site inspection on information security

From August to September 2014, and with the support of CSRC General Office and other relevant CSRC departments including DFIS, Department of Futures Supervision and Department of Market Supervision, the Office of Credit Supervision led a full-scaled inspection on the security safeguards and the use of digital certificates in the IT systems of core market institutions such as CSRC head office and exchanges as well as 350 business entities including relevant subsidiaries, securities companies, futures companies, and fund management companies. This round of inspections consisted of two phases: self-inspection and on-site inspection. In the latter phase, the CSRC conducted on-site inspection on the core institutions and their 22 subsidiaries and 3 business entities. Each CSRC regional office also formed a working group for the themed inspection on information security, and carried out on-site inspection of 114 business entities.

2015

	<p>1. On-site inspection “Two Reinforcements and Two Preventions”</p> <p>From January to May 2015, and with the support of DFIS, the Department of Private Fund Supervision, SAC, CFA and AMAC, the Enforcement Bureau launched the “Two Reinforcements and Two Preventions” campaign, a themed inspection targeted at securities and futures companies, fund management companies and private investment funds. This inspection was divided into three phases: self-check, random check, and rectification. All securities companies, fund management companies, futures companies, securities investment consultancy firms, private investment funds with AUM of more than RMB 500 million and some private investment funds with AUM of less than RMB 500 million but funded by a single institution were required to perform the self-check. The self-check covered the effectiveness of corporate governance, internal control, and risk management; businesses relating to investment banking, asset management, bond trading, and public and private investment funds; and compliance with securities and futures laws and regulations. For the random check phase, 203 institutions were sampled, including 35 securities companies, 20 fund management companies or subsidiaries, 30 futures companies or subsidiaries, 17 securities investment consultancy firms, and 101 private investment funds.</p> <p>2. On-site inspection on information technologies</p> <p>In August 2015, the DFIS conducted a thematic inspection on the IT systems of 25 business entities in 7 jurisdictions including Beijing. This inspection, covering 11 securities companies, 10 fund management companies or subsidiaries, and 4 futures companies or subsidiaries, focused on external access of the IT systems of business entities, unlicensed margin trading, illegal participation in unlicensed margin trading by asset management products, and IT security.</p> <p>3. On-site inspection on investor protection</p> <p>In December 2015, DFIS conducted a thematic inspection on 25 securities and futures companies with emphasis on investor protection. This inspection involved 7 securities companies, 1 asset management subsidiary of a securities company, 1 independent fund distributor, 3 futures companies, 3 risk management subsidiaries of futures companies, and 2 securities investment consultancy firms. This was a problem-driven and risk-oriented inspection, focusing on the risk management of innovative offerings of business entities and their management of customer suitability. As a result of its inspection programs, the CSRC has imposed both regulatory measures and administrative sanction on intermediaries. In 2013-15, it imposed a total of 445 regulatory measures on all intermediaries, and 34 administrative sanctions on firms and individuals, including 13 market bars.</p> <p><u>Regime applicable to banks providing wealth management services</u></p> <p>As well as providing WMPs that are CIS (see Principles 24-27), banks also provide securities intermediary services to clients (wealth management services). These services include the distribution of investment products including WMPs, individual portfolio management services, and financial advisory services including investment advice. The regulatory regime that applies to these types of intermediary services is referred to in this description.</p> <p>There is a single regulatory regime for all wealth management services (including WMP business) and the regime for these intermediary services overlaps with that that applies to WMPs that are CIS.</p> <p>Management, supervision and organizational requirements</p>
--	---

	<p>Banks providing wealth management services must establish an internal control and risk management system (see, for example, Article 2 of the <i>Notice on Investment Managements</i> (CBRC [2009] No 65). They must implement measures for supervision and independent verification, provide wealth management services in an orderly fashion, and protect the rights and interests of customers (Article 6 of the <i>Risk Management Guidelines</i>).</p> <p>Banks are required under Article 35 of the <i>Interim Measures</i> to establish an appropriate risk management system for the conduct of wealth management business. More detailed requirements are set out in the <i>Risk Management Guidelines</i> (Yin Jian Fa [2005] No 63) (see also under Principle 24). These <i>Guidelines</i> include requirements for a system of internal supervision (compliance) and internal audit (Article 12); provisions dealing with the monitoring and auditing of internal risks (Article 33); risk limitation management rules (Articles 40-45) and requirements for the segregation of duties (Article 47-49). The internal supervision department and the audit department must be independent from operational departments, and report supervision and audit findings directly to the board of directors and senior management (Article 49).</p> <p>A bank's directors and senior managers are given explicit obligations under the <i>Risk Management Guidelines</i>. For example, Article 11 directors and senior managers, among other things, must guarantee that internal management rules and risk control measures embody the principles of understanding customers and benefiting customers to the maximum extent. Article 32 requires directors and senior management to fully understand the risks of WMP activities and to establish an internal management and supervision system for these activities. The bank's board of directors and senior management must examine and decide on whether and what types of WMPs the bank sells (Article 36).</p> <p>Article 33 of the <i>Risk Management Guidelines</i> and Article 2 of the <i>Notice on Investment Management</i> (CBRC [2009] No 65), a bank must regularly test the independence, adequacy and validity of procedures for monitoring and auditing internal risks and the effectiveness of the internal control and risk management system.</p> <p>Protection of clients</p> <p>In providing wealth management services, banks have a general obligation of due care and diligence, and must observe the principle of meeting clients' interests (Article 4 of the <i>Interim Rules</i>), and follow the principle of integrity, diligence and honest disclosure (Article 5 of the <i>Sales Rules</i>).</p> <p><i>Client funds and assets</i></p> <p>Assets of individual investors are held in custody in similar terms than those required for WMPs. Accordingly, the bank must keep separate accounts for each portfolio that it manages. Further, as indicated in Principle 25, the custody function is undertaken by a separate department.</p> <p><i>Investor complaints</i></p> <p>A bank providing wealth management services must establish a customer complaint handling mechanism, promptly handle customer complaints and ensure that customers understand how to make a complaint and the complaint procedures (Article 5 of the <i>Notice on Relevant Issues Concerning Personal Financial Services</i> (CBRC [2008] No 47); see also Article 63 of the <i>Sales Rules</i>, which contains detailed requirements for the operation of the complaints system).</p> <p><i>Client information, know your client and suitability rules</i></p> <p>Banks providing wealth management services must establish a customer evaluation</p>
--	--

mechanism, and collect information so as to be able to understand clients' financial status, investment objectives, investment experience, risk tolerance and investment expectations before selling financial products to them (Article 2 of the *Notice on Issues Relating to Personal Financial Services* (CBRC [2008] No 47)).

More specifically, banks selling WMPs are required to undertake suitability obligations and follow the risk matching principle ("sell suitable products to suitable customers"). They may only sell a client a WMP with a risk rating equal to or lower than the client's risk tolerance, and are prohibited from misleading customers into buying products not matching their risk tolerance. Banks are required under Articles 24, 25 and 27 of the *Sales Rules* to:

- adopt appropriate methods to rate the risk of WMPs they intend to sell. The ratings must be categorized into at least 5 levels in terms of risk severity;
- assess the risk tolerance of clients and assign risk tolerance ratings to clients, including at least 5 grades in an ascending order;
- map the risk ratings of WMPs into clients risk tolerance ratings. The sales documentation of a particular WMP must clearly state the scope of suitable customers and restriction measures must be built into the sales system.

Minimum subscription amounts apply, with the minimum set according to the risk rating of the product (Article 38 of the *Sales Rules*): the minimum for lower risk products (risk level 1 or 2) is RMB 50,000; for medium risk products (level 3 or 4) RMB 100,000; and for higher risk products (level 5) RMB 200,000. As per current regulations, banks must make sure that when signing a contract that clients acknowledge that they understand the risks by signing the corresponding risk statement letter.

By Article 31 of the *Sales Rules* a bank must evaluate the risk tolerance of private banking client and high-net-worth individuals when providing services in connection with WMPs.

Conflicts of interest

Article 47 of the *Risk Management Guidelines* requires banks to take sufficient measures to keep separate different departments so as to avoid damaging the interests of customers through conflicts of interest.

More specifically:

- the wealth management activity of a bank must be segregated from its proprietary banking business;
- WMP activity must be segregated from a bank's other asset management business;
- each WMP must be segregated from other WMPs;
- the assets of WMP clients must be segregated from banking assets.

Records

Article 10 of the *Risk Management Guidelines* requires a bank to keep complete records of its wealth management services activity. Article 37 of the *Interim Rules* requires banks to keep records of customer information and assessments and their consultancy services. Banks must also keep records (including documents and sound recordings) relating to the

	<p>sales process of WMPs (Article 65 of the <i>Sales Rules</i>).</p> <p><i>Disclosure to clients</i></p> <p>Article 21 of the <i>Interim Measures</i> must sign a contract with a wealth management client that sets out the rights and obligations of both parties. Article 8 of the <i>Risk Management Guidelines</i> requires a bank to guarantee the contract has been fully authorized by the customer and reconfirm contracts at least annually.</p> <p><i>Reports to clients</i></p> <p>Where a client holds financial products issued by the bank, the bank must prepare and make available to investors quarterly financial statements containing information about market performance and other relevant material (Article 29 of the <i>Interim Measures</i>). During the life of the product a bank must provide customers with statements of account including the client's asset holdings, income and expenses and the value of assets at the end of the period at least monthly (Article 28 of the <i>Interim Rules</i>).</p> <p>On termination of a WMP, or upon payment of investment proceeds, a bank must provide holders with detailed information on the WMP investments and corresponding proceeds. Information to be disclosed includes the types of assets invested in, investment portfolio, proportion thereof, sales fees, custodian fees, investment management fees, and proceeds attributable to customers (Article 30 of the <i>Interim Rules</i>; Article 22 of the <i>Sales Rules</i>.)</p> <p><i>Information about remuneration</i></p> <p>Where a client purchases a WMP, the sales documents must set out the fees to be charged. If the bank changes the fees, the investor has the right to early redemption of his or her interest (Article 21 of the <i>Sales Rules</i>).</p> <p>Direct Electronic Access</p> <p>Not relevant to banks' wealth management services.</p> <p>Supervision</p> <p><i>Off-site review</i></p> <p>The reporting obligations described under Principle 24 in relation to WMPs that are CIS also apply to other WMP activity.</p> <p><i>On-site inspections</i></p> <p>As noted under Principle 24, the CBRC conducts on-site inspections of banks' WMP activities. Thematic inspections were undertaken in 2014 with a focus on WMPs' risk ratings, liquidity management, corporate bond management, statistics etc.); in 2015 with a focus on internal controls and supervision to prevent non-compliant and illegal conduct; and in 2016 with a focus on checking that appropriate steps had been taken to implement changes required as a result of the 2014 examinations.</p> <p>Market participants commented that these inspections were thorough and that the CBRC had required a number of changes to be made to their business operations as a result of them. These included changes to sales and marketing practices.</p>
Assessment	Broadly Implemented
Comments	The grade factors in challenges in both regimes as detailed below.

	<p>Regime for securities intermediaries under the CSRC</p> <p>The legal framework is robust. In particular, the assessors note the obligation of auditors to provide an opinion on the companies' assessment of their internal controls and risk management, which adds to the system of supervision. They also note the existence of robust systems to protect investors' assets both in the cash and futures markets. Finally they note the recent approval of a unified system for suitability obligations that applies now to both the cash and securities markets.</p> <p>In the end, regulation is as strong as its supervision and enforcement. In this regard, KQ 19 requires the regulatory authority to have a supervisory program that seeks to monitor intermediaries' compliance with their obligations. The CSRC has implemented a supervisory program that is based both on off-site monitoring and on-site inspections. The assessors note that the combination of centrally mandated inspections and the on-site inspections carried out at the initiative of regional offices (which include risk-driven, random and for-cause inspections) results in a significant number of inspections being conducted. Market participants informed the assessors that they were conscious of the likelihood that they may be subject to on-site inspections at any time. The assessors also note that, as well as being subject to CSRC inspections, regulated entities are also subject to on-site inspections by the SROs. Although the focus of SRO inspections is on compliance with SRO rules, these rules often reflect legislative or CSRC rules in a more granular form, and so SRO inspections add to the overall intensity of supervision. Similarly, on-site inspections by the stock and futures exchanges, focused on compliance with exchange rules, add to the degree of supervision.</p> <p>As indicated in Principle 12, the question is whether in light of the current market structure a more intense program of monitoring, in particular on-site inspections might be required. A more intense level of supervision is warranted for securities firms, given their more complex business models. This is in line with concerns in the market about the need to continue strengthening the internal controls and risk management of securities firms. Such additional intensity could be achieved in different ways. For example, by putting a segment of the population (based on their risk assessment) on a schedule of regular reviews, along with strengthening of thematic inspections to address the potential for clusters of small risks. In this context, the CSRC should consider whether a more structured approach to the identification of themes could be implemented, potentially linked to the process for emerging risk identification. In addition, given the large proportion of retail investors, distribution agents (including fund managers in the provision of this function) should also be closely monitored, in particular by the implementation of suitability requirements. The assessors are aware that this is already an area of focus of the CSRC, for example, in the context of MFs (as noted in Principle 24) and of the OTC markets (as noted in Principle 33).</p> <p>The assessors note the interest of the authorities to further develop the futures markets, which in turn may require changes in the business models of futures companies. As a result, the intensity of supervision for futures companies would also need to be adjusted. In line with this, as the industry develops the CSRC should consider whether a more systematic process for the risk assessment of futures companies is also needed.</p> <p>Finally the key concern relates to the effectiveness of enforcement and whether enforcement measures that are being taken are sufficiently vigorous to affect the behavior of securities intermediaries. These issues have been further discussed in Principle 12.</p> <p>Regime for the provision of asset management services by banks under CBRC</p> <p>The key concern relates to KQ 19 of the methodology. As indicated in the description, there are strong internal controls and risk management requirements applicable to banks</p>
--	---

	<p>in the provision of intermediary services (asset management). Obligations regarding suitability are strong, and there are obligations in place concerning the need to establish compliance systems.</p> <p>Furthermore, there is evidence that the CBRC has in place a supervisory program for WMPs activities of banks. Further market participants indicated that such program, and in particular on-site inspections have become stricter over the last few years. The key question is whether the intensity of the program is sufficient. In this regard, the high level regulatory framework for WMPs relies heavily on the effectiveness of the systems and processes adopted by banks to comply with regulatory requirements, This fact, combined with a still evolving practice concerning private and public enforcement, seems to require a higher use of on-site inspections than what is currently conducted.</p>
Principle 32	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>Plans for dealing with failure of regulated firm</p> <p>The CSRC has plans and procedures for dealing with the failure of securities companies and futures companies. The framework for these processes is set out in the <i>Regulations on Handling of Risks of Securities Companies</i> and the <i>Measures for the Administration of Risk Control Indicators of Futures Companies</i>.</p> <p>Early warning</p> <p><i>Securities companies</i></p> <p>The early warning mechanisms described under Principle 30 require securities companies to report to the CSRC if net capital or other risk control indicators fall below or are above prescribed thresholds. A securities company must also report to the CSRC if the net capital or other risk control indicators changes by more than 20 per cent compared with the previous month.</p> <p>The CSRC's information systems for the supervision of intermediaries receive monthly reports on net capital, risk capital reserves and the monitoring of risk control indicators. If these reports show that a securities company is failing to meet regulatory requirements, the system issues an early warning.</p> <p><i>Futures companies</i></p> <p>The CSRC has set early warning thresholds for net capital of futures companies as described under Principle 30. Where risk control indicators of a futures company fail to meet requirements or exceed the early warning thresholds, the company must provide a report to the CSRC. In addition, if the ratio of net capital to risk capital reserves changes by more than 20 per cent compared with the previous month, the futures company must submit a written report to the CSRC.</p> <p>Also, as indicated in Principle 31, the CFMMC carries out daily verifications of customers' margins. If any irregularity is discovered, it must be promptly reported to the CSRC.</p> <p>Regulator's powers to intervene</p> <p><i>Securities companies</i></p> <p>As noted under Principles 29 and 30, the CSRC has extensive powers of intervention to deal with at-risk securities companies. Article 150 of the <i>Securities Law</i> gives the CSRC power, among other things, to restrict or suspend activities. Article 70 of the <i>Regulations on the</i></p>

	<p><i>Supervision and Administration of Securities Companies</i>, gives it the power to replace directors, supervisors or senior managers, to temporarily take over the securities company and conduct an investigation, to suspend part or all of the company's business or branches, or to order the closing-down of a branch.</p> <p>Article 153 of the <i>Securities Law</i> provides that, where a securities company's illegal operation or any major risk associated with the company seriously disturbs the order of the securities market or injures the interests of the investors, the CSRC can take such supervisory measures as suspending the company's business for rectification, designating another institution to assume trusteeship of the company or to take it over, or cancelling the company.</p> <p>Under Article 6 of the <i>Regulations on Handling of Risks of Securities Companies</i>, if the CSRC detects any major risk at a securities company, it can dispatch an on-site working group for risk monitoring to conduct targeted inspection on the securities company, monitor the business operation and management activities of the company relating to transfer of funds, disposal of assets, deployment of personnel, use of the seals, and conclusion and performance of contracts. The <i>Regulations</i> also provide that, where a securities company is ordered to suspend its brokerage business for rectification, the company can entrust its business to a securities company recognized by the CSRC or transfer its clients to other securities companies within a prescribed time. If the company fails to do so, the CSRC itself can transfer the clients to designated securities companies.</p> <p>The <i>Regulations</i> provide rules for where the CSRC makes a decision to take over a securities company. These include a requirement that there be a takeover group consisting of professionals to operate and manage the process. Where the securities company is to be cancelled, a group of specialized intermediaries, including law firms and accounting firms, (a liquidation group) must be formed to carry out administrative settlement of the securities company.</p> <p><i>Futures companies</i></p> <p>The CSRC can take compulsory measures against futures companies experiencing material risks. Under Article 56 of the <i>Regulations on the Administration of Futures Trading</i>, if a futures company engages in any business in violation of the law or causes a material risk to arise in the business and thus severely disrupts the order of the markets or jeopardizes the interests of its clients, the CSRC can order the company to suspend its business for rectification or appoint another institution to exercise guardianship over, or take over, the company. Measures may also be taken against directors, supervisors and senior managers who are in charge and the other persons who are directly responsible.</p> <p>Article 21 of the <i>Regulations on the Administration of Futures Trading</i> requires a futures company, before its business license is revoked, to settle relevant futures business and return margins and other assets to clients. Branches must terminate their business operations and properly handle their clients' assets before their licenses are revoked.</p> <p>Use of powers</p> <p>The CSRC made extensive use of its powers to manage the failure of securities companies in the period from 2003 onward. A total of 31 high-risk companies were subject to the CSRC's powers to suspend business operations, place a company under the trusteeship of another company, order the company to be taken over, to cancel the company or put it into liquidation. A total of 26 companies went into bankruptcy and liquidation. Other</p>
--	--

companies continued their operations after funds injections from the government.

In this process, 11.53 million accounts were sorted out, more than seven million clients were transferred, and RMB 12.1 billion of individual debt claims were compensated for.

There have not been major failures since 2008.

Investor compensation—securities companies

SIPF was established with the approval of the SC in September 2005. It was funded initially by an injection from the SC through the MoF. It is now funded through fees based on transactions taking place on SSE and SZE, fees paid by securities companies (ranging from 0.5 to 5 percent, with the amount varying according to the relative risk of a company), interest earnings on escrow accounts of issuers of equities and bonds and recoveries from the liquidation of failed securities companies.

Under the *Measures for the Administration of Securities Investor Protection Fund*, SIPF's role includes indemnifying creditors of a securities company if the company is cancelled, closed, goes into bankruptcy, or is subject to compulsory regulatory measures of CSRC including administrative takeover or management by an administrator.

Two types of compensation for losses are available through SIPF:

- losses in the settlement account of the failed company (loss of margin). These are paid in full to all investors who suffer losses of this kind, including individuals and institutions;
- losses incurred by individuals as a result of the company's failure, such as losses other than investment losses from an individual portfolio management account. Losses of this kind are paid in full up to a limit of RMB 100,000, and a discount is applied to compensation for any losses above that amount.

In practice, the liquidation group of the failed company approaches SIPF when it has established that there have been compensable losses. SIPF operates on a "compensation first and recourse later" principle by acquiring claims from individual investors, paying compensation and then becoming a creditor in the company's bankruptcy proceedings.

Investor compensation-futures companies

Futures companies must, in accordance with rules of futures exchanges, contribute to a clearing guarantee fund and maintain the minimum balances required by the special purpose funds (including the settlement reserve) to ensure that their clients can trade as normal.

Clients of futures companies who suffer losses of margins as a result serious violations, misconduct or poor risk management by a futures company are entitled to claim from the Futures Investor Protection Fund. The Fund is funded by futures exchanges and futures companies. Prior to December 2016, futures exchanges contributed 3 per cent of their commission to the Fund and futures companies contributed five to ten ten-millionths of the value of their brokerage transactions. After December 2016, pursuant to the newly amended *Interim Measures for the Administration of Futures Investor Protection Fund* the figures will be changed to 2 per cent for futures exchanges and five to ten hundred-millionths for futures companies. CFMMC is responsible for operating the Fund. Futures investors can request compensation by the Fund for margin losses they have suffered (but not for losses investors due to market fluctuations or changes in the value of investment products). Under the *Interim Measures*, an individual investor may be compensated by the

	<p>Fund for 100 per cent of the portion of margin loss at or below RMB 100,000 and 90 per cent of the portion above RMB 100,000; for an institutional investor, those percentages are 100 per cent and 80 per cent, respectively.</p> <p>Communication and cooperation with other regulators</p> <p>The <i>Regulations on Handling of Risks of Securities Companies</i> requires the CSRC to establish coordination and quick response mechanisms for handling risks in securities companies, in collaboration with the PBoC, MoF, the public security department and other financial regulatory authorities under the SC, as well as with provincial governments. The Policy rules relating to the operation of SIPF were formulated jointly by the CSRC, the MoF and the PBoC.</p>
Assessment	Fully implemented
Comments	<p>The CSRC has established processes for dealing with the failure of intermediaries. These processes were developed and tested in practice in the period between 2003 and 2008, when a significant number of securities companies failed. Since that time, there have not been any significant failures of securities firms.</p> <p>Early warning systems are in place, and the CSRC has power to take action both before a default occurs and during the process of winding down a failing firm. Issues related to the timeframe of notification for the early warning system have been taken into consideration for the grade of Principle 30. Retail clients of a failed firm have the right to claim compensation for losses resulting from the failure, from SIPF (for securities) or the Futures Investor Protection Fund (for futures).</p>
Principles for the Secondary Markets	
Principle 33	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>Trading systems requiring authorization</p> <p><u>Securities markets</u></p> <p>The establishment or dissolution of a stock exchange is a decision taken by the SC. Article 102 of the <i>Securities Law</i> and articles 6 and 9 of the <i>Measures for the Administration of Stock Exchanges</i> require applications for approval to be examined and verified by the CSRC before the SC makes a decision. Only approved stock exchanges are permitted to use the term "stock exchange" or similar words.</p> <p>The NEEQ market was established with the approval of the SC.</p> <p><u>Futures markets</u></p> <p>Article 4 of the <i>Regulations on the Administration of Futures Trading</i> requires futures trading to be conducted only on legally established futures exchanges or other venues authorized by the CSRC. Under Article 6, the CSRC examines and approves futures exchanges. No entity or individual is permitted to establish futures exchanges or organize any forms of futures trading or related activities without approval of the CSRC.</p> <p>General registration requirements</p>

Securities markets

The CSRC's *Measures for the Administration of Stock Exchanges* set out detailed requirements for the establishment of stock exchanges, and their functions, including the function of regulating securities trading, stock exchange members and listed companies.

Stock exchanges must obtain the CSRC's approval to formulate or amend their constitutions or rules and regulations on listing, trading, and member management (Articles 103 and 118 of the *Securities Law* and Article 15 of the *Measures*). The general manager of a stock exchange is appointed by and dismissed by the CSRC (Article 107 of the *Securities Law*).

Similarly NEEQ must obtain the CSRC's approval before formulating or amending its constitution, changing the composition of its board of directors or board of supervisors, or formulating or changing the rules of procedure of the board of directors or board of supervisors. In addition, the chairman and vice chairmen of the board of directors, chairman of the board of supervisors and senior managers of NEEQ are nominated by the CSRC (Articles 15 to 19 of the *Interim Measures for the Administration of National Equities Exchange and Quotations Co., Ltd. (NEEQ Interim Measures)*).

In addition, the CSRC has the power to require stock exchanges and NEEQ to amend their constitutions or business rules (section 89 of the *Measures for the Administration of Stock Exchanges*).

The *Securities Law* and the *Measures for the Administration of Stock Exchanges* set out the information that must be provided to the CSRC to support an application for approval as a stock exchange. This includes the proposed constitution and rules; proposed members; candidates for the board of directors and their CVs; descriptions of the venue, facilities and availability of funds; and information on proposed managers. To be approved, the applicant must demonstrate, among other things, that it has the necessary regulatory capacity and recordkeeping and information management capability.

Article 10 of the *Measures* requires exchanges to provide an open, fair and equitable environment to ensure the normal operation of the securities market. The *Measures* include obligations for stock exchanges to regulate securities trading, members and listed companies. There are also obligations to provide investors with fair and equitable opportunities in opening accounts and accessing market trading; to provide safeguards for equitable and centralized trading; and to provide access to quotes and market information.

The *NEEQ Interim Measures* contain detailed requirements for the functions and organizational structure of NEEQ, and its regulatory role in supervising securities transfers, listed companies, chief agency brokers (market makers) and other securities service institutions and personnel. NEEQ must also obtain the CSRC's approval before adopting new share transfer methods. Suitability criteria for, and the percentage of shares that can be held by, shareholders as well as changes to capital must comply with the CSRC's requirements. NEEQ has obligations to maintain an open, fair and equitable market environment, ensure normal operation of NEEQ, and provide quality, efficient and low-cost financial services to all participants (Article 5 of the *NEEQ Interim Measures*).

Futures markets

The CSRC's *Measures for the Administration of Futures Exchanges* set out standards for the establishment and organizational structure of futures exchanges and for the content of their core business rules. The CSRC exercises its authority over futures exchanges by reviewing and verifying their constitutions, business rules, self-regulatory rules, executives' qualifications and trading systems and by confirming their operating capabilities through

these review and verification processes. Article 10 of the *Regulations on the Administration of Futures Trading* requires a futures exchange to establish rules and regulations designed to strengthen risk control over trading activities and regulation of members and employees. Article 11 provides that a futures exchange must establish specified risk management systems, including a margin system, a daily mark to market system, a price limit system, a position limit system and large position reporting system, a risk reserve system, and other risk management systems as may be required by the CSRC. The person-in-charge of a futures exchange is appointed and dismissed by the CSRC (Article 7).

Article 3 of the *Regulations on the Administration of Futures Trading*, futures trading must be carried out in line with the principles of openness, fairness, equitability, integrity and trustworthiness. Fraudulent behavior, insider trading, manipulation of futures prices and other unlawful acts are prohibited.

Prudential requirements and clearing and settlement arrangements

Securities markets

The CSDC, established under Chapter VII of the *Securities Law* and approved by the SC and the CSRC, is responsible for providing clearing, settlement and registration services for the markets operated by SSE, SZE and NEEQ. The CSDC is a CCP for the cash markets operated by the SSE and the SZSE.

For SSE and SZSE, prior to entering an order into the system, clients must deposit the securities or cash. For securities, the CSDC is able to see all clients' holdings given the "see through" nature of the system. As for cash, clients are required to post all required money to meet their obligations in the deposit bank. Brokers are required to check and so are the deposit banks. The Securities Investor Protection Fund can also see each investor cash account. This system of cash verification is currently not in place for proprietary trading nor for institutional clients; however, rules are under preparation to extend the system to all transactions. This extension was prompted by an incident that took place in 2013, with a "fat finger" transaction.

Pursuant to the regulatory framework, the CSDC must establish adequate risk management controls. Such risk management includes:

- **Strict access criteria:** Relevant rules establish minimum criteria for clearing members, including capital requirements. As per such criteria, there are two types of clearing members (A or B) depending on whether they can clear transactions of others or not. Such rules provide the CSDC with the authority to conduct off and onsite monitoring of members. In practice, The CSDC conducts offsite monitoring via the review of the periodic reports on their financial position. It has also instituted a program of on-site inspections,
- **Settlement reserve fund mechanisms:** Pursuant to current rules, clearing members must keep a minimum ratio of settlement reserve funds in settlement accounts that they must keep with the CSDC, determined according to the risk level of each clearing participant (which is largely based on the gross amount of securities purchased). The amount is updated on a monthly basis. Once a clearing participant is deemed as high-risk participant, the CSDC has the right to raise its minimal quota of settlement reserve funds at any time.
- **Settlement collateral mechanism:** in addition, under Article 56 of the Measures for the Administration of Securities Registration, Clearing and Settlement, the CSDC can, based on the risk profile of a clearing participant, adopt risk control measures

such as requiring the participant to provide settlement collateral.

- Monitoring of large holdings: as will be further explained in Principle 37, the CSRC requires exchanges to closely monitor investors who have large holdings.
- Mutual guarantee fund mechanism: Clearing members are required to contribute to it, also based on their level of activities in the market.
- General risk reserve fund: articles 163 and 164 of the Securities Law require the CSDC to establish a risk fund, which is designed to cover CSDC's losses resulting from settlement defaults, technical failures, operating errors or force majeure. This fund is financed by the CSDC's revenues and profits, and clearing participants may also be required to contribute in proportion to their securities trading volumes.

As for settlement banks, the CSDC manages its risks also by establishing criteria and using multiple settlement banks.

In addition, in regard to the risks faced by the clearing members vis-à-vis the brokers, the capital requirements of the brokers include a concentration ratio that requires additional capital if concentrated positions are held in equity securities (more than 10 percent) or a non-equity (more than 20 percent).

CSDC staff informed also that the CSDC and the exchanges have currently under consideration a joint rule that would impose a maximum cap on trading activity for brokers based on their net capital.

Futures markets

Pursuant to Article 10 of the *Regulations on the Administration of Futures Trading*, clearing and settlement of futures markets is carried out by clearing and settlement facilities established as separate departments of the futures exchanges. They operate as CCPs. There are several mechanisms in place through which the exchanges as CCPs manage clearing and settlement risk:

- Access criteria: similar to the securities exchanges, futures exchanges are required to establish access criteria for clearing members. They are also required to conduct monitoring of clearing members, via offsite reporting and on-site inspections. In practice the exchanges conduct off-site monitoring via the review of members' financial reports and have instituted a program of on-site inspections.
- Margin requirements: pursuant to the regulations, exchanges must establish margin requirements with respect to a futures contract in accordance with the size of open interests in that contract. The system requires "pre-margin", i.e. clearing members are required to post margins in advance of the trades. As indicated in Principle 31, clients' margins are held in separate individual accounts at deposit banks. The current regulatory framework allows for the imposition of intraday margins, as well as for the exchanges to set different margins on an individual basis as per the risk of a particular clearing member. The assessors understand that the latter option has been used by the exchanges.
- Mark to market of positions.
- Position limits: as will be further explained in Principle 37, exchanges are required to set position limits for each contract. Exchanges can adjust the position limits of

members and clients with respect to each listed product and contract based on market conditions, and adjust the position limits of a futures company member based on its net assets and state of operations. For any non-futures company member or client whose open interests have exceeded the applicable position limit, the exchange concerned may unilaterally liquidate the excess positions in accordance with relevant provisions.

- Mutual guarantee fund: A general risk reserve fund that requires a futures exchange to accrue 20 per cent of its income as risk reserves.

Market surveillance, member supervision, dispute resolution and appeal procedures

Securities markets

Under Articles 84 and 115 of the *Securities Law*, stock exchanges must exercise real-time monitoring of securities trading and report suspected irregularities to the CSRC. Securities companies, the CSDC and other securities services institutions that identify prohibited behavior in securities trading must immediately report it to the CSRC. Article 27 of the *NEEQ Interim Measures* stipulates that NEEQ must take timely regulatory actions against any violation of laws, regulations or business rules, and promptly report to the CSRC breaches of specified regulatory requirements or serious violations.

Under stock exchange rules, members have an obligation to report to the exchange if any client is suspected of trading in violation of the rules or regulations.

Article 30 of the *Measures for the Administration of Stock Exchanges* requires stock exchanges to formulate specific rules for the resolution of trading disputes and for the handling of trading rule violations. Articles 126, 127 and 128 of the *Detailed Rules for Stock Transfer on the National Equities Exchange and Quotations System* provide for the resolution of disputes between chief agency brokers and their clients.

Pursuant to these provisions the exchanges have established departments dedicated to market surveillance as well as arrangements for the investigation of violations and the imposition of disciplinary sanctions as will be further explained in Principle 36.

Futures markets

Article 10 of the *Regulations on the Administration of Futures Trading* makes futures exchanges responsible for, among other things, supervising trading on their markets and their members. Similar to securities exchanges, members also have the obligation to report to the exchange if any client is suspected of trading in violation of the rules and regulations.

Article 94 of the *Measures for the Administration of Futures Exchanges* provides that futures exchanges are required to formulate measures for the investigation and punishment of breach of their trading rules or implementing rules, and submit these measures to CSRC for approval. Futures exchange are required to promptly investigate and punish members and their clients, certified delivery warehouses, futures margin depository banks, and other participants of the futures market for any violation of futures trading rules within the scope of the exchange's measures, and report violations outside the scope of those measures to the CSRC. All futures exchanges provide for the resolution of disputes in their constitutions, trading rules and implementing rules.

All futures exchanges have a supervision department and a market monitoring systems and functions. The CFMCC receives direct feeds from all the futures exchanges' monitoring systems, and therefore has information on activity on all exchanges. It is also responsible

for the account opening process for futures clients and assigns a unique number to each individual client and can therefore monitor a client's trading on all futures exchanges. Exchanges and the CFMCC must report any suspected noncompliant and irregular behavior in trading activities to the CSR.

Technical system standards

Securities markets

Pursuant to Article 22 of Chapter 5 under Information Technology and Information Security Working Rules of CSRC (CSRC General Office Announcement [2014] No. 44), stock exchanges, futures exchanges, and CSRC affiliated institutions should report to the IT security authority and related CSRC functional departments 15 working days before the up and run of core business systems, major upgrade and changes, and equipment migration that could affect market operations.

Article 13 of the Provisions on the Reporting System of Stock Exchanges (Tentative) requires a stock exchange to report immediately to the CSRC if any fault with the trading or communication system results in all or some securities business departments being unable to receive real-time market data or trade normally; or if there is an unexpected event or irregularity that affects the normal operation of the exchange.

In addition, securities exchanges are required to conduct an annual independent assessment of their IT.

Securities exchanges are required to have recovery centers and in practice both SSE and SZSE have established local recovery centers. The SSE has also implemented remote data-level disaster recovery. Remote application-level disaster recovery is still under planning and discussion. A remote disaster recovery center for SZE is in the process of access testing.

As for the NEEQ, it currently has a data recovery system. The proposal for a local disaster recovery center has been developed, and is now under regulatory review. But the remote recovery center has not been listed on the agenda.

Futures markets

As indicated above, similar to stock exchanges, futures exchanges must report to the IT security authority and related CSRC functional departments 15 working days before the up and run of core business systems, major upgrade and changes, and equipment migration that could affect market operations.

The CSRC has developed technical standards for futures trading systems, requiring all futures exchanges to establish a disaster recovery center to record and preserve the system data and clearing and settlement records.

In addition, the *Contingency Plan for the Resolution of Material Technical Failures in the Securities and Futures Information Systems*, formulated by the CSRC and amended annually, provides mechanisms for coping with material technical failures in the trading system that could result in the market suspension of securities and futures exchanges.

Futures exchanges must report immediately to the CSRC any irregularity that affects normal trading (Article 12 of the *Regulations on the Administration of Futures Trading*).

In addition, similar to securities exchanges, futures exchanges are required to conduct annual independent reviews of their IT systems.

Ability to deal with disorderly trading conditions

	<p><u>Securities markets</u></p> <p>Article 114 of the <i>Securities Law</i> and the <i>Measures for the Administration of Stock Exchanges</i> provide that where an unexpected event has affected the normal course of securities trading or has triggered material abnormal trading activities, the stock exchange can order a technical suspension, a market suspension or a trading restriction on specified securities accounts. Further, the CSRC's <i>Contingency Plan on Securities/Futures Market Emergencies</i> provides that, in the event of abnormal trading or emergencies, the stock exchange can, among other measures, impose trading restrictions on certain accounts, suspend trading or suspend the market, or report the matter to the CSRC.</p> <p>There are currently no circuit breakers or other volatility management mechanisms in place for the stock exchanges. A review is being conducted of the market events of 2015 and early 2016, but this review is not yet complete.</p> <p>Trading is, however, subject to daily price limits. The price limit for single stocks is +/- 10 percent and for "special treatment" stocks +/- 5 percent. These limits do not apply to IPO stocks or stocks resuming trading after a suspension. Orders outside price limits will be rejected by the trading system.</p> <p>Stock exchange <i>Trading Rules</i> and <i>Options Trading Rules</i> permit the stock exchanges to adopt measures to manage risks in the market including: voiding or cancelling orders; adjusting margin rates; imposing contract price limits; mandating contract settlement prices; adjusting position limits for options trading; restricting options trading; ordering options trading institutions or investors to close positions; and cancelling transactions. Stock exchanges have adopted <i>Detailed Rules for the Resolution of Trading Irregularities (Tentative)</i> dealing with three major categories of irregularities: force majeure, chance events and technical failures.</p> <p>Articles 26 and 27 of the <i>NEEQ Interim Measures</i>, Section 3 of Chapter III of the <i>NEEQ Business Rules</i> and other self-regulatory rules specify that, in case of abnormal stock transfers, NEEQ may adopt measures including suspending shares transfer or restricting trading in specified securities accounts, and reporting the situation to the CSRC.</p> <p><u>Futures markets</u></p> <p>Article 12 of the <i>Regulations on the Administration of Futures Trading</i> provides that, in case of irregularities in the futures market, a futures exchange can, in accordance with its rules, adopt emergency measures including trade suspension. Irregularities must be immediately reported to the CSRC. Article 88 of the <i>Measures for the Administration of Futures Exchanges</i> defines the circumstances in which trading irregularities can be declared to have occurred. Article 104 of the <i>Measures</i> permits the CSRC to adjust the standards for the collection of margins by futures exchanges to reflect market conditions and to suspend, resume or cancel the trading of individual futures products. Article 105 permits the CSRC to impose a wide variety of measures if it identifies irregularities on the futures market. For example, it can postpone market opening, suspend trading or require early closing.</p> <p>The trading rules of the futures exchanges also set out the circumstances where irregularities can be declared and procedures for dealing with them. Where irregularities occur, a futures exchange can take a variety of measures including: adjusting price limits; increasing margins; changing the opening or closing times; suspending trading; raising margins; and requiring positions to be reduced or closed out.</p> <p>Similar to the securities market, price limits also apply to the futures exchanges. In addition, position limits exist which vary according to the product.</p>
--	--

Record-keepingSecurities markets

Stock exchanges, CSDC and securities companies conducting brokerage business must keep trading, clearing and agency records and keep important documents for no less than 20 years (Articles 44, 140, 147 and 162 of the *Securities Law* and Article 37 of the *Measures for the Administration of Stock Exchanges*). Pursuant to requirements of the *Information System Audit Standard for Securities and Futures Industry* (CSRC Announcement [2014] No. 58), NEEQ has made rules for keeping backup data from its trading support platform for 20 years. Additionally, in its self-regulatory rules, NEEQ requires chief agency brokers to preserve client instructions and transaction data for no less than 20 years. Stock exchanges, securities registration and clearing institutions are obliged to keep the confidentiality of information relating to individual investors.

Futures markets

Article 38 of the *Regulations on the Administration of Futures Trading* requires futures exchanges, futures companies and non-futures company clearing members to maintain complete data and records of futures trading, clearing and delivery. Article 92 of the *Measures for the Administration of Futures Exchanges* requires futures exchanges to preserve futures trading, clearing and delivery records for not less than 20 years. The constitutions of the futures exchanges require that confidential information, such as individual trading data, must not be disclosed.

Delegation and outsourcing

Article 37 of the *Measures for the Administration of Information Security Protection in Securities and Futures Industry* requires that that, in any procurement contract for software products or technical services relating to securities and futures trading, market data, account opening or clearing and settlement, the supplier must be contractually obliged to submit to information security inspections by the CSRC.

Article 8 of the *Measures for the Reporting, Investigation and Resolution of Information Security Incidents in Securities and Futures Industry* stipulates that key institutions, securities and futures companies, hardware and software suppliers and technical service providers involved in an information security incident must cooperate with the CSRC in the investigation and resolution of the incident.

Admission of products for tradingSecurities markets

Chapters II and III of the *Securities Law* and the rules of stock exchanges and NEEQ contain detailed requirements concerning the admission to listing of different products.

Before listing and trading any securities, the stock exchanges must develop or modify their business rules and submit them to the CSRC for approval or authorization. In practice, for the listing of a new product, each stock exchange is required to develop corresponding business rules and submit them to the CSRC for approval. As a general procedure, stock exchanges assess potential new products with respect to market demand, legal, technical feasibility and risk prevention and control. The results of this analysis are provided to the CSRC. As part of such analysis the exchanges must establish suitability requirements for investors to trade in these products. In this regard, while equity products are open to retail investors, bond products have minimum requirements (quantitative thresholds and in some cases experience requirements) that investors must meet to be able to trade in them.

	<p>Article 9 of the <i>NEEQ Interim Measures</i> provides that NEEQ must formulate essential business rules on the listing and transfer of stocks and the management of chief agency brokers, listed companies, and investor suitability. NEEQ must obtain the CSRC's approval for adopting or modifying essential business rules.</p> <p><u>Futures markets</u></p> <p>Article 13 of the <i>Regulations on the Administration of Futures Trading</i> requires a futures exchange to obtain the approval of the CSRC to formulate or amend its constitution or trading rules; or to list, suspend, cancel or resume the trading of a futures product.</p> <p>The CSRC, when reviewing for approval the listing of new exchange-traded futures products, takes into consideration market demand, legal and technical feasibility and risk prevention and control, and consults with any relevant departments under the SC. For commodity futures products, the CSRC has issued guidance on product design, including requirements that a new futures product must serve the needs of the national economy, assist the development of the spot market, and that the underlying spot market must be sophisticated and not be subject to price controls. These requirements are further operationalized in such guidance. In addition, similar to the exchange markets, futures exchanges must establish suitability requirements for investors to trade in the products.</p> <p>Admission of market participants</p> <p><u>Securities markets</u></p> <p>Articles 10 and 34 of the <i>Measures for the Administration of Stock Exchanges</i> require stock exchanges to provide an open, fair and equitable trading environment to ensure normal operation of the securities market and equal trading opportunities and equal access to market information and protection for all investors. Article 5 of the <i>NEEQ Interim Measures</i> prescribes that NEEQ must place public interest first, maintain an open, fair and equitable market environment, ensure normal operation of NEEQ, and provide quality, efficient and low-cost financial services to all participants.</p> <p>The membership rules of SSE and SZE set out specific requirements for membership management, providing that all securities companies meeting the stock exchanges' qualifications can apply for membership and participate in fair and equitable trading. NEEQ's <i>Detailed Rules on Stock Transfer</i>, the <i>Detailed Rules on the Administration of Chief Agency Brokers</i>, and the <i>Provisions for the Administration of Market-Making Business</i> set out rules for regulating chief agency brokers and provide that all qualified securities companies can participate in market trading on an equitable basis.</p> <p><u>Futures markets</u></p> <p>Article 3 of the <i>Regulations on the Administration of Futures Trading</i> provides that futures trading must conform to principles of openness, fairness, equitability and good faith. The membership rules of the futures exchanges contain specific requirements for membership management, including the membership eligibility criteria, transfer and change of membership, and regulation and oversight of members. The constitutions and trading rules of the exchanges all require them to organize futures trading with integrity through an open, fair, and just regime, The CSRC considers fair and equitable participation in trading as a critical factor in reviewing and approving the rules of futures exchanges.</p> <p>Order routing and order execution procedures</p> <p><u>Securities markets</u></p> <p>Securities traded on China's stock exchanges are not cross-listed and trade on one</p>
--	---

exchange only.

Under Article 113 of the *Securities Law*, stock exchanges must ensure the fairness of the centralized trading of securities. Article 10 of the *Measures for the Administration of Stock Exchanges* requires stock exchanges to provide an open, fair and equitable trading environment to ensure normal operation of the securities market.

Article 5 of the *NEEQ Interim Measures* prescribes that NEEQ must maintain an open, fair and equitable market environment, ensure normal operation of NEEQ, and provide quality, efficient and low-cost financial services to all participants.

Trading on the stock exchanges is fully electronic. In practice the trading rules of SSE and SZE are similar in structure and content. Trading is through an opening call auction followed by a continuous auction. In continuous auctions, orders are executed on a price-time priority basis. The trading rules also contain rules for block trades and for bond repo transactions. They also provide for opening and closing prices, listing, delisting, suspension and resumption, ex-rights and ex-dividends, and so on. The trading rules and other business rules of the stock exchanges are posted on their official websites and are consistently applied to all participants. Chapter III of the *NEEQ Business Rules* and other self-regulatory rules contain general provisions for securities trading; rules for brokerage trading, order submission, execution, and opening price and closing prices relating to transfer of shares through agreement, market-making or auction; and rules for listing, delisting, suspension and the transfer of securities. The *Rules* also state that paperless stock trading must be adopted and that the business rules and the electronic trading system must ensure the fairness of the order execution programs. The *Detailed Rules on Stock Transfer* and other business rules of NEEQ are posted on NEEQ's website.

There are currently two ways to trade on NEEQ: "transfer by agreement" (that can be carried out by bilateral agreement, "click and trade" or by automated matching in which a price time priority process is used) or through market-makers (chief agency brokers). At a future stage, trading may also be by an open auction process. Currently, companies listed on NEEQ elect which of the two available trading mechanisms are to apply to trading in their securities. For companies using market-making, there must be at least two market-makers, and between 40 and 50 percent of trading on NEEQ takes place in this way.

Futures markets

The *Regulations on the Administration of Futures Trading* contain the requirements for all aspects of futures trading, including issuing of trade orders, trading methods and clearing and delivery. The rules of the futures exchanges set out principles for execution of orders. The constitutions and trading rules of the exchanges require them to organize futures trading with integrity through an open, fair, and just regime and to ensure the normal course of futures trading. The call auction observes the principle of maximum trading volume, and auction trading after the opening observes the principle of price-time priority, with the settlement price of commodity futures based on the Volume-Weighted Average Price (VWAP) of the day, and that of financial futures based on VWAP in the last hour of the day. Exchange rules are posted on their websites.

Access to market systems

Article 15 of the *Measures for the Reporting, Investigation and Resolution of Information Security Incidents in Securities and Futures Industry* stipulates that key institutions and securities and futures institutions must establish monitoring and warning systems for risks related to network and information security, confirm the existence and extent of potential

risks, adopt necessary preventive measures and promptly issue warnings and reports if the situation is serious.

Securities markets

All system users have equal opportunity to connect, and maintain connection to, the electronic trading system. Stock exchanges and NEEQ have specific rules for exchange participants and chief agency brokers dealing with connection privileges and requirements, and provide technical guidelines to help them connect to the trading system. Relevant rules and guidelines are publicly available and are consistently applied to all market participants. The response time for different links may vary, however, before an order enters into the trading system because of the differences in connection methods and configurations. SSE, SZE and NEEQ allow the connecting party to select the method for link connections.

Stock exchanges implement a range of pre-trade risk control measures including share adequacy checks, securities account compliance checks, trading unit capital controls, limits on the maximum size of brokerage orders and price limits for stocks. For options trading, stock exchanges also impose control measures based on the funds of and positions held by clearing participants to ensure the safe execution of transactions. NEEQ's rules prohibit short selling and impose front-end control measures to ensure that the risks related to trading activities are within manageable limits.

Futures markets

Articles 28 and 34 of the *Regulations on the Administration of Futures Trading* prescribe that futures exchanges must implement strict margin rules to prevent trading risks. Article 56 of the *Measures for the Supervision and Administration of Futures Companies* requires futures companies to verify the funds and positions held by clients before transmitting their orders. Futures exchanges and futures companies verify client funds and open positions pre-trade. In addition, exchanges limit the maximum number of orders from each trading seat, and orders beyond that limit are rejected. This is designed to prevent automated trading systems from dominating order flow at the expense of other market participants. Some futures markets also regulate the speed of order flow, limiting the number of orders that can be placed per second, both to control potential system stress and to control trader behavior.

Automated trading systems

The CSRC has developed proposals for the regulation of automated trading systems. The proposed rules:

- establish controls over how trades are executed (including by requiring brokers to have automated systems to prevent abnormal trades directly entering the exchanges' servers);
- prohibit certain types of trading activity (for example frequently placing and withdrawing orders where the ratio of trades concluded is abnormally low) and
- permit exchanges to set daily net purchase position controls over program trading by securities companies and their clients.

These rules have not yet been adopted. In the meantime, the CSRC has provided guidance to the exchanges to the effect that a high rate of order cancellations should be treated as market abnormalities, and therefore should be followed up by the market surveillance

	<p>teams and reported as appropriate to the CSRC.</p> <p>Access to trading information</p> <p><u>Securities markets</u></p> <p>Article 113 of the <i>Securities Law</i> provides that a stock exchange must release free real-time quotes and prepare and publish daily trading information. Entities or individuals are not entitled to release real-time quotes without the permission of the stock exchanges. Articles 31 and 32 of the <i>Measures for the Administration of Stock Exchanges</i> and Chapter V of both the SSE and SZE <i>Trading Rules</i> require that the stock exchanges provide market participants with real-time quotes and ensure equitable access by investors to these quotes and other publicly disclosed information. Article 11 of the <i>NEEQ Interim Measures</i> provides that NEEQ must safeguard fair stock transfers and release real-time market data relating to stock transfers. Other self-regulatory rules specify that NEEQ must release on each transfer day real-time market data on stock transfers, public information on stock transfers and other relevant information.</p> <p>The stock exchanges provide to members and publicly release post-trade information. On each trading day, they also publish the identity of the members that are highest ranked in terms of the value of securities purchased or sold.</p> <p><u>Futures markets</u></p> <p>Article 27 of the <i>Regulations on the Administration of Futures Trading</i>, a futures exchange must release, in a timely manner, information relating to each listed futures contract, including trading volume, trading price, position, price limits and opening and closing prices. Article 90 of the <i>Measures for the Supervision and Administration of Futures Companies</i> requires a futures exchange to publish the rankings of its members' trading volumes and positions. Where physical delivery of commodities is involved, the amount of standard warehouse receipts and available capacity must be disclosed. Under the futures trading rules, a futures exchange must adopt effective means of communication and establish synchronous quotation and real-time trade confirmation systems.</p> <p>Under the trading rules of futures exchanges, exchange members, clients and the public are provided with futures trading information on a real-time, daily, weekly, monthly and yearly basis. Real-time information about market activity is sent to trade seats through computer networks and released to the public through the public media and information services.</p>
Assessment	Fully implemented
Comments	<p>The treatment of other markets different from exchanges</p> <p>As indicated elsewhere for purposes of grading the assessment has focused on the exchanges. However the assessors recognize the growing importance of both the NEEQ market and the regional trading platforms. It is critical that these markets are run and supervised in a way that offers confidence to investors in the capital markets as a whole.</p> <p>In this context, the assessors acknowledge that the CSRC conducted inspections on the NEEQ market as well as inspections to monitor compliance by securities companies with the conditions of the NEEQ market. Such supervisory actions should continue, followed, if appropriate, by enforcement actions.</p> <p>As for the regional platforms, the assessors acknowledge recent improvements to the</p>

regulatory framework that will provide a larger role for the CSRC in their regulation and oversight. This is a welcome development. Thus, the CSRC should give priority to the development and implementation of the corresponding code of conduct and to the establishment of adequate mechanism for the oversight of these platforms, supported in strong reporting requirements.

In the long run, the authorities should consider the development of one single set of regulations for all non-exchange trading platforms. This should not prevent the authorities from establishing tiered requirements based on different criteria including the size, and importance of the market, and the type of investors to which they cater. These criteria could also be used to determine the markets that would be subject to direct supervision by the CSRC. For example, in some jurisdictions the securities regulator can exempt from registration markets that do not meet certain thresholds.

Criteria for authorization, IT reliability and risk management

The assessors note that in China the authorities have actively participated in the establishment of the exchanges (as well as other trading platforms). That does not detract from the existence of a series of legal and regulatory requirements that the exchanges need to meet. In general the criteria for authorization of exchanges are robust. That said, the assessors concur with CSRC staff that reliability of the IT systems is an issue that needs to be kept under strict monitoring.

In addition, it is important to note that the assessment of CCPs and their risk management mechanisms is not covered under the IOSCO assessment, rather under the Principles for Financial market Infrastructure (PFMI). The assessors encourage the CSRC to review in such context whether the imposition of intraday margins is needed and if so, whether recalibration of initial margins would be warranted.

Tools to deal with market disruption

In general the tools available to the exchanges and the CSRC to deal with market disruption and volatility are similar to those used in other jurisdictions, save for the fact that circuit breakers are not currently in place.

The assessors note that both the securities and futures markets have been the subject to periods of sharp volatility. In particular the equities markets suffered a period of market volatility in 2015 and early 2016. The circuit breakers that had been recently implemented were suspended as they were ineffective. There is no formal report on the causes of the market volatility. Market participants referred to different factors coming into play. One key issue appeared to have been the amount of leverage in the securities market not just through "formal" lending mechanisms such as margin trading, but also through off-market lending from non-bank third-party lenders. One market participant stated that lending from banks peaked at RMB 2.3 trillion, but that total leverage may have reached as much as RMB 5 trillion because investors had access to unofficial lending. Since then, the CSRC has taken a number of steps to curb excess leverage, including: (i) requiring securities companies to comply with new leverage ratios, that require both on- and off-balance sheet leverage to be taken into account; (ii) changing the margin financing rules by raising the limit from 30 per cent to 50 per cent; (iii) in cooperation with other authorities, combating the unofficial lending channels, through enforcement actions. Other steps are also being taken that may have an effect on market stability. These include, for example, the development of rules relating to high frequency trading.

Another factor in the 2015 market events was that, as market prices began to fall, a number of listed companies sought voluntary trading suspensions to prevent falls in their

	<p>stock price. The large number of such suspensions may have further contributed to downward pressure on prices. The CSRC is currently examining the rules relating to trading suspensions with a view to limiting this conduct in future. However, the structure of the market, in particular the fact that retail investors dominate trading makes these markets more speculative in nature and thus poses challenges to the management of volatility. In this context the authorities are encouraged to continue taking measures to promote further participation of institutional investors in the market.</p> <p>In regard to the futures markets, there have been concerns in recent times about the level of speculation and the fact that in some of these markets the prices do not seem to reflect the fundamentals of the underlying assets. The markets in coordination with the CSRC have dealt with these concerns via increases in initial margins, and fees, price limits, and trading limits –combined with measures already in place such as position limits. At times, trading has been suspended.</p> <p>Similar to the comments above, the assessors note that the market structure is a long term challenge. In such context, the assessors encourage the authorities to consider a package of measures to foster a larger participation of end users in the futures market. End users could have a key role in addressing price deviations via arbitrage. Such measures could potentially include differentiated initial margins, differentiated fees, but they should also take into consideration issues such as the availability of credit lines for them, obviously under robust credit assessments.</p>
<p>Principle 34</p>	<p>There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p>
<p>Description</p>	<p>Market surveillance</p> <p><u>Securities markets</u></p> <p>Stock exchanges and NEEQ are responsible for day-to-day supervision of securities trading and for reporting irregularities detected in their supervision activities. Articles 84 and 115 of the <i>Securities Law</i>, Article 39 of the <i>Measures for the Administration of Stock Exchanges</i> and the stock exchange trading rules provide that the stock exchanges must, under the guidance of the CSRC, establish IT systems needed for market regulation and real-time monitoring, set up departments responsible for securities market supervision, conduct real-time monitoring of transactions, and discharge self-regulatory functions according to law.</p> <p>The stock exchanges have set up departments for market surveillance that are supported by automated systems for market monitoring. For example, the surveillance team of the SZSE is composed of 38 staff. The market monitoring systems of both exchanges have the capacity for real-time data processing and <i>ex post</i> analysis and verification. The systems used produce real-time alerts during the course of trading, for example when trading volumes or prices move beyond specified thresholds or there is information suggesting problems in the trading behavior of participants (such as spoofing or self-trading). Extensive post trade analysis is also carried out to detect possible problem conduct such as insider trading. These alerts are analyzed and investigated if they may involve breaches of trading rules. Because of the “real name system” under which each investor is assigned a unique identifier, exchange supervision staff has real-time access to the identity of each investor whose orders are active in the trading system. This makes it easier to identify problem activity. Activity that may indicate more serious breaches, such as market</p>

manipulation, is referred to the CSRC. For example, the SZSE reported 232 cases in 2014 and 197 cases in 2015.

The *Decision of the State Council on Issues Concerning the National Equities Exchange and Quotations System (NEEQ Decision)* requires NEEQ to develop a system of business rules, establish market surveillance system, improve risk management system and facilities, ensure the security of IT systems and information, and fulfill its self-regulatory functions. Article 4 of the *NEEQ Interim Measures* provides that NEEQ must regulate share transfers and related activities of NEEQ-listed companies. Article 27 requires NEEQ to establish market monitoring system and relevant IT systems, assign full-time market supervision officers, and monitor share transfers in real-time and in accordance with the law to promptly discover and prevent insider trading, market manipulation and other irregular transfers. NEEQ has a trading supervision department that uses a market monitoring system designed to detect market irregularities.

CSRS senior staff informed the assessors that, as part of its SRO functions, the NEEQ has imposed regulatory measures on members. For example, in 2015 it imposed 292 regulatory measures and imposed disciplinary sanctions in 5 quoted companies involving 12 actual controllers and 4 securities companies. Further, as part of its supervision tools, the NEEQ has a rating system of companies quoted and securities companies, which takes into consideration all measures imposed. The CSRC takes into consideration such rating to for purposes of its own supervisory program.

Futures markets

Futures exchanges are responsible for day-to-day supervision of their markets. The trading rules of the exchanges require them to regulate any conduct that breaches the "open, fair, and just" principle and engenders market risks. The detailed rules of the exchanges require them to monitor futures trading.

Each futures exchange has a department of supervision that is supported by automated trading systems. For example, in the Shanghai Futures Exchange the Department in charge of market surveillance has 30 employees. Similar to the equity exchanges, the systems of the futures exchanges produce real-time alerts during the course of trading, for example when trading volumes or prices move beyond specified thresholds, unusually frequent trading and (for commodities markets) significant deviations between prices in the spot and futures markets. Extensive post trade analysis is also carried out to detect possible problem conduct. These alerts are analyzed and, if they may involve breaches of trading rules, investigated. Activity that may indicate more serious breaches, such as market manipulation, is referred to the CSRC. Post-trade analysis is also carried out.

Monitoring of the futures market as a whole is also undertaken by CFMMC, which verifies day-to-day data submitted by the exchanges, margin depository banks and futures companies. The surveillance systems of all futures exchanges are connected to the CFMMC, which monitors nationwide daily trading, collects and analyses trading data, and reports potential irregularities to the CSRC.

CSRC supervision of exchanges

Securities markets

Rule approval

As noted under Principle 33, the constitution and rules of stock exchanges, such as listing rules, membership rules and trading rules, and any changes to them require the approval

of the CSRC. Similarly CSRC's approval is required for NEEQ's articles of association and its core business rules, and other rules must be filed with the CSRC. CSRC has the power to require exchanges and NEEQ to modify constitutions (articles of association for NEEQ) and their rules.

Reporting

Stock exchanges have extensive obligations to provide reports to the CSRC. Article 84 of the *Measures for the Administration of Stock Exchanges* requires stock exchanges to provide an annual audited financial report, quarterly reports on the status of their business activities and their compliance with legislation and regulations, and an annual work report. Articles 9 to 14 of the *Provisions on the Reporting System of Stock Exchanges* establishes obligations to provide weekly reports on activities; monthly reports on supervision, including an analysis of market irregularities, complaints, monitoring system alerts and investigation of suspected misconduct; and ad hoc reports such as faults with the trading system or abnormal situations. If stock indices experience significant fluctuations, stock exchanges must make daily reports to the CSRC. Exchanges must also submit meeting minutes from their executive meetings, meetings of the general manager's office, and other key meetings to the CSRC. Stock exchanges, the CSDC and securities companies must preserve data, trading records and settlement and clearing documents (Articles 44, 140, 147 and 162 of the *Securities Law* and Articles 37 and 75 of the *Measures for the Administration of Stock Exchanges*). Through these records, CSRC has access all pre-trade, trading and post-trade information, and information about market participants.

Under the *NEEQ Interim Measures*, NEEQ must, in the course of its day-to-day oversight, submit to the CSRC the minutes of its key meetings, and information on its market operations, its performance of self-regulatory duties and any new developments, as well as any other information required by the CSRC.

Inspections and other supervision activity

The CSRC, has the power to review all the self-regulatory practices of the stock exchanges (see Articles 7, 102, 179 and 180 of the *Securities Law* and Article 6 and Chapter IX of the *Measures for the Administration of Stock Exchanges*), and to request securities market information, business documents and other information as well as information about stock exchange members and listed companies (see Article 180 of the *Securities Law*).

The CSRC has undertaken on-site inspections of the stock exchanges for the first time in 2016 with a focus on how the exchanges monitor and enforce compliance relating to trading activity. See further under Principle 9.

Under the *NEEQ Interim Measures*, CSRC has the authority to conduct regular and *ad hoc* on-site inspections on NEEQ and assess the performance of its obligations and business operations. In practice the CSRC has carried out inspections on the NEEQ market each year since it commenced in 2013. CSRC staff indicated that CSRC conducted a comprehensive inspection of the NEEQ in 2015. That inspection focused on 5 aspects: NEEQ review of public offerings; company supervision; stock issuance recording, intermediaries supervision and transaction monitoring Both in 2015 and 2016 the inspections of NEEQ were complemented with inspections of market players (securities companies and companies traded in NEEQ) to assess their compliance with their obligations in the NEEQ market. As a result of these inspections, the CSRC delivered regulatory measures to 144 companies. In addition, it opened administrative cases on 20 companies for potential market abuse and other serious misconduct and imposed administrative sanctions on 6 of the companies. CSRC senior staff acknowledged that the rapid growth of the NEEQ market poses challenges to both the NEEQ and its own supervision of the market and its participants. It

also challenges the CSRC, on how to ensure that the NEEQ continues to grow so that it continues to provide access to funding to smaller companies, while ensuring that risks are adequately managed and contained.

Access to trading information

The stock exchanges, the CSDC and securities companies must keep all records of their activities, including trading records and settlement and clearing documents (Articles 44, 140, 147 and 162 of the *Securities Law* and Articles 37 and 75 of the *Measures for the Administration of Stock Exchanges*). The CSRC therefore has access all pre-trade and post-trade information of market trading and the activities of participants. Exchange systems enable the complete reconstruction of trading activity.

Futures markets

Rule approval

As noted under Principle 33, the constitution, the main rules of futures exchanges and any changes to them require the approval of the CSRC. The CSRC also has power to require exchanges to change their rules. Minor rules do not require the CSRC's approval but must be filed with it.

Reporting

Futures exchanges are required to submit quarterly and annual work reports to the CSRC on the state of operations and implementation of relevant laws, administrative regulations, rules, and policies; as well as annual audited statements (Article 102 of the *Measures for the Administration of Futures Exchanges*). For supervisory activities, futures exchanges are required to submit a monthly report on the identification and resolution of abnormal trading in the preceding month, and a semi-annual report on the use of algorithmic trading by clients. This latter report is expected to give an account of the software used in algorithmic trading, an overview of their basic features, number of users (including members and clients), scale of algorithmic trading by clients, and supervision and oversight (including whether any non-compliance or misconduct took place and the related supervisory measures).

Article 103 of the *Measures for the Administration of Futures Exchanges* requires a futures exchange to immediately report to CSRC if:

- it discovers a verified or potential serious breach of relevant laws, administrative regulations, rules, or policies of the state by a staff member;
- it is involved in any legal action that creates a risk exposure of 10% of its net assets or has a significant impact on its operating risks;
- it intends to make any significant expenditures or investment, or any major financial decision that may incur a high level of financial or operating risks; or
- it is involved in other matter the reporting of which is required by CSRC.

Article 49 of the *Regulations on the Administration of Futures Trading* requires futures exchanges, futures companies and other futures institutions, and CFMMC to submit financial statements, business documents and other relevant materials to the CSRC.

Inspections and other supervision activity

Article 48 of the *Regulations on the Administration of Futures Trading* gives the CSRC

	<p>power to conduct on-site inspections of futures exchanges, futures companies and other futures institutions, non-futures company clearing members, the CFMMC and delivery warehouses. Article 50 requires entities and individuals to cooperate with CSRC's inspections or investigations, and to provide truthful and accurate documents and materials.</p> <p>The CSRC carries out annual inspections of the four futures exchanges. Its focus is on market integrity, market surveillance, risk monitoring, risk handling capacity, and the implementation of rules. See also under Principle 9.</p> <p><i>Access to trading information</i></p> <p>Futures exchanges, futures companies and non-futures clearing members must keep futures trading, settlement and clearing data and records (Article 38 of the <i>Regulations on the Administration of Futures Trading</i>). These records are available to the CSRC.</p> <p>The FMFC also has comprehensive data on trading activity on all futures markets.</p> <p>Enforcement</p> <p><u>Securities markets</u></p> <p>Where it detects a breach of regulatory requirements, the CSRC has power under Article 94 of the <i>Measures for the Administration of Stock Exchanges</i> to circulate a notice of criticism, order the exchange to make rectifications, suspend its operation for rectifications by a designated deadline, or take other measures. A decision to dissolve an exchange must be made by the SC (Article 102 of the <i>Securities Law</i>).</p> <p>Article 32 of the <i>NEEQ Interim Measures</i> provides that if NEEQ or any relevant person fails to perform its supervisory duties or fails to perform relevant obligations under the <i>NEEQ Interim Measures</i>, the CSRC can impose on NEEQ or the person the same range of measures that it can impose on stock exchanges.</p> <p><u>Futures markets</u></p> <p>Article 65 of the <i>Regulations on the Administration of Futures Trading</i> provides that a futures exchange can be penalized if it commits any of the acts specified in the Article (for example, allowing a member to trade without sufficient margin, obstructing the CSRC, or any other action that violates the rules of the CSRC). In these circumstances, the CSRC can order corrective action, give a warning, and confiscate any illegal gains.</p> <p>Under Article 111 of the <i>Measures for the Administration of Futures Exchanges</i>, the CSRC can order a futures exchange to suspend its operation for rectification in a range of circumstances set out in the Article. These include engaging in businesses unrelated to futures trading; failure to comply with provisions relating to the inspection of members; and the non-compliance of trading and settlement systems or activities with regulations.</p>
Assessment	Fully Implemented
Comments	<p>The meetings held indicate that the stock and futures exchanges are dedicating a reasonable amount of resources to market surveillance. Further, they have sophisticated real-time monitoring systems that they use to produce alerts that identify unusual trading activity. These systems are also capable of doing extensive post trading analysis that the exchanges use, for example, to identify possible insider trading on the stock exchanges. There is also evidence that in practice, the exchanges are referring potentially serious cases</p>

	<p>of market misconduct to the CSRC for investigation (see further in Principle 36).</p> <p>Exchanges maintain close contact with the CSRC in their day-to-day operations, and report regularly to the CSRC on their supervisory activities. The CSRC carries out annual inspections of futures exchanges to ensure they are complying with their obligations as market supervisors. In 2016, the CSRC carried out its first on-site inspections of the stock exchanges, and plans to develop a program of regular review. Because of the importance of the stock exchanges, this is a welcome development and the assessors encourage the CSRC to proceed with such a program.</p> <p>For cross market supervision arrangements that apply to the stock exchanges and CFFEX, see under Principle 36.</p> <p>As indicated under Principle 33, for grading purposes the assessment has focused on the exchanges given the different nature of the NEEQ. Such difference in nature can justify differences in the intensity of supervision vis-à-vis the stock and futures exchanges. That said the assessors acknowledge the increased attention that the CSRC is paying to the supervision of this market as demonstrated by recent on-site inspection work. The assessors encourage the authorities to continue their active monitoring of this market given the impact that major problems in it could have for the overall confidence of investors in the capital markets.</p>
Principle 35	Regulation should promote transparency of trading.
Description	<p>The legislation governing the operation of both securities markets and futures markets requires market operators to make available both pre-trade and post-trade information. For securities exchanges these requirements are set out in Article 113 of the <i>Securities Law</i> and Articles 31 and 32 of the <i>Measures for the Administration of Stock Exchanges</i>; for the NEEQ market Chapter V of the <i>NEEQ Trading Rules</i> and the <i>NEEQ Business Rules</i>; and for futures exchanges Article 27 of the <i>Regulations on the Administration of Futures Trading</i>. These obligations are given effect by the rules of the exchanges and NEEQ.</p> <p>For the distribution of trading information, stock exchanges and NEEQ have entered into licensing contracts with end users through information agents, communication services providers, institutional information users and members.</p> <p>For commodity futures markets contracts that involve physical delivery of commodities, the amount of standard warehouse receipts and available capacity must be disclosed.</p> <p>Under the trading rules of futures exchanges, real-time trading information at futures exchanges must be sent to trading seats through computer networks and released to the public through the public media and information service providers that have signed information release agreements with the exchanges.</p> <p>Pre-trade transparency</p> <p><u>Securities markets</u></p> <p>The trading rules of the stock exchanges contain rules for real-time quotations during the continuous auction phase. For each security, the previous closing price, last executed price, highest price, lowest price, accumulated trading volume and value, and the five best bids and offers and volumes must be displayed (see Article 5.2.2 of the SSE and SZE Trading</p>

	<p>Rules).</p> <p>All bids and offers must be fully displayed and no hidden orders or partially disclosed orders (such as iceberg orders) are permitted.</p> <p>For trades by agreement on NEEQ, real-time quotations include each stock's previous closing price, latest execution price, highest intraday execution price, lowest intraday execution price, current-day cumulative trading volume, as well as the price, quantity, and order matching number for all fixed-price orders. Under NEEQ's market-making rules, market-makers must begin issuing two-way quotes by 9:30 at the latest on each transfer day, and must maintain quotes for at least 75 per cent of the time they spend on market-making, transferring, and order matching activities.</p> <p><u>Futures markets</u></p> <p>The trading rules of the futures exchanges contain rules for real-time quotations during the continuous auction phase. For each futures contract, full details of trading and orders are available. For orders, some exchanges display the five best bids and offers and volumes;. The Shanghai Futures Exchange displays only the best bid and offer.</p> <p>Post-trade transparency</p> <p><u>Securities markets</u></p> <p>Article 113 of the <i>Securities Law</i> and Articles 31 and 32 of the <i>Measures for the Administration of Stock Exchanges</i> require stock exchanges to publish real-time trading information and prepare daily, weekly, monthly and annual reports on market transactions and release them in a timely manner. In practice, trading information is disseminated throughout the trading day by authorized data distributors and by being posted on the exchanges' websites.</p> <p><u>Futures markets</u></p> <p>Article 28 of the <i>Regulations on the Administration of Futures Trading</i> requires each futures exchange to timely publish the trading volume, execution price, open interest, highest price and lowest price, opening price, closing price, and any other real-time trading data that should be published, and to ensure the truthfulness and accuracy of real-time trading data. No entity or individual may publish any real-time trading data on futures trading without the consent of the futures exchange concerned.</p> <p>Article 90 of the <i>Measures for the Administration of Futures Exchanges</i> provides that each futures exchange must publish through appropriate methods:</p> <ul style="list-style-type: none"> • real-time trading data; • ranking of open interest and trading volume; and • any other information that should be published per the exchange's trading rules and detailed implementing rules thereof. <p>If any commodity underlying futures trading is to be physically settled, the futures exchange must also publish information on the standard warehouse receipts and available warehouse capacity.</p> <p>The trading rules of various exchanges also contain similar provisions.</p> <p>The futures exchanges disseminate full post trade information including for each contract the opening price, closing price, highest price, lowest price, latest price, price change, best</p>
--	--

	<p>bid price, best offer price, bid volume, offer volume, settlement price, trading volume, and open interest. Trading information is published on the exchanges' websites throughout the trading day and in weekly, monthly and yearly reports. Trading information is also disseminated through authorized data distributors.</p> <p>Derogations from real-time transparency</p> <p>For securities markets, the CSRC has not authorized any stock exchange to permit derogation from the objective of real-time transparency. All trading must take place through an exchange's trading system. All orders are fully displayed and no dark trading or partially displayed orders (such as iceberg orders) are permitted. Block trades can be negotiated off the market, but must be reported to and confirmed by the exchanges. For securities for which there is no daily price limit, the price must be within $\pm 30\%$ of the previous closing price or between the highest and lowest traded prices on the day of trading.</p> <p>For futures markets, all trading must take place through the exchanges trading systems, although some exchanges permit exchange for physical transactions. All orders are fully displayed and no dark trading or dark orders are permitted.</p>
Assessment	Broadly Implemented
Comments	<p>Stock exchanges and futures exchanges have an obligation under the legislation to provide pre-trade and post-trade information to the market. For most exchanges the pre-trade information available includes the 5 best bids and offers. Post-trade transparency for both types of exchanges is extensive, and available to all market participants and users. The NEEQ market has appropriate arrangements, given the nature and function of the market, for pre-trade and post-trade transparency.</p> <p>The main issue under this grade is the pre-trade transparency on the Shanghai Futures Market, for the purposes of KQ 1.a. The market system for that exchange displays only the current best bid and offer (one level only). On an electronic market, this practice results in a lessening of the level of transparency that should be available, particularly since, as the assessors were informed, the market's systems are capable of displaying at least the 5 best bids and offers. Accordingly the assessors recommend that the CSRC reviews the level of pre-trade transparency requires for exchanges to ensure a minimum depth of the book displayed.</p>
Principle 36	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p>General</p> <p>The <i>Securities Law</i> explicitly prohibits market manipulation, misrepresentation, insider trading and other fraudulent practices. The <i>Regulations on the Administration of Futures Trading</i> prohibit fraud, insider trading, manipulation of futures prices and a variety of other illegal conduct. Definitions of related criminal violations, such as insider trading and market manipulation, are set out in Amendment VI and Amendment VII to the <i>Criminal Law</i>.</p> <p>Fraud and market manipulation</p> <p>Article 63 and Articles 73 to 84 of the <i>Securities Law</i> explicitly prohibit market</p>

manipulation, misrepresentation, insider trading and other fraudulent practices, and prohibit securities companies and their employees from violating clients' real intentions and damaging clients' interests.

Article 77 of the *Securities Law* prohibits market manipulation, defining specific prohibited conduct (such as market ramping and wash trading) but also containing a general prohibition on any other means of manipulating the market. Where market manipulation causes loss to investors, traders are liable for those losses.

Articles 78-82 of the *Securities Law* prohibit a variety of fraudulent practices. These include prohibitions on:

- State functionaries and employees, and relevant media persons from fabricating or disseminating false information (Article 78);
- securities companies and their employees carrying out a variety of fraudulent practices, such as buying or selling securities contrary to client instructions, enticing clients into unjustified transactions to earn commission, spreading false or misleading information, or any other activities against clients' intents or detrimental to them (Article 79);
- making illegal use of the accounts of other persons (Article 80).

Article 70 of the *Regulations on the Administration of Futures Trading* sets out the circumstances in which a person is taken to be manipulating futures trading prices. These include:

- deliberately colluding with another party to conduct futures transactions with each other at a time, at a price and in a method agreed upon in advance so as to influence the futures trading prices or the fixtures trading volume;
- wash trades;
- hoarding goods in order to influence futures market prices; or
- committing other acts manipulating futures trading prices as prescribed by the CSRC.

There are no legislative provisions prohibiting front running of client orders by brokers. For securities brokers, however, Article 136 of the *Securities Law* requires that proprietary trading must be strictly segregated from brokerage activity. There are detailed rules requiring separation between the two types of trading in terms of account creation, fund management, trading instructions and clearing accounts. Securities companies must have effective information barriers and the CSRC's *Guidelines on Internal Control for Securities Companies* require securities companies to establish a sound Chinese wall system between their primary business departments, so as to ensure that businesses relating to brokerage, proprietary trading, and entrusted investment management, investment banking, and research and consultancy are independent of one another. Own account trading and client trading must be carried out from different trading seats. A breach of all these obligations could be pursued as a breach of clients' interest but also potentially as insider trading. (See also *Guidance for the Securities Proprietary Businesses of Securities Companies*)

Insider trading

Articles 73 to 76 of the *Securities Law* prohibit insider trading. Article 74 defines insiders in

broad terms to include company officers and employees, significant shareholders, staff of company sponsors and underwriters, staff of stock exchanges, clearing and settlement institutions and securities service institutions, and staff of regulatory authorities. Article 75 defines what constitutes inside information in both specific terms and also in general terms to include any information that has an effect on the trading price of securities. Article 76 extends the prohibition to persons who obtain inside information unlawfully.

Article 69 of the *Regulations on the Administration of Futures Trading* provides that a person who has inside information about futures trading or a person who illegally obtains inside information is subject to a penalty if he or she trades in futures by taking advantage of the inside information, or if he divulges the inside information to any other person so that the second person conducts futures trading by taking advantage of the inside information. Inside information is information which, prior to the information being made public, may significantly affect the futures trading price.

Monitoring

Securities markets

The division of responsibilities between the exchanges, NEEQ and the CSRC in conducting surveillance of the market for market manipulation, insider trading and other market abuse is described in Principle 34.

The exchanges' electronic monitoring systems are designed to identify unusual trading activity. Any abnormal trading detected is reviewed by the exchanges to determine if market participants have violated any laws or rules. To detect market abuse such as market manipulation or insider trading, the exchanges have automated surveillance systems that monitor trading for unusual movements in prices or volumes and generate alerts if they move outside of set parameters. Once an alert is triggered, if exchange staff determines that there is a strong likelihood of market abuse, they expand the review to a full investigation. Exchanges monitor trading both on an intra-day basis and after the close of the trading day. Potentially serious cases are reported to the CSRC.

The surveillance approach of NEEQ is similar to that of SSE and SZSE. NEEQ monitors abnormal transfers via an electronic monitoring system. Automatic warning could be triggered if the price or volume exceeds the preset parameters. NEEQ staff will upgrade the monitoring from a simple trading surveillance to a full investigation if they deem violation is probable, and will report to CSRC when a case is of gross violation.

Futures markets

As noted under Principle 34, the futures exchanges have front-line responsibility for monitoring market conduct. They have automated real-time surveillance systems that generate alerts when trading prices or volumes move outside set parameters. If analysis of an alert indicates the possibility of a violation of legislation or rules, the exchange will carry out an investigation. Potentially serious violations are reported to the CSRC.

In addition to monitoring market activity, the exchanges have in place other measures to reduce the risk of manipulation or other market abuses such as cornering or squeezing in commodity futures markets. These include position limits and large position reporting systems. Position limits apply both to the maximum number of positions and the percentage of overall open interest that can be held. They apply both to brokers and their clients. The maximum number of positions that can be held decreases as contracts approach the delivery month. If the positions held by a member or a client reach the futures exchange's reporting limit, the member or client must submit a report to the futures exchange; where a client fails to make the report, its carrying member must report

to the futures exchange for the client. Exchange staff contact large position holders to understand their trading objectives, and where relevant their holdings in underlying commodities and intentions at expiry of the contract. The CSRC also has access to information on position concentrations through CFMMC.

Some commodity futures exchanges have rules designed to minimize the risk of manipulation of settlement prices, for example by calculating the daily closing price based on the VWAP or the last hour's trade and the price on contract expiry on the last two hours' VWAP.

Sanctions

A person who commits a violation of provisions in the legislation, regulations, or exchange rules is subject to sanctions that can be imposed, subject to the severity of the violation, by the exchanges, CSDC, the CSRC and judicial authorities at various levels. The most severe penalties are those that can be imposed by judicial authorities and the *Criminal Law* makes insider trading and market manipulation criminal offences.

The exchanges and NEEQ can impose a range of regulatory measures such as revoking qualification licenses, refusing to process relevant businesses and restricting trading activity. They can also take disciplinary measures such as circulating a notice of criticism, public censure, suspending trading privileges for a specified period and ((for securities exchanges) publicly identifying the parties involved as unsuitable for the posts of director, supervisor, or senior manager of a listed company. The futures exchanges also have power to impose monetary penalties on their members.

CSRC

Article 203 of the *Securities Law* provides that the CSRC can impose the following penalties for entities that violate the market manipulation prohibition:

- order divestment of the illegally held securities;
- confiscate illegal gains;
- impose a fine of not less than one time but not more than five times the illegal gains;
- if there are no illegal gains or the illegal gains are less than 300,000 yuan, impose a fine of between 300,000 yuan and 3,000,000 yuan;
- where a unit engages in insider trading, warn the person directly in charge and the other persons directly responsible and impose a fine of between 100,000 yuan and 600,000 yuan on each of them.

Article 202 of the *Securities Law* provides that the CSRC can impose the following penalties for violations of the insider trading prohibition:

- order divestment of the illegally held securities;
- confiscate illegal gains;
- impose a fine of not less than one time but not more than five times the illegal gains;
- if there are no illegal gains or the illegal gains are less than 30,000 yuan, impose a

	<p>fine of between 30,000 yuan and 600,000 yuan;</p> <ul style="list-style-type: none"> • where a unit engages in insider trading, warn the person directly in charge and the other persons directly responsible and impose a fine of between 30,000 yuan and 300,000 yuan on each of them; • if a staff member of the CSRC engages in insider trading, impose heavier penalties. <p>The CSRC also has power to impose restrictions on securities trading by a party who is the subject of an investigation into illegal activity such as insider trading or market manipulation (Item 7 of Article 180 of the <i>Securities Law</i>).</p> <p>Article 70 of the <i>Regulations on the Administration of Futures Trading</i> empower the CSRC to impose penalties for futures market manipulation:</p> <ul style="list-style-type: none"> • orders for correction; • confiscation of illegal gains; • fines of not less than one time but not more than five times the illegal gains; • if there are no illegal gains or if the amount of the illegal gains is less than 200,000 yuan, fines of between 200,000 and 1 million yuan; • imposing the directly liable person-in-charge and other directly liable persons disciplinary sanctions and fines between 10,000 and 100,000 yuan on the directly liable person-in-charge and other directly liable persons. <p>Article 69 of the <i>Regulations on the Administration of Futures Trading</i> sets out the penalties for violations of the prohibition on insider trading in futures markets. The CSRC can:</p> <ul style="list-style-type: none"> • confiscate illegal gains; • impose a fine of not less than one time but not more than five times the illegal gains; • if there are no illegal gains or the illegal gains are less than 100,000 yuan, impose a fine of between 100,000 yuan and 500,000 yuan; • where an entity engages in insider trading, warn the person directly in charge and the other persons directly responsible and impose a fine of between 30,000 yuan and 300,000 yuan on each of them; • if a staff member of the CSRC, a futures Exchange or CFMMC engages in insider trading, impose heavier penalties. <p>Enforcement</p> <p>CSRC staff indicated that about two thirds of the cases sanctioned for market abuse stem from referrals from the exchanges. For example, the SZSE reported 232 clues in 2014 and 197 clues in 2015. Additional information on referrals has been provided in Principle 12.</p> <p>Market participants and CSRC staff indicated that administrative sanctions are rising sharply. They highlighted the existence of more challenges in the criminal arena. However, they indicated that certain positive steps are being taken. In particular new guidelines were</p>
--	---

issued or insider trading in [2013] which make easier to prosecute this type of case.

The following table shows the number of CSRC market manipulation and insider trading enforcement actions. Additional information on sanctions imposed has been provided in Principle 12.

Table. Unfair Trading Practices			
Year	2013	2014	2015
Market manipulation	8	15	18
Insider trading	51	69	64

Source: CSRC.

Regarding criminal enforcement, it is the understanding of the CSRC that out of the 23 criminal cases where judgments were made during 2015-2016, three involved market manipulation and nine involved insider trading. In the three cases involving market manipulation, the person convicted was sentenced to a fixed term of imprisonment of 2.5 years while in the other two cases probation was given. In the nine cases of insider trading, in two cases the persons convicted were given fixed sentences of 6 and 5.5. years respectively, while probation was given in six cases and a fine in the remaining case. Most of these cases were transferred in 2015.

Regarding the cases transferred in 2015-2016, the criminal courts have made judgments in 12 cases. In four cases the persons convicted were given probation. In the case involving market manipulation whose judgment was made in January 2017, the person convicted was given a fixed term of 5.5 years and a fine of RMB 11 billion was also imposed by the court.

Cross-market trading

Domestic markets

There is no cross listing of securities or futures on China markets. The issue is therefore linkages between securities market and financial futures products traded on CFFEX and between cash and options securities markets.

The CSRC has the power to require stock exchanges to establish inter-exchange information sharing and joint regulatory systems to monitor cross-market trading abuses and control market risk (Article 39 of the *Measures for the Administration of Stock Exchanges*). CSDC is required to provide any relevant data and information needed to enable a stock exchange or the CFFEX to perform their duties Article 14 of the *Measures for the Administration of Securities Registration and Clearing*).

In practice the CSRC has established arrangements for cross –market surveillance. Under these arrangements the CSRC, SSE, SZE, CFFEX, and CSDC have developed a data and information exchange mechanism involving a secure “intraday green channel” which provides real time data on market activity to all five institutions. There are also quarterly meetings to discuss cross-market issues, and the institutions cooperate with one another in the investigation of abnormal market volatility.

In addition, as indicated under Principle 6, over the last 6 years the CSRC has been enhancing its capability to monitor systemic risk, via institutional arrangements (the creation of the CMSMC), data arrangements (the development of the Central Regulatory

	<p>Information Platform and the development of a single identification number for investors across their cash and futures accounts.</p> <p><u>Foreign markets</u></p> <p>The Shanghai-Hong Kong Stock Connect commenced in 2014. An MOU between the CSRC and the Hong Kong Securities and Futures Commission provides for investigatory cooperation, including the exchange of clues and investigation information, investigation assistance, joint investigation, service of documents and enforcement assistance. Under the <i>Provisions on the Pilot Program of Shanghai-Hong Kong Stock Connect</i>, Shanghai Stock Exchange and Hong Kong Exchanges and Clearing Limited (HKEx) are required to perform real-time monitoring of trades executed under the program and establish information exchange and collaborative monitoring systems to jointly monitor cross-border trading abuses and prevent market risk.</p> <p>There is recent evidence that the joint supervision arrangements that apply to the cross trading arrangements between SSE and HKEx are supporting the detection of potential cases of market abuse involving this trading link. In this regard early in 2017 the CSRC fined a group of stock traders more than \$173 million for market manipulation, including via the Shanghai-Hong Kong Stock Connect in the first cross-border case of its kind involving the scheme. The case was brought, with support from the Hong Kong SFC under the terms of the MoU.</p> <p>In December 2016, the Shenzhen-Hong Kong Connect commenced. The arrangements for joint supervision and regulatory cooperation are the same as those for the Shanghai-Hong Kong Stock Connect.</p> <p>China's futures markets are not open to foreign investors.</p>
Assessment	Fully implemented
Comments	<p>Market misconduct, including insider trading and market manipulation, is prohibited on both securities markets and futures markets. The exchanges actively monitor market activity to identify misconduct of this kind. Potentially serious breaches are reported to the CSRC. The CSRC has been active in investigating and taking action where market abuse is established.</p> <p>However it is important that the levels of sanctions authorized by the laws and regulations be reviewed; in particular the reasons for a difference in the sanctions available for market abuse in the cash versus the future markets. Within the framework imposed by the Law increasingly the CSRC is imposing more drastic sanctions for severe violations. As further discussed in Principle 12, the assessors note challenges in criminal enforcement. At the same time, they acknowledge recent steps taken by the criminal authorities to strengthen the way they deal with this type of crimes. In addition, larger imprisonment penalties are starting to be imposed. These issues have been taken into consideration for the grade of Principles 3, 11 and 12.</p> <p>Because of the relationship between the securities exchange markets and the futures market operated by CFFEX, it is important that there are effective arrangements in place to monitor cross-market activity. The arrangements outlined in the description appear appropriate, but need to be kept under review as new equity based futures contracts are developed by CFFEX.</p>

Principle 37	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>Management of large exposures</p> <p><u>Securities</u></p> <p>Trades in equity and bonds are cleared and settled through CSDC, which operates as the CCP. The settlement cycle for A shares is T+1 and for B shares T+3. Settlement is done on a gross basis for securities and on a multilateral net basis for cash. Securities are transferred at the night of T, while cash is transferred on T +1. Risks are managed via full margin by clients and third party deposits of settlement funds. Cash is not settled in central bank money, but through settlement banks.</p> <p>There is a wide range of options for settling bonds, with different settlement cycles. For bond transactions (such as government bonds and pledged repos) that fall within the scope of netting by the central securities depository and clearing institution, the settlement cycle is T+1; for those that outside this scope and to be settled without collateral, it is T+1, T+0, or intraday in real-time.</p> <p>As explained under Principle 33, there are several mechanisms in place to manage clearing and settlement risk. They include:</p> <ul style="list-style-type: none"> • ex-ante verification of the existence of the securities and cash (the latter for retail investors) prior to entering an order into the system; • access criteria for clearing members; and • financial measures including settlement reserve fund requirements by clearing members based on the gross amount of securities purchased, settlement collateral mechanisms, a mutual guarantee fund, and a risk reserve fund. <p>In addition, the CSDC has established criteria for settlement banks and uses multiple settlement banks.</p> <p>There are no reporting obligations for holders of large “positions” in the cash markets. However investors are categorized by their holdings and the CSRC requires exchanges to closely monitor investors who have large holdings by market value. The real name system that requires an investor to have a unique identification number for all its securities transactions and holdings means that the CSDC has direct information on the securities accounts, positions and trading details of clearing participants and their clients down to the individual security holder level. CSDC and the CSRC therefore have access to information on investors’ positions from a centralized data source, and do not need to go through brokers for this information.</p> <p>In addition, broker capital requirements include a concentration ratio that requires additional capital if concentrated positions are held in equity securities (more than 10 percent) or a non-equity (more than 20 percent).</p> <p>CSDC staff informed the assessors that the CSDC and the exchanges have currently under consideration a joint rule that would impose a maximum cap on trading activity for brokers based on their net capital.</p> <p>Futures markets</p> <p>As noted under Principle 33, clearing and settlement of futures is carried out by the</p>

clearing departments of the futures exchanges. As explained therein, there are several mechanisms in place through which the exchanges as CCPs manage clearing and settlement risk. Essentially they include (i) access criteria for clearing members, and (ii) financial mechanisms including pre-margining by clearing members; daily mark to market of positions; a mutual guarantee fund and a general risk reserve funds.

In addition, positions limits have been established by the exchanges to manage the risk of large exposures. Exchanges can adjust the position limits of members and clients with respect to each listed product and contract based on market conditions, and adjust the position limits of a futures company member based on its net assets and state of operations. Positions opened and held for hedging purposes are not subject to such rules. Arbitrage trades and speculative trades are treated as non-hedging trades and are subject to position limits and trading limits imposed by the exchanges. For any non-futures company member or client whose open interests have exceeded the applicable position limit, the exchange may unilaterally liquidate the excess positions in accordance with relevant provisions.

Article 11 of the *Regulations on the Administration of Futures Trading* requires futures exchanges to adopt a large position reporting system. Under futures exchanges' trading rules, exchange members and their clients must report to the exchange once their speculative position in a contract exceeds 80 per cent of the position limit for the contract. A client must report the information through a member futures company, and where the client fails to do so, the member must make the report. Futures exchanges may adjust the position reporting standards based on market risks. Given the see through system, the exchanges can already see the level of individual positions. Thus, the large position report is useful to provide more detailed information on the specific investor holding the position including the trading purpose. Each futures exchange has in place a department specializing in real-time monitoring of large positions.

If any member or client has violated related futures trading rules in a way that creates or is likely to create adverse effects on the market, the futures exchange can take preventative measures (Article 85 of the *Measures for the Administration of Futures Exchanges*). These measures can be taken against the member or the member's client and include restricting the deposit and withdrawal of funds, restricting the opening of positions, raising the margins level, or liquidating positions.

Sharing of information on large positions

The CSRC, the CBRC and the CIRC have established an information sharing and joint conference mechanism, under which information including that on the large positions of investors is shared as needed. Information-sharing mechanisms have also been established between the CSRC headquarters, CSRC regional offices, the CSDC, stock exchanges and the CFFEX so that these entities share information on large positions of investors for the purpose of surveillance and assessment of cross-market participants

Default procedures

Securities markets

Chapter VII of the *Measures for the Administration of Securities Registration, Clearing and Settlement* provides in detail for default procedures where a clearing participant defaults. The *Measures* define the circumstances in which the CSDC can adopt default procedures, the assets of a clearing participant that can be subject to these procedures and the detailed resolution measures that can be taken.

Pursuant to such *Measures for the Administration of Securities Registration, Clearing and*

Settlement, in case of default, the CSDC can withhold the member's securities and require the clearing participant to make up for shortfalls in funds or submit a settlement guarantee within a designated time limit. Where a clearing participant fails to make up for shortfalls in capital or securities within the time limit, the CSDC can dispose of collateral or sell securities. If this is not sufficient, in cascading order: (i) the portion of the clearing member in the guarantee fund can be used, (ii) then the whole fund (iii) and if all this is not sufficient then liquidation procedures are followed. In such liquidation procedures, the securities held by the clearing member in its proprietary account can be used to cover shortfalls. If any loss is incurred, then it is covered through the general risk reserve fund.

Futures Markets

The futures exchanges have developed measures for the handling of defaults, and disclose them. These measures set out detailed procedures for handling defaults. They define when default procedures can be taken, who may take them and the scope of the procedures that may be taken.

Under Article 36 of the *Regulations on the Administration of Futures Trading*, margins are to be used to cover trading defaults by exchange members. If margins are insufficient, the exchange must use in cascading order: (i) the clearing members' portion of the guarantee fund, (ii) the remaining part of the fund; (iii) the risk reserve and its own funds to meet the liabilities on the member's account, with a right to claim repayment from the member.

Client protection

Securities markets

There are mechanisms in place designed to protect clients' assets from a default of a member. Securities are protected due to the "see through" system. As for cash, the SIFP protection applies as described in Principle 32.

Futures markets

According to Article 59 of the *Provisions of the Supreme People's Court on Issues Concerning the Settlement of Futures Disputes*, where a futures exchange or futures company is in debt, the people's court is not permitted to freeze or transfer the funds in the margin accounts, whether those margin accounts are held by futures companies at the exchange, or by clients at the futures companies. This protects clients' funds and assets from the default of a market intermediary or the exchange. The Futures Industry Protection Fund is available to compensate clients for losses of margins – see under Principle 32.

Short selling

In the Chinese market, "short selling" falls under the broader category of securities financing, because a short seller must first borrow the stock before executing the trade. CSRC and the relevant SROs have developed rules to regulate securities financing, including the *Measures for the Administration of the Margin Trading and Securities Financing Business of Securities Companies*, the *Detailed Implementation Rules for Margin Trading and Securities Financing* of SSSE and SZE, and the *Statistical and Monitoring Rules for Margin Trading and Securities Financing (Tentative)* of China Securities Finance Co., Ltd. (CSF).

These rules provide for the information reporting and regulatory regime for securities financing. CSF is responsible for establishing a risk control indicators and dynamic monitoring system, periodically reporting transaction information from margin trading and securities financing to CSRC, and, in the event of major emergencies, promptly reporting relevant situations to CSRC. CSF is also responsible for publishing the balance and trading data of margin trading and securities financing on a daily basis. Strict compliance and

	<p>enforcement rules are in place, including:</p> <ul style="list-style-type: none"> • a prohibition on “naked short selling”; • implementation of an uptick rule for securities financing; • strict control over business size by requiring that the quantity of any single underlying stock available for securities financing must not be more than 25% of the free-float market cap of the stock; and • giving CSF exclusivity on the provision of centralized margin trading and securities financing services. <p>SSE and SZE perform real-time monitoring of each securities financing transaction.</p> <p>In China’s stock market, share transfers through market-makers are only possible with NEEQ. NEEQ has made special institutional arrangements to accommodate the exceptional circumstances related to market-making transfers. For example, market makers are exempt from the general rule that investors are not allowed to transfer the shares they have purchased on the day of purchase (Article 37 of the <i>Detailed Rules for Stock Transfers on the National Equities Exchange and Quotations System</i>). Indeed, Articles 64 and 66 of the Detailed Rules specifically provide the method and time that market-makers may adjust their stock inventories.</p> <p>Settlement failures</p> <p>As described above ex-ante control exists vis-à-vis clients in both the securities and futures markets, whereby clients are required to post cash or securities (depending on their position as buyer or seller) in the cash markets and post margins in the futures markets. Also as described above, several mechanisms exist at the level of the clearing members aimed at minimize the risk of settlement failure. As a result, settlements failures are not material.</p>
Assessment	Fully implemented
Comments	<p>Monitoring of large positions takes place on both securities and futures markets, and the futures exchanges have in place large position limits that they enforce robustly. China’s unique real-name system means that in both types of market the identity of those who hold positions is directly available to market authorities. There are arrangements for relevant authorities to share information.</p> <p>If an intermediary is at risk of failing, market authorities can take decisive action. Default “waterfall” procedures are in place for both securities and futures markets. These mechanisms are sufficient to manage the default of a market participant without significant flow through effects to the markets</p> <p><i>CCPs treatment</i></p> <p>As indicated under Principle 33 the assessment of CCPs is not covered under the IOSCO assessment, rather under the PFMI-IOSCO. During the process the CSRC assesses the CCPs against such Principles, it is recommended to review whether intraday margin should be required, and if so whether a recalibration of initial margins is needed. In addition, they are encouraged to consider the benefits of constituting the CCPs for the futures markets as separate legal entities.</p>

