April 2012
IMF Country Report No. 12/80

People's Republic of China: Detailed Assessment Report: IOSCO Objectives and Principles of Securities Regulation

This assessment report was prepared by a staff team of the International Monetary Fund and The World Bank as part of the 2011 Financial Sector Assessment Program documentation. It is based on the information available at the time it was completed on March 2012. The views expressed in this document are those of the staff team and experts and do not necessarily reflect the views of the government of People's Republic of China nor the Executive Board of the IMF.

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International Monetary Fund
Washington, D.C.

FINANCIAL SECTOR ASSESSMENT PROGRAM

PEOPLE'S REPUBLIC OF CHINA

IOSCO OBJECTIVES AND PRINCIPLES FOR SECURITIES REGULATION

DETAILED ASSESSMENT OF OBSERVANCE

MARCH 2012

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR
DEVELOPMENT VICE-PRESIDENCY EAST ASIA
AND PACIFIC REGION VICE PRESIDENCY

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GLOSSARY

AML	Anti-Money Laundering
ASBE	Accounting Standards for Business Enterprises
CASC	China Accounting Standards Commission
CBRC	China Banking Regulatory Commission
CCO	Chief Compliance Officer
CFA	China Futures Association
CFFE	China Financial Futures Exchange
CFMMC	China Futures Margin Monitoring Center
CICPA	Chinese Institute of Certified Practising Accountants
CIRC	China Insurance Regulatory Commission
CIS	Collective Investment Scheme
CISP	Comprehensive Intermediaries Supervision Platform
CPA	Certified Public Accountant
CPSS	Committee on Payment and Settlement Systems
CSRC	China Securities Regulatory Commission
DCE	Dailan Commodity Exchange
GEB	Growth Enterprise Board
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IPOs	Initial Public Offerings
ISA	International Standards of Auditing
IT	Information Technology
MMOU	Multilateral Memorandum of Understanding on Exchange of Information
MOF	Ministry of Finance
NAFMII	National Association of Financial Market Institutional Investors
NAV	Net Asset Value
NDRC	National Development Regulatory Committee
NPC	National People's Congress
PBC	People's Bank of China
PRC	People's Republic of China
QDIIs	Qualified Domestic Institutional Investors
SAC	Securities Association of China
SC	State Council
SD&C	China Securities Depository and Clearing Corporation Limited
SHFE	Shanghai Futures Exchange
ShSE	Shenzhen Stock Exchange
SIPF	Securities Industry Protection Fund
SME	Small- and Medium-sized Enterprises
SROs	Self-Regulatory Organizations
SSE	Shanghai Stock Exchange
VWAP	Volume-Weighted Average Price
ZCE	Zhengzhou Commodity Exchange

I. Summary, Key Findings, and Recommendations

A. Introduction

1. **This is an initial report of the International Organization of Securities Commissions (IOSCO) assessment[1] performed in 2010 as part of the FSAP of China.** The assessment was performed by Mr. Greg Tanzer, a technical consultant to the IMF/World Bank FSAP mission.

B. Information and Methodology Used for Assessment

2. **The assessment was prepared on the basis of a self-assessment prepared by the China Securities Regulatory Commission (CSRC), public information contained on the CSRC website and the websites of other entities in China, and a review of relevant Chinese laws and regulations.** Mr. Tanzer interviewed numerous staff of the CSRC, as well as other governmental officials, representatives of Chinese SRO and private sector professionals working in the capital markets in China. These interviews were conducted over a two week period in May 2010. Compliance with each principle as of 2010 was assessed using the four level methodology adopted by IOSCO—fully implemented, broadly implemented, partly implemented, and not implemented. In preparing the detailed assessment, Mr. Tanzer relied upon the IOSCO Assessment Methodology for guidance on the subjects to be examined for each principle, which provides key questions to help ensure consistency and the criteria for assessing implementation.

3. **The timely completion of this assessment was greatly facilitated by the cooperation provided by numerous members of the staff of the CSRC.** The CSRC staff were extremely generous with their time, their willingness to provide detailed answers to questions, and their assistance in arranging interviews with persons in the private sector. Staff of the Self-Regulatory Organizations (SROs), exchanges, and other organizations interviewed were similarly helpful with their explanations and commentary and equally generous with their time.

C. Institutional and Market Structure—Overview

4. **The CSRC was established in October 1992.** It performs centralized supervision and regulation of the securities and futures markets on the Chinese mainland.

5. **China adopts a sectoral supervision model for its financial industry, with securities,** banking and trust, and insurance sectors under separate supervision by CSRC,

[1] This assessment used the IOSCO Objectives and Principles of Securities Regulation (May 2003) and the Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation (February 2008), available at www.iosco.org. Monetary figures (except for the CSRC budget figures and actual fines levied) are quoted in U.S. dollars, and for simplicity have been converted from RMB at the exchange rate applying as at November 19, 2010 (RMB 6.64 to US$1).

China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC) respectively. In accordance with the laws, and as duly authorized by the State Council (SC), the CSRC performs centralized and unified supervision and regulation of the nation's securities and futures markets, with the aim both of promoting soundness in the markets and promoting market development. This dual aim necessarily involves balance and compromise, especially with respect to financial innovation. However, the CSRC has been able to introduce a range of important market development reforms in recent years, such as those concerning non-traded shares and the introduction of a financial futures contract, which are described later in this report.

6. **Under this arrangement, the CSRC headquarters undertake the following responsibilities:** formulating, amending and revising rules and regulations concerning the securities and futures markets, making market development plans, processing key reviews and approvals, guiding and coordinating efforts in risk disposals of insolvent securities or futures companies, organizing investigation of and enforcement against material violations and non-compliances, and guiding, inspecting, promoting and coordinating the nation-wide regulatory efforts. Under the supervision of the CSRC headquarters, its 36 regional offices are responsible for front-line supervision within their respective jurisdictions.

7. **SRO are critical components of the regulatory system.** To supplement the regulatory activities of the CSRC, SROs including the stock and futures exchanges, China Securities Depository and Clearing Corporation Limited (SD&C), Securities Association of China (SAC), China Futures Association (CFA) are responsible for self-regulation and front-line supervision over securities/futures trading activities of their members or listed companies. In addition, the National Association of Financial Market Institutional Investors (NAFMII) was established in 2007 to oversee the trading of fixed term instruments through the inter-bank lending and bond market.

8. **The CSRC is subject to the general authority of the SC which appoints the Chairman.** The Chairman holds Minister rank in the Chinese Government, on the same level as the Chairmen of the CBRC and CIRC. The responsibilities of the CSRC are clearly articulated in the *Securities Law* and the *Law of the Peoples Republic of China on Securities Investment Funds* (henceforth the *Fund Law*) and in a series of related laws that have expanded the duties and powers of the CSRC.

9. **The CSRC has broad regulatory authority over the stock and futures exchanges, the SD&C and other clearing and settlement institutions, securities companies, futures companies, and collective investment scheme (CIS) operators.** It has clear authority to perform on-site examinations, to require reports and to investigate misconduct and to impose sanctions for violations of applicable laws.

10. **Other governmental agencies in China have responsibility for discrete regulatory functions that are included in the IOSCO principles.** The major authorities are described below. Others are mentioned in the detailed principle-by-principle assessment.

11. **The People's Bank of China (PBC), the Central Bank, formulates and implements monetary policy, prevents and resolves financial risks, and safeguards financial stability.** Of particular relevance to the IOSCO assessment the PBC is primarily responsible in China for anti-money laundering (AML) regulation, guiding and organizing the AML work of the financial sector and regulators including the CSRC and monitoring relevant fund flows. It also regulates the inter-bank lending market and inter-bank bond market, and was the Government entity which provided seed funding for the Securities Investment Protection Fund (SIPF), which was established to assist with the resolution of a large number of failed securities companies and compensate investors earlier this decade.

12. **The Shanghai Stock Exchange (SSE) was established in 1990.** As at the end of 2009, SSE had a total of 870 listed companies, 1,351 listed stocks with US$2.78 trillion market capitalization, and US$5.22 trillion stock turnover. It has 107 securities firm members and 7 domestic and overseas special members. Securities listed on SSE are traded through an electronic bidding system with automatic price matching according to price and time priority through the SSE's mainframe. The trading system is capable of processing and executing 180 million orders for A-share trading and 4 million orders and 11 million transactions for B-share trading on a daily basis. The continuous processing capacity is 85,000 transactions per second. The Shenzhen Stock Exchange (ShSE) was also founded in 1990, and has a Main Board, small- and medium-sized enterprises (SME) Board, Growth Enterprise Board (GEB) and the stock transfer agent system. At the end of 2009, it had 467 companies on the Main Board, 327 companies on the SME Board and 36 companies on the GEB with market capitalizations of US$0.6 trillion, US$0.25 trillion and US$24.1 million respectively. Its 1,165 listed securities had a total market capitalization of US$1.4 trillion. Between 2006 to 2009, the annual total turnover value on the exchanges increased from around US$1,360 billion (RMB 9,050 billion) to around 8,070 billion (RMB 53,600 billion). The exchanges' trading and business rules are subject to the approval of the CSRC.

13. **Currently there are three commodities futures exchanges and one financial futures exchange in mainland China, the Shanghai Futures Exchange (SHFE), the Dalian Commodity Exchange (DCE), the Zhengzhou Commodity Exchange (ZCE) and the China Financial Futures Exchange (CFFE).** The SHFE, DCE, and ZCE trade only in commodity based futures contracts, covering commodities such as gold, oil, copper, aluminium, zinc, steel, rubber, corn, and soybeans. Trading in commodity futures has seen significant growth in recent years, from nearly 450 million contracts in 2006 to nearly 2.15 billion contracts in 2009, with turnover value increasing from around US$3.16 trillion in 2006 to 19.58 trillion in 2009. The CFFE, which is owned by the other commodity futures exchanges, recently commenced trading in stock index futures, China's first financial derivative contract, and it is intended to launch other market-oriented derivatives such as

options and potentially futures and options on treasury bonds and foreign exchange to diversify the financial derivatives market. The commodity exchanges' trading and business rules are subject to the approval of the CSRC.

14. **The SD&C was founded in 2001 and establishes rules for participants in the clearing and settlement process, in particular for managing clearing and settlement accounts**. The SD&C is required as a securities registration and clearing institution to establish securities and clearing accounts, clear and settle securities and the cash associated with securities transactions, and distribute entitlements as instructed by the issuer (Article 157 of the *Securities Law*). It has developed detailed rules to ensure its members' compliance with the relevant laws and regulations, including rules related to the administration of securities accounts, administration of clearing participants, and the administration of securities reserve funds, which are subject to the approval of the CSRC. The disciplinary powers include restricting or cancelling the use of participating accounts, and suspending or terminating the clearing participants' clearing rights. As at the end of 2009, SD&C managed approximately 140 million investor accounts and 2,240 registered securities as depository with market value around US$3.8 trillion, while the average daily transfers of securities amounted to some 28.9 million, and average daily settlement footings of US$117 billion.

15. **There are two primary types of CIS business in China: securities investment funds managed by fund managers, and collective asset management business conducted by securities companies.** As of December 2009, securities investment funds under management reached US$0.4 trillion, while the collective asset management schemes of securities companies stood at US$22.33 billion. At the end of 2009 there were 118 registered fund management distribution institutions, comprising 33 commercial banks, 84 securities companies and 1 securities advisory institution. Commercial banks serve as the primary sales channel for securities investment funds. At the end of 2009, the 33 commercial banks qualified as fund sales agents accounted for 74 percent of the market share of fund sales. In addition, banks and insurance companies market and operate some wealth management business. These wealth management products have grown considerably in size in recent years—at the end of 2009 wealth management products of banks totaled US$147.6 billion, of which investment grade products accounted for more than US$96.4 billion. In addition, some funds, specifically private equity style funds administered through a trust company, are regulated by the CBRC; and some other funds, specifically private equity funds linked to industry development, are regulated by the National Development Regulatory Committee (NDRC).

16. **The SAC and the CFA are national SROs for the securities and futures industries respectively.** They aim to implement self regulation over the securities and futures industry under the centralized supervision and regulation of the CSRC; to serve as a bridge between the government and the securities and futures industries; and to maintain fair competition in the securities and futures industries, promote transparency, fairness and

equitability of the market and its healthy and steady development. As of the end of 2009, the SAC had 327 members in total, including 107 securities companies, 61 fund management companies, 95 securities investment consulting companies, and 5 credit rating agencies. The CFA was composed of 201 members, including the 4 futures exchanges and 164 futures companies. The SAC and CFA are responsible for frontline supervision of members and under delegation from the CSRC conduct initial qualification examinations for members of the securities and futures industries.

17. **The Chinese securities sector has seen considerable volatility but overall has grown very quickly, especially in the last five years.** Between 2006 and 2009 the number of individual securities accounts more than doubled to over 170 million accounts, futures trading volume increased by nearly four times, and total market capitalization increased nearly three times from US$1.34 trillion to US$3.67 trillion. At the end of 2009, there were 106 securities companies with total assets of US$305 billion, accumulated annual operating revenue of US$31 billion, and accumulated net profit of US$14 billion, an increase of 93 percent on the previous year's level. There were 167 futures companies, with total assets of US$3 billion and total profits of US$0.35 billion, an increase of 160 percent on the previous year's level. However, the market is also quite volatile: market capitalization fell from a high of US$4.92 trillion in 2007 to US$1.82 trillion the following year as the global financial crisis affected market sentiment, and then rebounded to US$3.67 trillion in 2009.

18. **At the regulatory level, there have been a number of important regulatory reforms to support the movement towards a more market-based financial sector.** The reform of non-tradable shares introduced a market-based pricing system for so-called non-tradable shares in listed companies closely held by government and semi-government authorities. While many of these shares remain subject to voluntary lock-up agreements, these reforms have been welcomed by market participants and the corporate sector as improving liquidity and providing a better basis for pricing shares as a whole. The securities sector also underwent a significant overhaul in the early part of this decade following widespread solvency problems and misappropriation of funds held on behalf of clients in securities firms and funds management companies. This overhaul included introducing extensive third party custodian requirements for handling client property and risk-adjusted capital requirements for securities firms. These reforms appear to have been successful in providing greater stability to securities firms and protecting client assets: despite a significant fall in the benchmark SSE index from 6124 points in 2007 to a low of 1665 points, no securities firms defaulted on their settlement obligations and there have been no misappropriations of client funds observed.

19. **As part of the FSAP, a separate report is being prepared on development of the capital markets,** in particular on the prospects for development of the corporate bond market.

D. Preconditions for Effective Securities Regulation

20. **The Chinese regulatory regime has adopted a clear set of accounting and auditing standards which are well advanced in the process of converging with International Financial Reporting Standards (IFRS) and IAS and which are of high and internationally acceptable quality.** The accounting and audit profession is growing and developing in professional competence and capacity. Similarly, the private legal profession and the capacity of the judicial system to handle commercial disputes has also been developing, but the involvement of institutional and retail shareholders in corporate governance is less well developed. As a result, more of the burden of dealing with commercial failures that involve regulatory breaches falls onto the CSRC than in jurisdictions with more active shareholders and easier access to litigation to resolve serious disputes.

21. **There are various levels of law making within China.** The highest level are laws developed by the National People's Congress (NPC) or its Standing Committee, which include the *Securities Law* and the *Fund Law*. At the next level there are Administrative Regulations promulgated by the SC subject to the Constitution and other laws. At a third level, there are rules and regulations developed and promulgated by the CSRC in accordance with (and subordinate to) the laws and regulations of the SC. These CSRC rules and regulations may be described as "Tentative" or "Trial" where they are new regulatory requirements or relate to innovations, but they have the same status as other rules or regulations promulgated by the CSRC and are enforceable as such.

22. **In some cases the strict letter of the law has been buttressed by opinions issued by the Supreme People's Court, and these appear to have been effective.** For example, the Supreme Court has issued opinions that establish the legality and enforceability of Article 139 of the *Securities Law* and similar provisions which establish that in the insolvency of a securities firm funds held on behalf of a client shall not be treated as part of the liquidation but remain the property of the client: see the *Circular of the Supreme People's Court on Relevant Issues Concerning the Freeze and Transfer of Funds in the Clearing Accounts of Stock or Futures Exchanges (1997)*. In the bankruptcy case of Minfa Securities, the insolvency administrator had proposed that around US$11.29 million worth of clients' transaction settlement assets it had secured should be regarded as property in the liquidation. The Supreme People's Court ruled that such funds did not belong to the liquidation and should be used to cover the shortfall in clients' transaction settlement funds.

E. Key Findings

23. **As noted above the Chinese securities and futures industry and their regulation has undergone considerable development since the establishment of the establishment of the CSRC less than 20 years ago.** Reforms in recent years, in particular the non-tradable shares reforms, the introduction of stock index futures trading in 2010, and the overhaul of third party custodian and risk-based net capital requirements for securities firms, have

enhanced the transparency of the market, broadened the range of available products and improved the financial soundness of intermediaries, to the considerable benefit of investor protection in China. These reforms have been carefully planned and implemented, and have been welcomed by market participants. They provide evidence of an active and strategic approach to regulation of the Chinese securities markets on the part of the CSRC and other authorities. These reforms have built on an extensive set of regulatory provisions which have drawn on the experience of other more developed securities markets, the United States and Hong Kong amongst others. There are few areas in which the regulatory framework does not meet the IOSCO standards. As noted above, the preconditions for an efficient market framework are also undergoing considerable development, and some of the areas for improvement identified in this report look to further improvements in the legal and accounting environment.

24. **The Regulator:** The responsibilities of the regulator responsible for securities regulation, the CSRC, are clearly set out in three primary pieces of legislation: the *Securities Law*, the *Fund Law*, and the *Regulations on the Administration of Futures Trading*. A sectoral approach to regulation applies in China, under which the CBRC regulates banking and banking institutions and the CIRC regulates insurance and insurance companies. Where banking or insurance companies engage in securities type activities, such as establishing and distributing wealth management products, the CBRC and CIRC have corresponding regulatory authority. In addition, some entities such as hedge funds and private equity funds are either not regulated or lightly regulated by other entities. In the interests of avoiding regulatory arbitrage, products performing a similar function should be regulated in a similar way, and the authorities should pay particular attention to wealth management products in this regard. With respect to hedge funds and private equity funds, the IOSCO Principles as in force at the date of this assessment do not require their regulation. However, given the rapid growth in these funds (especially private equity funds) and the potential for them to be used as retail investment vehicles, the authorities should consider placing them under the regulatory authority of the CSRC. The CSRC has power to develop rules and regulatory documents within the authority granted by laws and the *Legislation Law* for the purpose of performing its functions. It operates in practice as an independent agency free from political or commercial interests, but as a SC administrative organ it is required to follow civil service staffing and budgetary procedures which do not necessarily keep pace with developments in the regulated population, and some greater flexibility in this regard would help it discharge its regulatory functions. The CSRC's budget is not sufficient to enable it to exercise its powers and responsibilities, having regard to the rapid growth in the market and the nature of other market discipline mechanisms at this stage of China's capital market development. There is considerable attention devoted to investor education, but significant further efforts are required to address retail investors' understanding of the market and risk.

25. **SROs:** The regulatory arrangements in China place significant reliance on SROs to perform regulatory functions, under the authority and supervision of the CSRC. These SROs include the exchanges, clearing and settlement institutions, and industry associations. Given

the growth of the Chinese capital markets and in particular in listed companies, retail investors and regulated entities, the SROs will need to give continued attention and resources to their regulatory functions. While the CSRC exercises significant authority and oversight over the SROs and communicates regularly with them, it should consider instituting a formal program whereby it conducts regular comprehensive inspections of the exchanges.

26. **Enforcement:** The CSRC has comprehensive powers related to inspection, investigation, surveillance and enforcement, and in particular has a useful power under which it can freeze assets by administrative order for the purpose of safeguarding them during the completion of an investigation. The laws and regulations provide a range of private rights of action for compensation and other action in the event of non-compliance causing damage to investors, but the legal system (in particular, the commercial courts) and the effect of market discipline provided by institutional investors and other participants on corporate governance is not as significant in China as in other jurisdictions. While private enforcement action is not a substitute for public enforcement action, supervision and regulation, it can supplement and support it. In combination, these factors undermine the capacity of private legal action to have a meaningful practical impact on compliance. Given the very high level of retail participation in the market, this means that the CSRC and authorities a greater share of the burden of ensuring compliance than in other markets. Arrangements for surveillance of abnormal trading are extensive and some substantial enforcement actions have been taken to deter market manipulation and insider trading, but there is need for continued attention and resources to enforce the laws with respect to illegal investment activity (including Ponzi schemes and bucket shops).

27. **Cooperation:** The CSRC has the ability to share public and non-public information with both domestic and foreign counterparts without other external process, for the purpose of performing regulatory and supervisory functions. The CSRC has established formal information sharing arrangements with the CBRC and CIRC, and with a large number of foreign securities and futures regulators. The CSRC and other domestic regulators should give more consideration to the efficacy of their cooperative arrangements, especially with respect to ensuring that products or activities that have a similar function are regulated similarly to avoid the potential for regulatory arbitrage. The CSRC is a signatory to the IOSCO Multilateral Memorandum of Understanding on Exchange of Information (MMOU) and actively makes and responds to requests for information and assistance with foreign regulators.

28. **Issuers:** The regulatory regime contains detailed requirements and followup mechanisms of the CSRC and exchanges for the disclosure of comprehensive information about financial results and risks of listed companies and other investment offers. The CSRC should promulgate a clearer requirement that advertising refer potential investors to the prospectus, similar to the requirement for CIS. The regulatory regime adequately addresses the rights and equitable treatment of shareholders, including with respect to mergers. However, the timeframes for the provision of annual and semi-annual financial statements,

and the thresholds for reporting changes in substantial shareholdings, appear long by the standards in place in other major markets and should be reviewed. The regulatory regime has adopted a clear set of accounting and auditing standards which are well advanced in the process of converging with IFRS and which are of high and internationally acceptable quality. Continued attention will need to be given to the development of the private accounting and audit profession in China, and the level of fines for the provision of false or misleading financial statements should be reconsidered, to ensure that financial statements are professionally prepared and audited.

29. **CIS:** There are clear regulatory requirements for those that wish to operate or market a CIS, which provide reasonable entry requirements, ongoing eligibility and conduct rules, and requirements aimed at managing conflicts of interest. The regulatory regime adequately provides rules governing the legal form and structure of CIS. Segregation and protection of client assets is assured through a mandatory system of third party custodianship, and there are comprehensive disclosure requirements to enable a prospective investor to evaluate the suitability and prospects of the scheme. There are adequate provisions governing valuation requirements including audit requirements, and specific requirements concerning the pricing of subscription to or redemptions from funds. However, the provisions related to the professional qualifications and experience of fund managers should be reviewed as the industry develops. Given the high level of retail participation in the market, it is very important that all information should be provided in clear and simple language, and the CSRC will need to monitor this closely. The CSRC should be wary of the potential for unlicensed CIS activity, such as Ponzi schemes, to arise in the Chinese market and give attention to detecting and deterring it.

30. **Market Intermediaries:** The Chinese regulatory regime requires that market intermediaries must be licensed with the CSRC, and are subject to initial and ongoing capital and experience and qualifications requirements. The CSRC should consider amending its rules on investment consultants to require such consultants to disclose in detail to clients their personal backgrounds and career records, working experience, compliance record, investment strategies and fee structure, as the development of an independent financial advising capacity can be an important part of markets with significant levels of retail participation. The regulatory regime in China provides appropriate prudential controls with respect to market intermediaries and that relate to the risks involved in the particular businesses that market intermediaries undertake. The initial registered capital requirements and the ongoing risk-based net capital requirements provide a significant level of prudential buffer in respect of risks. As the system of risk-based net capital is relatively new, the CSRC should continue to monitor it carefully to ensure that it captures all relevant risks. The regulatory regime requires market intermediaries to have an internal risk management function and controls to protect the interests of clients. The CSRC could consider some extensions of technical aspects of the regulatory regime to cover existing parts of the industry, such as whether the concept of suitability included in the requirements for trading in stock index futures should be more generally applied, in light of the broad retail

participation in Chinese capital markets and the need for investors to be informed about the risks of products appropriate to their circumstances, and whether some form of third party custodianship should apply to the management of client margins currently held by futures companies. The Chinese regulatory regime makes adequate provision for dealing with the failure of an intermediary, building on experience with significant failures of securities companies in the early part of this decade. However, the authorities should consider altering the threshold in the relevant regulations, that in the absence of a failure to observe a rectification order that the failure "severely threaten the order" of the market, to ensure that the CSRC can act promptly before the problem becomes too large.

31. **Secondary Markets:** The Chinese regulatory regime makes adequate provision for authorization and oversight of entities which wish to operate a stock or futures exchange, covering the exchanges themselves, admission of products to trading, trading information, and execution procedures. The regulatory regime provides for market authorities to monitor the risk of large and open positions that pose a risk to the market or clearing. In the event of default, there are procedures in place to ensure that the problem is isolated and does not affect other market participants, and for apportioning any loss appropriately. While CSRC staff maintain regular dialogue with the stock exchanges especially on listed company disclosure and trading issues, and membership and trading rules of the exchanges are subject to approval by the CSRC, instituting a formal progam whereby it conducts regular comprehensive on-site inspections like for other exchanges should also be considered. The CSRC and exchanges have implemented systems for the ongoing surveillance and supervision of trading to ensure market integrity, and have devoted considerable human and technological resources to detecting and deterring insider trading and market manipulation. At the same time, given the size of the market, its rapid growth, and the enormous interest generated by new listings, the number of abnormal trades detected and on which action is taken seems low. The CSRC should consider some extra and continuing efforts to detect and deter unfair trading practices.

Table 1. Summary Implementation of the IOSCO Principles—Detailed Assessments

Principle	Rating	Findings
Principle 1. The responsibilities of the regulator should be clearly and objectively stated	BI	The responsibilities of the regulator responsible for securities regulation, the CSRC, are clearly set out in three primary laws: the *Securities Law,* the *Fund Law*, and the *Regulations on the Administration of Futures Trading*. The CSRC has power to develop rules and regulatory documents within the authority granted by laws and the *Legislation Law* for the purpose of performing its functions. It is required to follow the legal principles established by the *Legislation Law* and the *Constitution of the Peoples Republic of China*, including principles of transparency. In practice, the CSRC has developed several rules, regulations and statement of guidance or opinion related to its functions, and market participants express satisfaction with the transparency of the consultation process. A sectoral approach to regulation applies in China, under which the CBRC regulates banking and banking institutions and the CIRC regulates insurance and insurance companies. Where such institutions engage in securities type activities, such as establishing and distributing wealth management products, the CBRC and CIRC have corresponding regulatory authority. There is potential for gaps and inequities to arise where products with similar characteristics are not regulated in the same manner, so a review of the requirements across the banking, insurance and securities sectors with respect to wealth management products should be conducted to ensure consistent regulatory approaches and avoid any unjustified differential treatment.
Principle 2. The regulator should be operationally independent and accountable in the exercise of its functions and powers	PI	The CSRC operates in practice as an independent agency free from political or commercial interests. The reforms that it has introduced in recent years, including the tradable shares reform, introduction of stock index futures, and reforms aimed at redressing solvency and conduct problems of securities and fund management companies provide strong indications of its independence. However, it is not entirely operationally independent in form from political interests as the Chairman is appointed by the SC and it is subject to SC oversight with respect to its operating structure. The provisions concerning the potential liability of staff should be made clearer that they do not bear any liability for the bona fide discharge of their functions and duties and that their protection is not subject to the discretion of the CSRC. The CSRC's budget is not sufficient to enable it to exercise its powers and responsibilities, having regard to the rapid growth in the market

		and the nature of other market discipline mechanisms at this stage of China's capital market development, notwithstanding positive developments in the accounting and legal framework. There is a strong system of accountability in place for regulatory and administrative decisions.
Principle 3. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers	PI	The powers and authorities of the CSRC are sufficient, taking into account the nature of China's capital markets. However, the CSRC's budget has not kept adequate pace with the growth in regulated entities and activities and its salaries are a very small proportion of comparable industry standards, which constrains the CSRC's ability to retain staff with industry experience.
Principle 4. The regulator should adopt clear and consistent regulatory processes	FI	The CSRC adopts clear and consistent processes in making regulatory and administrative decisions and provides adequate opportunities for review. There is some considerable attention given to investor education, but significant further efforts are required to address retail investors' understanding of the market and risk.
Principle 5. The staff of the regulator should observe the highest professional standards	FI	The CSRC staff observes high professional standards including avoiding conflicts of interests and preserving the confidentiality of information obtained in the course of their duties. The CSRC staff are subject to legislative provisions and a written code of conduct, which requirements not to hold to trade in securities and futures, not to hold any positions in regulated entities, and not to misuse information.
Principle 6 The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets	FI	The regulatory arrangements in China place appropriate and significant reliance on SROs to perform regulatory functions, under the authority and supervision of the CSRC. These SROs include the exchanges, clearing and settlement institutions, and industry associations.
Principle 7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities	BI	The SROs are subject to appropriate authorization and oversight arrangements exercised by the CSRC to provide assurance of their ability to perform their functions. Given the growth of the Chinese capital markets and in particular in listed companies and regulated entities, the SROs will need to give continued attention and resources to their regulatory functions. The CSRC should consider instituting a formal program whereby it conducts regular comprehensive on-site inspections of the exchanges.
Principle 8. The regulator should have comprehensive inspection, investigation and surveillance powers	FI	The CSRC has comprehensive powers related to inspection, investigation and surveillance.

Principle 9. The regulator should have comprehensive enforcement powers	BI	The CSRC has comprehensive enforcement powers, and in particular has a useful power under which it can freeze assets by administrative order for the purpose of safeguarding them during the completion of an investigation. The threshold for exercise of its formal investigation powers should be amended to provide the regulator with more discretion on when to bring those powers to bear. The laws and regulations provide a range of private rights of action for compensation and other action in the event of non-compliance causing damage to investors, but the legal system (in particular the commercial courts) and the effect of market discipline provided by institutional investors and other participants on corporate governance is not as significant in China as in other jurisdictions. In combination, these factors undermine the capacity of private legal action to have a meaningful practical impact on compliance. Given the very high level of retail participation in the market, this means that the CSRC and authorities a greater share of the burden of ensuring compliance than in other markets.
Principle 10.The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	BI	The CSRC oversees a credible and active inspection, surveillance, and investigation system which provides adequate oversight of the market. The CSRC should consider means of encouraging investors who have a problem to raise their concerns with the CSRC, both to bolster the market intelligence available from this source and to boost investor confidence in the regulatory framework. Arrangements for surveillance of abnormal trading are extensive and some substantial enforcement actions have been taken to deter market manipulation and insider trading, but there is need for continued attention and resources to enforce the laws with respect to illegal investment activity (including Ponzi schemes and bucket shops).
Principle 11 The regulator should have the authority to share both public and non-public information with domestic and foreign counterparts	FI	The CSRC has the ability to share public and non-public information with both domestic and foreign counterparts without other external process, for the purpose of performing regulatory and supervisory functions.
Principle 12. 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	FI	The CSRC has established formal information sharing arrangements with the CBRC and CIRC, and with a large number of foreign securities and futures regulators. The CSRC and other domestic regulators should give more consideration to the efficacy of their cooperative arrangements, especially with respect to ensuring that products or activities that have a similar function are regulated similarly to avoid the potential for regulatory arbitrage.
Principle 13. 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 a signatory to the IOSCO MMOU and actively makes and responds to requests for information and assistance with foreign regulators.
Principle 14. There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions	BI	The regulatory regime contains detailed requirements and follow up mechanisms of the CSRC and exchanges for the disclosure of comprehensive information about financial results and risks of listed companies and other investment offers. The CSRC should consider

		promulgating a clearer prohibition on advertising unless it refers potential investors to the prospectus, similar to the requirement for CIS. The timeframes for the provision of annual and semi-annual financial statements appear long by the standards in place in other major markets and should be reviewed. In addition, continued attention will need to be given to the development of the private accounting and audit profession in China, and the level of fines for the provision of false or misleading financial statements should be reconsidered, to ensure that financial statements are professionally prepared and audited.
Principle 15. Holders of securities in a company should be treated in a fair and equitable manner	FI	The regulatory regime adequately addresses the rights and equitable treatment of shareholders, including with respect to mergers. While the Law makes adequate provision for these matters, the extent to which a private institutional shareholder or group of retail shareholders can practically take action through the Court system appears to be constrained by the cost and by the capacity of the courts. Hence, the practical effect is that market discipline is inadequate to enable enforcement of these rights or compliance with these obligations, which places more burden to deal with cases of non-compliance on the CSRC or the SROs. The reporting obligation for changes in substantial shareholding (currently for changes of 5 percent) should be reviewed, in keeping with the standards in other major markets.
Principle 16. Accounting and auditing standards should be of a high and internationally acceptable quality	PI	The Chinese regulatory regime has adopted a clear set of accounting and auditing standards which are well advanced in the process of converging with IFRS and which are of high and internationally acceptable quality. There is a need to continue to develop the size and experience of the accounting and audit profession in China, given the significant role that accountants and auditors play in providing assurance on the accuracy and completeness of financial statements of listed companies and other investment vehicles.
Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a CIS	BI	There are clear regulatory requirements for those that wish to operate or market a CIS, which provide reasonable entry requirements, ongoing eligibility and conduct rules, and requirements aimed at managing conflicts of interest. The provisions related to the professional qualifications and experience of fund managers should be reviewed as the industry develops. The CSRC should be wary of the potential for unlicensed CIS activity, such as Ponzi schemes, to arise in the Chinese market and give attention to detecting and deterring it. The provisions relating to delegations, and in particular a requirement that the fund manager, custodian or securities company maintain adequate oversight of the actions of delegates, should be made clearer.
Principle 18. The regulatory system should provide for rules governing the legal form and structure of CIS and the segregation and protection of client assets	FI	The regulatory regime adequately provides rules governing the legal form and structure of CIS. Segregation and protection of client assets is assured through a mandatory system of third party custodianship.

Principle 19. Regulation should require disclosure, as set forth under the principles for issuers, 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	FI	There are comprehensive disclosure requirements for CIS which provide the information necessary to enable a prospective investor to evaluate the suitability and prospects of the scheme. There are adequate provisions governing valuation requirements to enable an investor to determine the value of their investment. Given the high level of retail participation in the market, it is very important that all information should be provided in clear and simple language, and the CSRC will need to monitor this closely.
Principle 20. Regulation should ensure that there is a proper and disclosed basis for assets valuation and the pricing and the redemption of units in a CIS	FI	There are detailed regulatory requirements governing the valuation of CIS assets including audit requirements. There are also specific requirements concerning the pricing of subscription to or redemptions from funds.
Principle 21. Regulation should provide for minimum entry standards for market intermediaries	FI	The Chinese regulatory regime requires that market intermediaries must be licensed with the CSRC, and are subject to initial and ongoing capital and experience and qualifications requirements. The CSRC should consider amending its rules on securities and futures investment consultants to require such consultants to disclose in detail to clients their personal backgrounds and career records, working experience, compliance record, investment strategies and fee structure, as the development of an independent financial advising capacity can be an important part of markets with significant levels of retail participation.
Principle 22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake	BI	The regulatory regime in China provides appropriate prudential controls with respect to market intermediaries and that relate to the risks involved in the particular businesses that market intermediaries undertake. The initial registered capital requirements and the ongoing risk-based net capital requirements provide a significant level of prudential buffer in respect of risks. As the system of risk-based net capital is relatively new, the CSRC should continue to monitor it carefully to ensure that it captures all relevant risks.
Principle 23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters	BI	The regulatory regime requires market intermediaries to have an internal risk management function and controls to protect the interests of clients. The concept of suitability included in the requirements for trading in stock index futures should be more generally applied to trading in both futures and securities, given the need for retail investors to be provided with sufficient information about products and services to be able to make an informed investment decision. The recently introduced "Know-your-client" regulations for securities companies should be carefully monitored to ensure that they are resulting in investors making better informed investment decisions, given the growth of the market and the level of retail participation in it. In light of the apparent effectiveness of the third party custodian requirements for securities firms and fund management companies in preventing problems of misappropriation of client assets, the CSRC should consider whether some form of third party custodianship should apply to the management of client margins currently held by futures companies.

Principle 24. 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	FI	The Chinese regulatory regime makes adequate provision for dealing with the failure of an intermediary, building on experience with significant failures of securities companies in the early part of this decade. However, the authorities should consider altering the threshold in the relevant regulations, that the failure "severely threaten the order" of the market, to ensure that the CSRC can act promptly before the problem becomes too large.
Principle 25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight	FI	The Chinese regulatory regime makes adequate provision for authorization and oversight of entities which wish to operate a stock or futures exchange, covering the exchanges themselves, admission of products to trading, trading information and execution procedures. While CSRC staff maintains regular dialogue with the stock exchanges especially on listed company disclosure and trading issues, annual inspections like for other exchanges should also be considered. The CSRC should also consider providing more autonomy to the stock exchanges in choosing its Chief Executive.
Principle 26. 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 CSRC and exchanges have implemented systems for the ongoing surveillance and supervision of trading, to ensure market integrity. Membership and trading rules of the exchanges are subject to approval by the CSRC.
Principle 27. Regulation should promote transparency of trading	FI	The regulations require the provision of pre- and post-trade information to market participants on a timely basis, including requirements to provide such information to all participants on an equitable basis.
Principle 28. Regulation should be designed to detect and deter manipulation and other unfair trading practices	FI	The CSRC and exchanges have devoted considerable human and technological resources to detecting and deterring insider trading and market manipulation. At the same time, given the size of the market, its rapid growth, and the enormous interest generated by new listings, the number of abnormal trades detected and on which action is taken seems low. The CSRC should consider some extra and continuing efforts to detect and deter unfair trading practices.
Principle 29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption	FI	The regulatory regime provides for market authorities to monitor the risk of large and open positions that pose a risk to the market or clearing. In the event of default, there are procedures in place to ensure that the problem is isolated and does not affect other market participants, and for apportioning any loss appropriately.
Not assessed. Please refer to the separate CPSS/IOSCO assessment of payment, clearing and settlement systems.	n/a	
Aggregate: Fully implemented (FI) – 18, broadly implemented (BI) – 8, partly implemented (PI) – 3, not implemented (NI) – 0, not applicable (N/A) – 1.		

F. Recommended Action Plan and Authorities' Response

Recommended action plan

Table 2. Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 1	Where banks or insurance companies engage in securities type activities, such as establishing and distributing wealth management products, they should be regulated in the same manner as wealth management products regulated by the CSRC, to avoid regulatory arbitrage. A review of the requirements applying to wealth management products across banking, insurance and securities should be conducted to ensure consistent approaches and to avoid gaps or unjustified differential treatment.
Principles 2 and 3	The operational budget of the CSRC should be adjusted according to the size of the regulated population, and some freedom should be provided to allow the CSRC to structure itself and pay salaries which enable it to retain staff with appropriate qualifications and industry experience. The provisions concerning the potential liability of staff should be clarified to ensure that staff does not bear liability for the bona fide discharge of their functions and duties.
Principle 4	The CSRC, SIPF, and SROs should increase their efforts to educate investors about the market and risk.
Principle 7	Given the growth of the Chinese capital markets and in particular in listed companies and regulated entities, the SROs will need to give continued attention and resources to their regulatory functions. The CSRC should consider instituting a formal program whereby it conducts regular comprehensive on-site inspections of the exchanges.
Principle 9	It would be useful and provide greater legal certainty to the CSRC in its enforcement role if the threshold for exercise of its formal statutory investigation powers were amended to provide greater discretion on when it may bring those powers to bear.
Principle 10	The CSRC should consider means of encouraging investors who have a problem to raise their concerns with the CSRC, both to bolster the market intelligence available from this source and to boost investor confidence in the regulatory framework. In addition the CSRC needs to devote continued attention and resources to enforcing the laws with respect to illegal investment activity (including Ponzi schemes and bucket shops).

Principle	Recommended Action
Principle 12	The CSRC and other domestic regulators should give more consideration to the efficacy of their cooperative arrangements, especially with respect to ensuring that products or activities that have a similar function are regulated similarly to avoid the potential for regulatory arbitrage.
Principle 14	The CSRC should consider promulgating a clearer prohibition on advertising unless it refers potential investors to the prospectus. The level of fines for the provision of false or misleading financial statements should be reconsidered. The statutory timeframes for the provision of annual and semi-annual reports by listed companies should be reviewed.
Principle 15	The obligation to report changes in substantial shareholdings (currently only for changes of over 5 percent) should be reviewed, in keeping with the standards in other major markets.
Principle 16	Continued attention should be given to the development of the private accounting and audit profession in China, to ensure that financial statement are professionally prepared and audited.
Principle 17	The provisions related to the professional qualifications and experience of fund managers should be reviewed as the industry develops. The CSRC should be wary of the potential for unlicensed CIS activity, such as Ponzi schemes, to arise in the Chinese market and give attention to detecting and deterring it. The provisions relating to delegations, and in particular that the fund manager, custodian or securities company maintain adequate oversight of the performance of a delegate, should be made clearer.
Principle 21	The CSRC should consider amending its rules on investment consultants to require such consultants to disclose in detail to clients their personal backgrounds and career records, working experience, compliance record, investment strategies and fee structure, as the development of an independent financial advising capacity can be an important part of markets with significant levels of retail participation.
Principle 22	As the system of risk-based net capital is relatively new, the CSRC should continue to monitor it carefully to ensure that it captures all relevant risks.

Principle	Recommended Action
Principle 23	The concept of suitability included in the requirements for trading in stock index futures should be more generally applied to trading in both futures and securities, given the need for retail investors to be provided sufficient information about products and services to be able to make an informed investment decision. In light of the apparent effectiveness of the third party custodian requirements for securities firms and fund management companies in preventing problems of misappropriation of client assets, the CSRC should consider whether some form of third party custodianship should apply to the management of client margins currently held by futures companies. The recently introduced "Know-your-client" regulations for securities companies should be carefully monitored to ensure that they are resulting in investors making better informed investment decisions, given the growth of the market and the level of retail participation in it.
Principle 24	The authorities should consider altering the threshold in the relevant regulations for intervention in the failure of a market intermediary, that the failure "severely threaten the order" of the market, to ensure that the CSRC can act promptly before the problem becomes too large.
Principle 25	Annual inspections of the stock exchanges should be instituted, as they are for futures exchanges. The CSRC should consider providing more autonomy to the stock exchanges in choosing its Chief Executive.
Principle 28	The CSRC should consider some extra and continuing efforts to detect and deter unfair trading practices, including: • Educating company officers, officers of securities and futures companies and related parties that insider trading and other market manipulation is a criminal offence; • Educating prosecutors and judges about the impact that insider trading has on investor confidence in the market; • Redoubling efforts at investigating suspicious trading around events likely to involve it, like initial public offerings (IPOs) and merger announcements, and lowering the thresholds for investigating or making enquiries; • Considering whether special rules should be developed to suspend or quarantine the proceeds of suspicious trades, including considering lowering the threshold of the level of suspicion (for freezing or quarantining actions) or altering the definition of abusive or suspicious trades to facilitate taking civil or disciplinary action; and

Principle	Recommended Action
	• Considering measures related to product design, especially in relation to futures products, to make them sufficiently broad-based that it is difficult for insider trading or market manipulation to be successful.

Authorities' response to the assessment

CSRC appreciates the immense time, efforts and resources devoted by the FSAP Assessors, the World Bank and the International Monetary Fund, to the FSAP assessment, and to the compiling of the *Report of Observance of Standards and Codes: IOSCO Assessment of Securities Markets (*hereinafter: *the Report).* T*he Report* has*,* in a general sense, managed to reflect the implementation of the IOSCO objectives and principles by China's securities and futures regulatory system. We fully understand how challenging and complex it was to conduct such a project as to review China's capital market, the world's largest emerging market in transition. Therefore, we marvel at and are moved by how much the Assessors managed to accomplish in relatively limited amount of time. They held scores of meetings with the CSRC headquarters and regional offices. They met with various regulated entities, SROs, service providers and local governmental officials. They also went through colossal volumes of reading materials. The Assessors have not only conducted comprehensive reviews of China's capital market and its regulation, but also put forward many valuable comments and recommendations.

We are grateful for the opportunity to make a formal response to *the Report*. We identify with most of *the Report*, including its major Findings and part of the Recommendations. To start with, *the Report* highly recognizes the development and achievements of China's capital market over the past two decades, as well as the regulatory efforts thereof, noting "Reforms in recent years, in particular the nontradable shares reforms, the introduction of stock index futures trading in 2010, and the overhaul of third party custodian and risk-based net capital requirements for securities firms, have enhanced the transparency of the market, broadened the range of available products and improved the financial soundness of intermediaries, to the considerable benefit of investor protection in China. These reforms have been carefully planned and implemented, and have been welcomed by market participants. They provide evidence of an active and strategic approach to regulation of the Chinese securities markets on the part of the CSRC and other authorities." Meantime, *the Report* also points out that these reforms have built on an extensive set of regulatory provisions which have drawn on the experience of other more developed securities markets, and that there are few areas in which the regulatory framework does not meet the IOSCO standards. In addition, *the Report* acknowledges that "the Chinese regulatory regime has adopted a clear set of accounting and auditing standards which are well advanced in the process of converging with the IFRS and IAS and which are of high and internationally accepted quality."

After reading the Recommendations of *the Report*, we recognize that all of them are worthy of immense attention and some of the Recommendations have already been incorporated into our work plans. For example:

Regarding the regulator

With lessons drawn from the latest financial crisis, we identify with relevant Recommendations in *the Report*, such as strengthening regulatory coordination among different Regulators (i.e., the CSRC, the CBRC, and the CIRC), placing unregulated markets and products under regulation, allowing greater flexibility for the Regulator in terms of staffing and budget, clarifying relevant provisions to ensure that regulatory staff do not bear liability for the bona fide discharge of their functions and duties, etc. In response to these Recommendations, China's regulatory authorities will take further measures to enhance the efficacy of the CBRC-CSRC-CIRC Memorandum of Understanding (MOU) to avoid potential regulatory gap. Meantime, China's regulatory authorities are taking active measures that will cover the previously unregulated institutions and products (e.g., private equity funds). With regard to Recommendations to increase regulatory resources and to exempt staff from liability for the bona fide discharge of duties, the CSRC will further consult with relevant government agencies, as well as legislative and judicial authorities. We believe more regulatory resources that are proportionate to China's political system, economic status and the overall income level of its financial industry will manage to satisfy the regulatory demand of an ever-expanding market.

Regarding SROs

We agree with *the Report* that the SROs will need to give continued attention and resources to their regulatory functions; and that the CSRC, SIPF, and SROs should increase their efforts to educate investors about the market and risk. We recognize that given the rapid growth of the Chinese capital market and in particular in listed companies and regulated entities, the functions of SROs need to be further tapped into. The CSRC will enhance its regulation of and communication with the SROs, and will seriously consider relevant Recommendation to conduct regular comprehensive onsite inspections of the stock exchanges.

However, we cannot agree with some Findings and Recommended Actions in *the Report*, which we think are misunderstandings and erroneous. We feel that such misunderstandings and errors are partly due to the lack of sufficient understanding of China's capital market, its features and mechanisms; and partly due to the failure to acknowledge the remedies that have already been put in place, or perhaps to the lack of trust in the efficacy of existing mechanisms and measures. In some cases, *the Report* even denies, without sufficient proof that such regulatory practices are ineffective, some tried-and-trusted practices that are unique to the Chinese market. We would like to express our concerns.

Regarding enforcement

We do not think *the Report* has sufficiently reflected CSRC's efforts and achievements in cracking down on illegal investment and insider-trading. In 2006, the Steering Group on Cracking Down upon Illegal Securities Activities was jointly established by the CSRC and Ministry of Public Security. With the aim to organize and coordinate domestic efforts in combating illegal securities activities, the work of this Steering Group has yielded visible results. In our daily work, the CSRC monitors various public news media including the internet, in order to timely detect clues of securities violations for prompt handling. In 2001, the CSRC enacted the *Notice on Implementing an Incentive Mechanism for the Reporting of Illegal and Fraudulent Securities and Futures Trading,* encouraging investors to blow whistles on illegal securities and futures activities. Pursuant to China's securities laws, any securities or futures violation that exceeds RMB 300 thousand constitutes a crime, and shall be referred by the CSRC to public security authorities. To sum up, illegal investment activities akin to Ponzi schemes and boiler rooms have been effectively detected and punished.

Regarding intermediaries

The Report recommends that there should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake. *The Report* also recommends that "as the system of risk based net capital is relatively new, the CSRC should continue to monitor it carefully to ensure that it captures all relevant risks." However, we believe that CSRC's supervision of net capital is sufficient and appropriate. The risk-based net capital system, featured by off-site supervision and on-site inspection, and timely and effective regulatory measures taken against problematic intermediaries, has proved to capture risks very well. Moreover, ever since 2007, the CSRC has been continuously monitoring and assessing the net-capital based risk regulatory system via information technology (IT) monitoring platforms, and requires regular stress-test thereof.

Regarding accounting and auditing standards

We regret to say that we cannot identify with the Rating result of IOSCO Principle 16. A "Partly Implemented" fails to reflect the fact that China's capital market accounting and auditing regulatory practice has broadly met with the internationally recognized high standards. Neither does it acknowledge CSRC's regulatory efforts and effects in this regard.

While *the Report* suggests that both the CSRC and China's stock exchanges are short of highly skilled staff in accounting supervision, the fact is quite the opposite—the CSRC and China's stock exchanges have accounting regulatory staff sufficient to meet the current regulatory needs. China's capital market accounting and auditing regulatory mechanism is a comprehensive network, of which the CSRC is responsible to perform comprehensive

supervision of accounting firms, CSRC regional offices are responsible to oversee the auditing quality of the annual reports of listed companies, and the exchanges are responsible to ensure the compliance of financial reporting and disclosure. Such a complementary regulatory network consisting of the CSRC, its regional offices and the exchanges guarantees the comprehensive, timely and all-round supervision of capital market accounting and auditing, and ensures the effective implementation of accounting and auditing standards in the capital market. Meantime, this comprehensive regulatory mechanism has sufficient regulatory personnel resource with regard to accounting and auditing. According recent statistics, over 1/5 of the staff of the securities regulatory mechanism are currently engaged with accounting and disclosure related work, all of them have years of working experience in the accounting industry, are well educated and continuously trained in the profession. China's capital market accounting and auditing are of internationally recognized standards, and incommensurate with the stage of development of the market.

On the number and professionalism of accountants and auditors, an issue suggested by *the Report*, we feel the findings of *the Report* lack factual grounds. As a matter of fact, in order to ensure high quality auditing, the CSRC has established a qualification license system, allowing only accounting firms that have obtained the qualification license for securities and futures business to perform auditing for securities companies. The CSRC conducts regular on-site inspection of these accounting firms (currently there are 54 of them), via which we are convinced that the number and professionalism of capital market accountants and auditors can meet the current needs of this market. Meantime, investors as well as various market participants are satisfied with both the accounting quality of listed companies and the auditing quality of accounting firms.

As for the compliance actions taken against some accounting firms during the three-year overhaul of securities firms, another issue raised by *the Report*, we regret to say that *the Report* fails to take into full consideration the then conditions, laws and regulations. In 2004 when the comprehensive overhaul of securities firms were started, the CSRC also launched an accountability mechanism of accounting firms. Under this mechanism, substantial investigations were done regarding relevant accounting firms, to draw a strict line between accounting responsibility and auditing responsibility. As a result, 11 accounting firms which were found to have failed their auditing responsibilities were sanctioned. Meantime, relevant laws and regulations were amended to strengthen capital market accounting and auditing oversight. Judging from our supervision of the securities companies, the quality of their accounting information and auditing reports has greatly improved.

The Report makes frequent reference to the World Bank *ROSC Repor*t, a document released in 2009, citing only the individual issues and disregarding the general conclusion. However, the *ROSC Report* was actually very affirmative and positive with regard to China's capital market accounting and auditing. The CSRC has provided explicit explanations on this issue and submitted substantial materials that evidence the broad implementation of Principle 16.

We are sorry that *the Report* should give a "Partly Implemented" rating on the Principle without objectively observing relevant assessment methodologies. We look forward to continued dialogues with the assessors, the World Bank and the IMF to eliminate current misunderstandings.

While we may not agree with everything *the Report* says, we fully agree with what the Assessors kindly reminded during one of our numerous meetings—that we should not take pride in the findings, nor rest on our past laurels. In this sense, the FSAP Assessment stands as a good chance for us to retrospect the past and take a prudent look into the future. After all, given the tremendous changes that the world is undergoing, China's capital market is exposed to profound changes and challenges, both home and abroad, while its regulators are encountered with an increasingly complex market and ever-growing tasks of maintaining sound and steady growth. An incomplete list of the challenges that we are facing include issues such as how to further build and improve the market legal framework, enhance enforcement and deterrence, so as to better protect the lawful rights of investors; how to strengthen regulatory coordination and function-based regulation with regard to various wealth management products offered to the public, so as to minimize potential regulatory gaps; how to regulate the once unregulated markets and products, striking appropriate balance between financial innovation and regulation; how to prevent and resolve systemic risks, strengthen the oversight of cross-border capital flow and sound early warnings of risks from abroad; how to cultivate sophisticated investors and encourage institutional investors, etc. We recognize that they are but some of the challenges we are faced with, that call for our unremitting effort and commitment. As regulators of China's capital market, we have a long and promising way ahead of us.

II. DETAILED ASSESSMENT

Detailed Assessment of Implementation of the IOSCO Principles

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	The CSRC, an institution reporting to the SC and the NPC, has responsibility for fundraising by listed companies, regulation of securities markets and participants, mutual funds, and futures markets and participants. Its responsibilities, powers and authorities are set out under three primary laws: the *Securities Law*, the *Fund Law* and the *Regulations on the Administration of Futures Trading*. A Futures Law is currently in development. The CSRC has power to develop rules and regulatory documents within the authority granted by laws and the *Legislation Law* for the purpose of performing its functions. It is required to follow the legal principles established by the *Legislation Law* and the *Constitution of the Peoples Republic of China*, including principles of transparency. The *Legislation Law* provides that rules and regulations need to be within the scope of authority granted by higher level laws, and the CSRC's Regulations *on the Procedures for Formulation of Securities and Futures Laws* has set out specific procedures for developing rules and normative documents issued by the CSRC. In making administrative decisions, the CSRC has a process for appeals from administrative decisions to an internal committee, and external appeal rights also exist. A sectoral approach to regulation applies in China, under which the PBC is responsible for overall monetary policy and systemic stability, the CBRC regulates banking and banking institutions, the CIRC regulates insurance and insurance companies, and the CSRC regulates the securities and futures markets and participants. Where banking and insurance institutions engage in securities type activities, such as establishing and distributing wealth management products, the CBRC and CIRC have corresponding regulatory authority. These wealth management products have grown considerably in size in recent years—at the end of 2009 wealth management products of banks totaled US$147.6 billion, of which investment grade products accounted for more than US$96.4 billion. By comparison, the size of securities investment funds registered by the CSRC in 2009 was US$0.36 trillion. In addition: • Some funds, specifically private equity style funds administered through a trust company, are regulated by the CBRC; and • Some other funds, specifically private equity funds linked to industry development, are regulated by the NDRC. Commercial banks also serve as the primary sales channel for securities investment funds. At the end of 2009, the 33 commercial banks qualified as fund sales agents accounted for 74 percent of the market share of fund sales. Outside these cases a separation of activities between the institutions operating in the banking, insurance and securities sectors is in place. For example, a bank is not permitted to have a

	securities company subsidiary. Apart from the role played by the CBRC, CIRC, and the PBC in the overall regulatory framework, SROs, in particular the SAC, CFA and the stock and securities exchanges, play an important role in regulating Chinese capital markets. The role and effectiveness of these SROs is assessed under Principles 6, 7, and 28. The CSRC, CBRC, and CIRC have an MOU covering cooperation in regulation of the financial system, based on the principles of clear division of responsibility and coordination as necessary, especially on data collection. The regulatory authorities have power to seek information from and provide information to each other for the purpose of performance of their regulatory functions (see Principles 11 and 12). They have a formal quarterly Joint Working Meeting to discuss and resolve related issues, and a Government Task Force is currently examining issues of possible regulatory overlap and arbitrage. In practice, as all regulators are keen to mitigate risks arising in their areas of responsibility, there is an incentive to avoid regulatory arbitrage which leads to gaps in regulatory requirements for like activities. For example, in 2007 the CSRC and CBRC commenced joint reviews of fund sales institutions. In 2009 the CSRC and CBRC examined 28 commercial banks focusing on promotional materials, safekeeping of capital, fund sales agreements, internal controls and investor education. While standards had improved since 2008, problems remained in areas such as insufficient implementation of fund sales applicability requirements, unauthorized preparation and use of promotional material, and gifts in the opening of accounts or fund sales.
Assessment	Broadly Implemented
Comments	The CSRC's responsibility, authority and powers are clearly defined and transparently set out in law and regulations. It carries out unified and centralized administration of matters within its regulatory responsibility, through the Central Office and a network of 38 Regional Offices. It exercises jurisdiction through a combination of rule making, registration/licensing, inspection and enforcement activities. In practice, the CSRC has developed several rules, regulations and statement of guidance or opinion related to its functions, and market participants express satisfaction with the transparency of the consultation process. The CSRC has a process for issuing opinions on the application of securities and futures laws, developed by the relevant functional department and reviewed by the Legal Affairs Department, to ensure that the interpretation is consistent and transparent. Its enforcement powers include extensive administrative remedies, such as revocation of licenses or registration, and court based remedies including criminal sanctions in appropriate matters. The judicial system with respect to commercial matters is in a state of development, and the volume of cases suggests an insufficient level of public confidence in the system to enable market discipline and private legal action to play a significant role in enforceability at this stage. As a result of the sectoral approach to financial regulation adopted in China coordination between the regulators is very important, to ensure that similar products and activities and products such as wealth management products regardless of the offering entity are regulated in a similar way and avoid potential regulatory arbitrage. Given the importance of coordination between the regulators, the authorities have recently published the MOU between the CBRC, CIRC and CSRC (see the CBRC website, www.cbrc.gov.cn). The CSRC imposes regulation on CIS of securities investment companies and securities companies, while the CBRC and CIRC impose regulation on investment products provided by banks and investment-linked insurance products offered by insurance companies. The latter has

	grown to very considerable proportions in recent years, to a little over one quarter of the value of securities investment funds registered by the CSRC, but is not subject to similar disclosure or sales practice requirements. A review of the requirements across the banking, insurance and securities sectors with respect to wealth management products should therefore be conducted to ensure consistent regulatory approaches and avoid any unjustified differential treatment.
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	While its Chairman holds Ministerial rank and is appointed by the SC, the CSRC itself exercises its day-to-day functions independent of external political influence. The NPC and its Standing Committee review and approve the budgets and implementation of the budgets of the central and local governments including those of the CSRC's, in accordance with the Budget Law, and may conduct "law enforcement inspections" to check on the implementation of laws and regulations by state organs. The NPC Standing Committee last inspected the *Securities Law* in 2001 and published a report. In 2009 it inspected the enforcement of three laws. The CSRC is wholly funded from the Central Government budget. The CSRC is an institution under the SC and has no administrative affiliation with other departments of the SC, but it is subject to civil service salaries and an administrative organ of the SC approves changes in structure of other SC organs, including the CSRC. The SC also reviews CSRC rules and administrative reconsiderations in accordance with the *Legislation Law* and *Administrative Reconsideration Law*. Since 2007 3 cases have been submitted to the SC in which the CSRC is a respondent. Two are pending and in the other one the CSRC's decision was upheld. The formulation of CSRC regulatory policies does not require the approval of other departments, although in practice there is extensive consultation depending on the strategic importance of the issue. On matters where more than one domestic regulatory authority is responsible, consultation is required and carried out in accordance with Article 72 the *Legislation Law* and relevant administrative regulations. In such cases the regulators are required to consult with each other and either request the SC to formulate administrative regulations, or formulate joint regulations. The MOU between the CBRC, CIRC and CSRC provides a specific consultation mechanism for the three authorities on major financial regulatory issues, market responses to new policies and assessment of the results of such policies. Concerning its budget, the CSRC has a stable source of funding through the Central Government budget for its regulatory and operational needs. The budget is prepared and approved annually. All supervision fees levied by the CSRC on securities and futures market participants are paid directly into the national Treasury. The CSRC's staffing levels in recent years:

Year	**2006**	**2007**	**2008**	**2009**	**2010**
Employees	1,930	2,126	2,409	2,512	2,621
Turnover (%)	2.64	3.01	2.20	2.09	n/a

The CSRC's budget levels: (Unit: RMB million yuan)

Item	2006	2007	2008	2009	2010
Basic Expenditure, comprising:	346.9	409.8	479.6	545.3	506.1
Personnel Expenditure	138.3	160.4	213.3	255.4	222.3
Public Expenditure	208.5	249.4	266.3	289.9	283.8
Administrative Expenditure	77.6	137.4	222.8	242.9	245.0
Administrative sub-total (Basic plus Administrative Expenditure)	424.5	547.2	702.4	788.1	751.1
Infrastructure	57.2	205.2	411.6	186.9	11.0
Total	481.7	752.4	1,114.0	975.0	762.1

Some indicative data on the CSRC's regulatory population: (Source: CSRC Annual Report 2009)

Item	2006	2007	2008	2009	06/09 % inc.
Onshore listed companies	1,434	1,550	1,625	1,718	19.8
Offshore listed companies	143	148	153	159	11.2
Market cap (US$100 mn)	13,464	49,268	18,278	36,738	72.8
Securities accounts (mn)	78.5	138.9	152.0	171.5	118.5
Futures trading volume (10,000 lot)	44,947	72,800	136,396	215,743	380.0

The CSRC and its staff, in the discharge of their functions and powers, have appropriate legal protection from liability in respect of the discharge of their governmental, regulatory and administrative functions and powers. Article 9 of the *Civil Servant Law* provides that the discharge of functions and powers by civil servants are protected by law. 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 Peoples Republic of China* and Article 68 of the *Administrative Procedure Law* provide that in case any staff member of a state organ causes damage to the legitimate rights of any citizen when discharging his functions and powers, the state organ is to assume civil and administrative liabilities. In the case of deliberate or material faults the state organ is entitled to order the person concerned to assume the compensation partly or wholly.

The appointment of the principal officers of the CSRC, including its chairman, five vice chairmen and three assistant chairmen, follow specified procedures. Paragraph 2 of Article 134 of the *Civil Servant Law* provides that a civil servant shall not be removed or disciplined without

	a legally prescribed cause or following legal procedures. Various articles specify the circumstances for dismissal or expulsion. Under relevant regulations, the CSRC chairmen hold office for a fixed term of five years and can serve for a maximum of two consecutive terms. The main legal basis for dismissal of any CSRC staff members is the *Provisions on the Dismissal of Civil Servants* and the *Regulation on Disciplinary Actions against Civil Servants of Administrative Organs*. Article 3 provides that dismissal of civil servants shall be made based on the statutory circumstances (which cover matters such as fraud, corruption and dereliction of duty), within the statutory authority and subject to statutory procedures.
Assessment	Partly Implemented
Comments	While the Chairman of the CSRC holds Ministerial rank in the Chinese Government and is appointed by the SC, the CSRC itself exercises its day-to-day functions independent of external political influence. The NPC, its Standing Committee and the SC supervise the CSRC's operations but do not interfere in day-to-day operations. The substantive reform efforts in recent years dealing with insolvent securities companies and non-tradable shares provide tangible evidence of the CSRC's independence from commercial and sectoral interests. The CSRC performs centralized and unified supervision and regulation of the nation's securities and futures markets, with the aim both of promoting soundness in the markets and promoting market development. This dual aim necessarily involves balance and compromise, especially with respect to financial innovation. There may be times when the two mandates conflict. However, the CSRC has been able to introduce a range of important market development reforms in recent years, such as those concerning non-traded shares and the introduction of a financial futures contract, described later in this report, which suggests that the combination of these two mandates is manageable. The process for the CSRC in developing administrative rules and procedures provides for consultation and market participants express satisfaction with its transparency and effectiveness. The MOU between the CBRC, CIRC and CSRC has recently been published and is therefore transparent to the market. The CSRC feels that its budget is sufficient for its operational and regulatory needs, but is concerned that its staff salaries are significantly less than those payable in the industry which may make staff retention increasingly difficult. However, the CSRC's budget does not appear to be sufficiently linked to changes in the regulatory population, and it is subject to restrictions common to other administrative organs under the SC which restrict its flexibility with respect to structure and salaries. Its operational independence would be enhanced if more flexibility were available. The CSRC's budget is largely based on historical spending, save for special funding provided for specific projects, and is not adjusted to take account of changes in the size of the regulated population or the amount of fees collected from the industry. Hence, its budget has not kept pace with the substantial growth in the securities markets that it regulates, and a substantial disparity is developing between the salaries it pays its staff and the salaries available in the industry they regulate. As a result the CSRC is finding it increasingly difficult to retain its staff. The CSRC has advised that it has access to a scheme for paying higher salaries to better qualified staff and is

	currently considering how to implement it. The CSRC Chairman and senior staff are subject to appropriate appointment and termination procedures. The CSRC and its staff must observe a range of appropriate provisions concerning avoidance of conflicts of interest including bans on bribery and concurrent positions and the like, and have legislative protections from personal liability in respect of the proper performance of their duties. However, it would be useful if it was made clearer that no liability attaches to an individual staff member if they act bona fide in the discharge of their powers and functions, as there is some ambiguity about an individual's liability if they act honestly but still cause material damage to the legitimate rights of a citizen.
Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	The CSRC has responsibility for carrying out centralized and unified regulation of securities and futures markets in China. In particular, responsibility for regulation of futures markets was conferred on the CSRC following failures in futures markets regulated at provincial level during the 1990s. Some other authorities have responsibility for regulation of aspects of the capital markets. In particular, the NDRC registers certain private equity funds, and the investment management activity of banks is subject to the regulation of the CBRC. The CSRC has extensive and comprehensive powers and authorities with respect to entities regulated by it conferred under the *Securities Law*, *Fund Law* and *Regulations on the Administration of Futures Trading*, including rule making, licensing, and registration of issues and market participants, inspection, surveillance, and investigation. It has powers to restrict trading by particular participants or in particular securities or futures contracts, and a power to order the freezing of assets in certain circumstances which is not found in other jurisdictions and is very useful for enforcement purposes. The funding for the CSRC is appropriated annually from the budget of the Central Government, which covers ongoing salaries, administrative and capital expenses. It currently has around 2600 staff across 38 offices. The yearly appropriation is largely based on building on previous year's funding allocations, and the budget process also enables funding of special purpose projects, such as IT upgrades or new installations. See Principle 2 for more details. Within the scope of the annual budget provided by the Central Government, the CSRC is able to allocate its resources as it sees fit to pursue its functions and priorities. However, changes to the structure and senior staffing positions are subject to approval by another administrative organ under the SC. The CSRC employs a range of training methods including overseas training to ensure that its staff is adequately trained. It will be important for the CSRC to maintain high levels of training especially using industry professionals to ensure that its staff obtains sufficient industry knowledge to be credible in their regulatory roles.
Assessment	Party Implemented
Comments	The CSRC reports that the annual budget enables the CSRC to provide a good working environment and to attract sufficient well-qualified staff to perform its core functions, its staff turnover is within acceptable levels, and it has been able to attract some staff with industry experience. Generally speaking, salaries are tied to civil service salary scales, which are

	increasingly out of step with comparable industry standards to such a degree that the CSRC's ability to retain its staff is questionable in the long term. That said, the CSRC reports that as at 2010 staff members have an average of 8 years experience at the CSRC and high and medium level staff an average of over 11 years working experience at the CSRC. 6 percent of its staff holds PhD degrees, nearly 50 percent hold Masters degrees and over 31 percent hold bachelor degrees. Its turnover of staff (between 2006 and 2009 the CSRC saw annual turnover of between 42 and 64 staff, at rates of between 2 and 3 percent, and anecdotally its Zhejiang Regional Bureau [which covers a significant number of futures companies] has only seen 16 of its 100 staff leave over ten years, a turnover rate of less than 2 percent pa) does not suggest a current problem with retaining staff, but the level of discrepancy with comparable industry salaries (the CSRC suggests a ratio of 15 or 20:1 between industry and CSRC salaries for comparably qualified staff) suggests a medium term problem with retaining adequately qualified staff. It also suggests that the CSRC may be unlikely to be able to attract staff with industry experience in the future. Article 17 of the *Regulations for Implementation of the Budget Law of the People's Republic of China (PRC)* stipulates that the various departments should compile their annual budgets according to their responsibilities, task and development plans, implementation of budgets from the previous year, and factors affecting the revenues and expenditures for the current year. Nevertheless, the budget process does not appear to have taken adequate account of increases in the size of the regulated population, which is growing very quickly. For example, between 2006 and 2009 there were the following percentage increases in areas relevant to the CSRC's regulatory responsibilities: onshore listed companies 19.8 percent; Market capitalization 72.8 percent; Securities accounts 118.5 percent (to 172 million); and Futures trading volume 380 percent. See Principle 2 for further details.
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	The CSRC publishes the laws relating to its responsibilities, and subsidiary rules, regulations and opinions on its website and through other mechanisms, such as periodic publications. Under the general regulations applying to rule making under the *Legislation Law*, there are requirements for soliciting opinions on proposed rules and policies from persons affected. The CSRC has promulgated and published its own regulations, the *Regulations on the Procedures for Formulation of Securities and Futures Regulations* and the *Tentative Rules on Soliciting Public Comments on Drafts of Securities and Futures Regulations*, which set out its rule-making process and provide for public consultation on proposed rules, and market participants express satisfaction with the level of consultation and the responsiveness of the CSRC to comments provided. In terms of administrative licensing, the general criteria for licenses are required to be established by rules and regulations which must be published. The CSRC publishes through its website and makes available through its offices the procedures, required documents and timelines for administrative 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 are entitled to a hearing with respect to any decision to grant, deny or revoke an administrative license. The CSRC is required to give written reasons for its decisions (Articles 24, 25, and 40 of the *Regulations on the Procedures for Implementation of Administrative Licensing*, and Article 39 of the *Administrative Penalty Law*). In relation to banning actions, the CSRC is required to provide the parties concerned with the facts as alleged, a right to make statements and request a hearing.

	The *Administrative Reconsideration Law* and the *Administrative Procedure Law* provide for applications for administrative reconsideration (by the CSRC) or for separate administrative proceedings (with a people's court) to be filed in respect of material decisions or actions of the CSRC. From 2007 to 2009, the CSRC received 68 applications for administrative review, and was the defendant in 19 cases filed with the people's court and the respondent in three cases submitted to the SC for ruling. On administrative review, the original administrative action was revised on four occasions and revoked in 6 out of the 68. On the cases filed with the people's court, except for one case still under review, all CSRC decisions have been upheld or the case withdrawn by the litigant. In the SC, two matters are still under review and the decision of the CSRC was upheld in the other. Other than decisions on administrative penalties or bannings as described above, the CSRC does not make public reports of investigations and other enforcement actions. In publishing these matters, the CSRC is under obligations to maintain the confidentiality of, e.g., trade secrets and personally private information as appropriate. The CSRC has established on Investor Education Office which is responsible for inspecting, promoting and implementing investor protection initiatives. The SIPF devotes part of its funding and activities (approximately US$1.5 [RMB 10] million in 2009) to investor protection activities and investor awareness and confidence surveys, and to the improvement of corporate governance in an effort to prevent fraud and misappropriation. Various regulations administered by the CSRC require specific risk disclosure and assessment of suitability by market participants, and it also conducts various investor education campaigns.
Assessment	Fully Implemented
Comments	The CSRC is subject to rules requiring that its administrative decisions and actions, and its rule making processes, are reasonably and consistently made and are subject to appeal mechanisms. The CSRC is required to observe the principles of procedural fairness in its rule making and administrative decision making, and has procedures for appeal from such decisions as appropriate. Industry participants report satisfaction with the CSRC's approach to its administrative decision making and its consultative processes on rule making, and appeal figures and details (see above) provide evidence that the CSRC consistently applies its powers and discharges its functions. General rules promulgated by the SC require that the costs of legislation and the enforcement and social costs after implementation should be considered in the legislation process (Article 17 of the *Program for Promoting Administration by Law in an All-round Way*). The CSRC uses its consultation processes to seek to implement new rules in a targeted and efficient way, but it could consider systematically undertaking formal cost benefit analyses of rules proposals. There have been some impressive developments in investor education undertaken by the CSRC, SIPF and other bodies. However, given the massive growth in individual securities accounts in recent years (118 percent between 2006 and 2009) there is a great need to redouble efforts on investor education, especially given the savings culture of the population and the apparent lack of knowledge of markets and financial risk in investments amongst retail investors.
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	CSRC staff are subject to the *Civil Servant Law* and relevant provisions of the *Securities Law*,

	and to other regulations and Codes of Conduct, requiring them to observe high professional standards and dealing with conflicts of interests in the discharge of their functions. Staff are subject to a specific prohibition on holding any position in an entity subject to regulation (see Article 187 of the *Securities Law*), and are prohibited under the *Civil Servant Law* from taking up a position with a regulated entity for at least two years after resignation. The *Code of Conduct for the Staff of the CSRC* requires that employees observe relevant recusal provisions and not engage in any conduct that causes conflicts of duties with their regulatory duties. Under Article 43 of the *Securities Law*, CSRC staff, and their direct relatives, are not permitted to directly hold shares in publicly listed companies. This prohibition extends to staff of the stock exchanges, clearing organizations, and securities companies. Article 26 of the *Regulations on the Administration of Futures Trading* prohibits CSRC staff from engaging in futures trading. The *Code of Conduct* includes specific provisions requiring CSRC staff to abstain from trading in securities or futures. Article 182 of the *Securities Law* is specific that CSRC staff shall not take advantage of their position to seek illegitimate gains, or disclose trade secrets, and shall be impartial and honest in the discharge of their duties. In addition, CSRC staff fall within the definition of persons possessing inside information relating to securities trading, and so are subject to the prohibitions on insider trading and tipping under Articles 73 and 76 of the *Securities Law*. In terms of observing appropriate standards of confidentiality, both the general law (*Law of the PRC on Guarding State Secrets* and the *Regulations on the Disclosure of Government Information*) and securities specific regulation (*Interim Measures for Disclosure of Securities and Futures Regulatory Information*) contain protective provisions on matters related to State, trade secrets and personal privacy. The *Code of Conduct* includes provisions (Articles 19 and 20) which specify that CSRC staff shall not inquire into information that is irrelevant for the discharge of their duties and shall not share or disclose information relating to securities or futures except in the discharge of their duties.
Assessment	Fully Implemented
Comments	The CSRC staff observes high professional standards including avoiding conflicts of interests and preserving the confidentiality of information obtained in the course of their duties. The CSRC staff are subject to legislative provisions and a written code of conduct, which requirements not to hold to trade in securities and futures, not to hold any positions in regulated entities, and not to misuse information. CSRC staff are subject to administrative sanction or criminal action if they violate these standards. 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.
Principles of Self-Regulation	
Principle 6.	The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	The regulatory framework in China relies on several SROs, subject to the centralized supervision and administration of the CSRC: **Stock Exchanges:** There are two stock exchanges in China performing self regulatory functions, the SSE and the ShSE. These exchanges establish and administer rules of eligibility for trading of products by participants on the exchanges. Articles 10 and 11 of the *Measures for the*

	Administration of Stock Exchanges provide that a stock exchange shall create an open fair and equitable trading environment and shall perform the following functions amongst others: providing the venue and facilities for securities trading, formulating business rules, listing rules, organizing and supervising trading, regulating members, and regulating listed companies. The exchanges have published detailed listing, trading and membership management rules to this effect. The disciplinary powers available include public censures and identifying that parties involved in violations are not permitted to act as a director or senior officer of a listed company. **Futures exchanges:** Under Article 11 of the *Measures for the Administration of Futures Exchanges*, futures exchanges are required to specify membership qualifications and management rules which set forth the conditions for obtaining and terminating membership. In addition to public censures, futures exchanges may suspend the operation of a member, force liquidation, or ban a person from the market. Under Article 10 of the *Regulations on the Administration of Futures Exchanges*, futures exchanges are required to formulate various rules and regulations, enhance risk controls of trading activities and strengthen supervision of its members and staff members. Under Article 11, a futures exchange is required to establish risk management systems including margins, mark-to-market, price and position limits, large position reporting, and risk reserves. The rules are subject to approval of the CSRC, and senior officers of the exchanges or wither nominated by or subject to the approval of the CSRC. **SD&C:** The SD&C establishes rules for participants in the clearing and settlement process, in particular for account management and management of clearing participants. The SD&C is required as a securities registration and clearing institution to establish securities and clearing accounts, clear and settle securities and cash, and distribute entitlements as instructed by the issuer (Article 157 of the *Securities Law*). It has developed detailed rules to ensure its members' compliance with the relevant laws and regulations, including rules related to the administration of securities accounts, administration of clearing participants, and the administration of securities reserve funds, which are subject to the approval of the CSRC. The disciplinary powers include restricting or cancelling the use of participating accounts, and suspending or terminating the clearing participants' clearing rights. **Securities and Futures Associations:** The SAC and CFA are responsible for organizing the initial qualification examinations for practitioners from securities and futures companies, and for conducting disciplinary actions against members who breach relevant conduct rules. The disciplinary powers include public censures and suspending or terminating the person's or entity's membership or eligibility to practice. These bodies perform important self regulatory roles, especially having regard to the size and geographic spread of the Chinese investment market. In addition, the NAFMII was established in 2007 to perform self-regulatory functions overseeing the trading of various fixed income instruments through the inter-bank lending and bond market. It is subject to oversight by the PBC, although securities firms and insurance companies are eligible to become NAFMII members.
Assessment	Fully Implemented
Comments	The regulatory arrangements in China place appropriate reliance on SROs to perform regulatory functions, under the authority and supervision of the CSRC. These SROs include the exchanges, clearing and settlement institutions, and industry associations.
Principle 7.	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	All SROs in China operate under the supervision of the CSRC. Stock exchanges are required to be authorized by the SC rather than the CSRC. The other SROs described in this section are subject to authorization by the CSRC. The rules of the stock exchanges, SD&C, and futures exchanges and any amendments thereto are required to be approved by the CSRC to ensure that they are consistent with the policy directives established by it. (See Article 118 of the *Securities Law*, Articles 15 and 89 of the *Measures for the Administration of Stock Exchanges*, and Article 158 of the *Securities Law* and 10 of the *Measures for the Administration of Securities Registration and Clearing* respectively). The Articles of the SAC and CFA are filed with the CSRC for the record, and according to the filing procedures the CSRC has power to require the SROs to revise them if they are inconsistent with relevant regulations or policy directives. The stock and futures exchanges, SD&C, and the SAC and CFA are all established as non-profit entities with purposes specified relating to the efficient and fair development of the securities and futures industries, which reduces the scope of likely conflicts of interest. In relation to significant operational matters which might give rise to a conflict, there are clear reporting requirements to the CSRC and division of responsibility between the SROs and CSRC. As for requirements for SROs and their staff to operate fairly and observe appropriate standards of confidentiality: • **Stock exchanges:** The *Measures for the Administration of Stock Exchanges* specify that the membership, listing and trading rules should apply to all prospective applicants and members in a fair and consistent manner. The Membership Management Rules of the Shanghai and ShSEs include requirements to act honestly and in good faith, and explain to clients risks arising from products. Apart from the general requirements for the stock exchanges to provide an open, fair and equitable trading environment, there are some specific provisions relating to conduct by staff. Article 44 of the *Securities Law* requires stock exchanges and the SD&C to maintain the confidentiality of client records. Article 82 of the *Measures for the Administration of Stock Exchanges* requires a staff member of a stock exchange to recuse himself where he or one of his relatives is an interested party. Articles 14 and 16 of the *Measures for the Administration of Securities Registration and Clearing* provide that the SD&C and its staff are required to maintain the confidentiality of information and not divulge business secrets. • **Futures exchanges:** Under Article 3, futures trading shall follow the principles of openness, fairness, equitability and good faith. The rules of the futures exchanges provide for investor protection through a range of risk control, trading and membership rules. Under Articles 67 and 100 of the *Regulations on the Administration of Futures Exchanges*, staff of the futures exchanges are required to maintain the confidentiality of information and are prohibited from insider trading or other profit from use of inside information. • **SD&C:** Article 3 of the *Securities Law* and Articles 1, 3, and 4 of the *Measures for the Administration of Securities Registration and Clearing* require that the principles of openness, fairness and equitability, together with safety and efficiency, shall be followed in securities registration and clearing activities. In addition, Article 20 of the *Rules of the China Securities Depository & Clearing Corporation on the Administration of Clearing Participants* requires clearing participants to act in good faith and with due diligence, and to take effective measures to protect the safety of its clients' assets. In terms of SD&C staff, Article 44 of the *Securities Law* requires stock exchanges and the SD&C to maintain the confidentiality of client records. Articles 73 and 78 of the *Securities Law* stipulate that the prohibitions that apply to CSRC staff relating to insider trading etc also apply to staff of the

	exchanges and the SD&C. • **Securities and Futures Associations:** The SAC is responsible for exercising self regulatory functions with respect to securities companies and fund companies under the *Securities Law* and the *Fund Law*. The CFA is responsible for self regulation of futures companies under Articles 47 and 49 of the *Regulations on the Administration of Futures Trading.* Both organizations specify in their constitutions that they aim to promote adhere to or promote the openness fairness and equitability of the securities and futures markets. Both organizations' articles of association refer specifically to them having a purpose to protect the interests of investors, and provide transparent rules with respect to governance of the SROs being subject to the general meeting of the members and the duly elected Board of Directors. The SAC and CFA have established procedures with respect to staff professional standards, and published internal manuals to guide staff in this respect. In order to ensure the fairness, equitability and openness of self-regulatory sanctions, the SAC and CFA have set up a Disciplinary Committee which makes disciplinary decisions based on the investigations of the secretariat on the conduct of members and practitioners, and an Appeal Committee to guarantee the appeal right of members and practitioners. The stock and futures exchanges have available a range of sanctions such as revoking qualification certificates and restricting trading to public censures. The SD&C can delay or deny providing settlement services, restrict or cancel the use of securities settlement accounts, and suspension or termination of a member's clearing business. The SAC and CFA have powers to issue public censures and restrict or suspend the qualifications of members for particular periods. Stock and futures exchanges are required under the *Securities Law* and the *Measures for the Administration of Futures Trading* to have a Board of Directors as their decision making bodies subject to the overall authority of the general assembly. A majority of directors are elected by the general assembly. For the SD&C, its shareholders are the stock exchanges which elect the SD&C Board. The articles of association of the SAC and CFA provide appropriate powers for the general assembly and board of directors of those bodies. The CSRC has specific powers to inspect or otherwise inquire into matters affecting the market, through enquiries or inspections of the SROs, through inspections or enquiries directed to regulated market participants, or through investigation and enquiry powers directed to investors and any other persons. • **Stock exchanges and SD&C:** Article 180 of the *Securities Law* provides for the CSRC to conduct on-site inspection of stock exchanges and clearing institutions. Article 90 of the *Measures for the Administration of Stock Exchanges* provides for the CSRC to dispatch staff to oversee and inspect the business of exchanges and clearing institutions. However, in practice the CSRC does not conduct on-site inspections of stock exchanges due to other institutional arrangements which the CSRC sees as providing adequate oversight. The CSRC is required to organize a departure audit when the President of an exchange or clearing institution leaves office, and stock exchanges and the SD&C are required to provide audited financial reports annually and operational work reports quarterly. In addition, there are immediate reporting requirements for specified events under the relevant regulations. • **Futures exchanges:** Under Article 51 of the *Regulations on the Administration of Futures Exchanges*, the CSRC is empowered to conduct inspections of futures exchanges and clearing institutions. Article 52 requires exchanges and clearing institutions to submit annual audited financial statements and Article 102 quarterly operational reports, and under Article 103 to report immediately on certain specified matters (such as serious violations by staff, significant financial expenditures or exposures, and significant litigation). • **Securities and Futures Associations:** The SAC is responsible for exercising self regulatory

	functions with respect to securities companies and fund companies under the *Securities Law* and the *Fund Law*. The CFA is responsible for self regulation of futures companies under Articles 47 and 49 of the *Regulations on the Administration of Futures Trading.* Both organizations are required to act in accordance with the guidance and supervision of the CSRC, and are subject to annual and periodic reporting requirements.
Assessment	Broadly Implemented
Comments	The regulatory framework in China places significant reliance on the role of SROs in specific aspects of regulation of the market, such as entry qualifications administered by the SAC and CFA, listing requirements administered by the exchanges, and the clearing requirements administered by the SD&C. The roles assigned to the SROs and the manner in which they perform them appear appropriate for the nature of development of the Chinese securities markets. Given the size of the market and the sheer number and geographic spread of investors, the role played by SROs can be expected to grow. As a result, the SROs will need to give continued attention and resources to their regulatory functions, and their performance will need to be carefully monitored by the CSRC to ensure that the SROs are appropriately discharging their regulatory functions. The relevant legislation provides for and the CSRC, SD&C, exchanges and SAC report that there is regular exchange of information and cooperation between them in respect of their self regulatory function. SD&C has branches at the Shanghai and ShSE to facilitate this exchange of information. For example: • in the supervision of unusual market trading, there is regular exchange of information and cooperation between the exchange surveillance staff, SD&C and relevant CSRC regional office staff; and • in the leadup to the launch of stock index futures there was detailed liaison between the CSRC, CFA, and the futures exchanges to enhance the systems' capacity of members who wished to trade in these instruments. As noted above, in practice the CSRC does not conduct on-site inspections of stock exchanges due to other institutional arrangements which the CSRC sees as providing adequate oversight. In the interest of better defining the respective roles of the CSRC and the exchanges, the CSRC should consider instituting a formal program whereby it conducts regular comprehensive on-site inspections of the exchanges. See Principle 25. In relation to suspected allegations of misconduct (such as insider trading or market manipulation), the relevant laws and regulations provide for the SROs to report those matters to the CSRC in a timely manner. The CSRC has adequate enforcement powers enabling it to enquire into and take action on those matters or to refer them to other judicial authorities for criminal action (see Principle 10). Outside these specific matters the SROs and CSRC report extensive consultation and exchange of information, and satisfaction with the clarity of the division of responsibility between them. Details concerning the exchanges' market surveillance functions and the exchange of information between them and the CSRC in this respect are at Principle 28. There are no explicit provisions that require SROs to avoid anti-competitive rules and situations. However, as SRO rules are subject either to approval or filing with the CSRC, and the SROs themselves are subject to overriding statutory statements of objects and purposes which include

	promoting honesty and good faith in conduct, investor protection and the development of the securities and futures industry.
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	The CSRC has comprehensive powers to conduct inspections and surveillances of a regulated entity's business operations, with or without giving prior notice. The primary source of power is Article 180 of the *Securities Law*, which provides power to conduct on-site inspections of securities issuers, listed companies, securities companies, stock exchanges and clearing institutions, and to inquire of any party involved in or connected with an event under investigation, and to access copy or seal up records and documents related to an event under investigation. Articles 67 and 68 of the *Regulation on the Supervision and Administration of Securities Companies* the CSRC may require any entity or individual associated with a securities company under inspection to provide relevant materials relating to the business operation of the company, including inquiring of responsible officers and directors, entering offices and taking copies of documents and computer records. Under Article 24 of the *Guidelines for On-Site Inspections of Securities Companies* and Article 84 of the *Working Practices for On-Site Inspections of Fund Companies*, the CSRC may carry out inspections without notice. For futures companies, Articles 84 and 85 of the *Measures for the Administration of Futures Trading* provide similar powers of inspection and enquiry to the CSRC and its regional offices. In practice, the CSRC has developed standard practices for the conduct of regular, periodic or ad hoc inspections. In conjunction with the SROs it monitors financial indicators and in particular the risk based net capital requirement for regulated entities to identify lines for possible inquiry. Under Article 65 of the *Regulation on the Supervision and Administration of Securities Companies,* the CSRC designates specific personnel to examine and verify the annual and periodic reports submitted by securities companies. The staff compare the data with that on clients' transaction settlement accounts to identify any illegal use of funds or securities. Similar requirements apply to futures trading and funds management companies. In practice, the CSRC conducts either general (termed comprehensive) inspections or special investigations depending on the area of interest. For example in August 2009 the Shenzhen office conducted inspections of funds management companies, primarily directed at detecting possible violations. Through June to August 2009 the CSRC regional offices conducted inspections of securities companies aimed at assessing and improving internal risk management and controls. See Principle 10 for details of CSRC inspection activities. The CSRC has extensive record keeping and retention requirements for regulated entities. Securities companies are required to keep clients' account opening materials, instruction and transaction records, and all material relating to their internal management and business operations for 20 years, and it is an offence to conceal, alter or destroy such records (Article 147 of the *Securities Law*). Similar requirements apply for the SD&C, funds management companies, auditors and other professionals who issue opinions, and futures companies. In relation to anti money laundering, under Article 19 of the *Law of the Peoples Republic of China on AML*, financial institutions are required to keep client identification and transaction information for at least five years after the business relationship with the client has ended. The PBC has put in place a set of rules and regulations governing anti money laundering, which apply to entities regulated by the CSRC. Regulated entities are required to have in place client identity

	verification systems, large and suspicious sum reporting, and internal control systems. The CSRC incorporates these requirements into its surveillance and inspection processes, and is active in interacting with the PBC on significant AML problems and AML information concerning securities and futures industry. For example, the CSRC shared AML information and problems with the PBC following its 2009 nationwide survey of AML work performed by securities and futures institutions. Moreover, CSRC regional offices have also established AML joint meetings, work coordination systems and relevant mechanisms with PBC branches for timely sharing of AML information. Concerning surveillance of trading, the regulatory regime requires the intermediaries, SD&C and the exchanges themselves to conduct frontline supervision of trading to identify any illegal trading or trading that is not covered by sufficient funds or securities, with the CSRC performing a monitoring and enforcement role with respect to more significant issues. However, Article 180 of the *Securities Law* provides that the CSRC has power to inspect any stock exchange or intermediary and hence it retains ultimate authority, and Article 4 of the *Measures for the Administration of Stock Exchanges* specifies that the stock exchanges are subject to the administration and supervision of the CSRC. Similar provisions apply to futures exchanges under the *Regulations on the Administration of Futures Trading*. The exchanges have immediate reporting requirements for issues involving serious violations or other matters potentially having a serious impact on the market, or any market closure due to force majeure or for technical reasons (Articles 84-86 of the *Measures for the Administration of Stock Exchanges,* and Articles 12, 102, and 103 of the *Measures for the Administration of Futures Trading*). For information on referrals from exchanges to the CSRC, see Principle 10. In relation to tracing funds and securities, Article 180 of the *Securities Law* provides power to access and copy securities trading records, transfer registration records, financial and accounting information and any other relevant information of parties connected with an event under investigation. In practice, CSRC staff can obtain this information from securities companies, or from the SD&C. In addition, because of the implementation of third party custodian requirements for securities companies, this information can also be accessed independently from custodian banks. Since the institution in 2002 of the *Measures for the Administration of Transaction Settlement Funds of Clients of Securities Companies*, and especially since the collapse of some securities companies and attendant misappropriation of client funds which led to the promulgation of the *Regulation on the Supervision and Administration of Securities Companies* in April 2008, third party custodian requirements with individual client accounts have been put in place and securities companies and custodian banks have been required to file account data with the regulator and the SD&C on a regular basis.
Assessment	Fully Implemented
Comments	The CSRC has comprehensive powers related to inspection, investigation and surveillance. The CSRC does not outsource inspection or other enforcement authority to a third party. The SROs perform frontline supervisory functions as described under Principle 6 and 7, and the CSRC has oversight responsibility as described there. The CSRC does not have authority with respect to the investigation of criminal violations of the relevant laws. The CSRC refers such matters to the Economic Crime Investigation Department of the Ministry of Public Security, which has some officers despatched to work in CSRC offices. This relationship is discussed further under Principles 9 and 10.

Principle 9.	The regulator should have comprehensive enforcement powers.
Description	The CSRC is responsible for the investigation of violations of the securities and futures laws and conduct of administrative proceedings with respect to them. The CSRC's administrative proceedings may lead to a range of administrative orders, including banning and other disqualification orders, fines, freezing orders, and compensation or confiscation orders with respect to violations of the securities and futures laws. This is an extensive suite of investigation and enforcement powers, in particular the freezing power with respect to funds which are perceived as at risk of removal or concealment. Under Article 179 of the *Securities Law*, the CSRC is required to investigate and penalize violations of laws and regulations affecting the securities market. The primary investigative power is in Article 180 of the *Securities Law*, which provides power to enter premises, access copy and seal up records, and inquire of and seek explanations from persons related to a matter under investigation. In cases of market manipulation or insider trading, these powers extend to temporary banning trading in particular securities, and in cases where there is evidence that important evidence or funds or securities may be concealed or removed, to freeze or seal up the same. Article 77 of the *Fund Law* and Article 51 of the *Regulations on the Administration of Futures Trading* have similar effect with respect to funds and futures. Article 233 of the *Securities Law* enables the CSRC to ban a person from entering the securities market in the event of a serious violation. The CSRC has established an Administrative Sanctions Committee, composed of eight full-time Commissioners, for the purpose of hearing and making judgments and orders on cases brought by the CSRC. One member conducts the hearing and examines the facts and materials, and any final recommendation on penalty measures is made on the deliberation and agreement of two other members. For major cases a full meeting of the Committee may be held. The opinions of the Committee, if approved by the Chairman of the CSRC, become decisions of the CSRC and enforceable as such. For details of case results, see Principle 10. The CSRC is not entitled to initiate civil proceedings, and refers criminal violations of the securities and futures laws to the Ministry of Public Security for investigation and prosecution action. In some cases a matter may first be subject to administrative sanction and then referred for criminal action. The criteria for the referral of criminal matters are publicly disclosed. In relation to determining matters which should be referred for criminal investigation, the key determinants are the intention of the perpetrator, the amount of loss or profit involved, and the severity of the violation (e.g., taking into account repeated violations, the number of persons affected, or whether State assets or some damage to social order is involved). These standards, jointly established with the Special Prosecutor and Supreme Court, are published. The amount of loss or profit is: • for disclosure type violations: losses of over RMB 500,000 (US$75,300), or if the asset value is falsified by 30 percent or more; and • for insider trading or market manipulation: tipping or trading over RMB 500,000 (US$75,300). The Chinese regulatory regime provides a broad range of private remedies for investors who have suffered loss as a result of misconduct. For example, Article 69 of the *Securities Law* enables an investor to recover compensation for damage caused by a misleading statement in or

	omission from a prospectus, periodic disclosure or listing report of a listed company from directors, senior management, sponsors and underwriters. Under Articles 76, 77, and 79 of the *Securities Law*, a person who suffers loss as a result of insider trading, market manipulation or fraud can recover compensation. Similar provisions appear in the *Fund Law* and the *Regulations on the Administration of Futures Trading*. The CSRC reports that, particularly in tort cases concerning misrepresentations by listed companies, aggrieved investors have been able to gain desirable legal outcomes to recover investment losses often through class actions. For the most common violation, false statements, the Supreme People's Court has issued a judicial interpretation to specify the requirements for a civil remedy. The CSRC is also collaborating with the Court on development of a judicial interpretation concerning civil damages cases related to the securities market. Article 185 of the *Securities Law* enables the CSRC to establish information sharing mechanisms with other financial regulatory authorities under the SC. Similar provisions empower the PBC, the CBRC and the CIRC to establish such information sharing mechanisms. The CSRC, CBRC, and CIRC have signed a MOU on Division of Responsibilities and Cooperation in Financial Regulation which prescribes a specific consultation mechanism for the three commissions and also contains explicit provisions relating to consultation on financial sector issues.
Assessment	Broadly Implemented
Comments	The CSRC has comprehensive enforcement powers, and in particular has a useful power under which it can freeze assets by administrative order for the purpose of safeguarding them during the completion of an investigation. In practice, if there is sufficient evidence of a violation, the CSRC is able to use its full suite of investigation powers. In cases where the evidence of a violation is not strong, the CSRC uses informal powers of inquiry, rather than its formal powers of inquiry, sealing up records or funds, or trading restrictions. The CSRC has established conditions upon which it decides whether to place a case "on file" which forms the basis for formal action. However, as the securities market grows it can be anticipated that these conditions and internal processes may come under challenge from the targets of an investigation. In this respect it would be useful and provide greater legal certainty to the CSRC in its enforcement role if there were greater precision over the circumstances in which the CSRC is entitled to use its formal statutory powers. In particular, the threshold for exercise of its formal investigation powers should be amended to provide the regulator with more discretion on when to bring those powers to bear. The laws and regulations provide a range of private rights of action for compensation and other action in the event of non-compliance causing damage to investors, but at this stage there is little evidence available that these laws have translated into a practical mechanism for market discipline and investor action, especially institutional investor action, to assist in securing compliance with the securities and futures laws. Private legal action is not a substitute for public enforcement action, supervision and regulation, but it can provide an amount of market discipline which supports official action. The level of development of the privately enforceable legal system (in particular the commercial courts) and the effect of market discipline provided by institutional investors and other participants on corporate governance appears to be not as significant in China as in other jurisdictions. In combination, these factors undermine the capacity of private legal action to have a meaningful practical impact on compliance. Given the very high level of retail participation in the market, this means that the CSRC and authorities a greater share of the burden of ensuring compliance than in other markets.

	The CSRC reports that it sometimes finds in relation to unlicensed securities advisory cases that they constitute violations of the criminal law (involving the Ministry of Public Security) and violations of business scope as registered with the relevant industry and commerce authorities. In practice, the CSRC and the Economic Crime Investigation Department of the Ministry of Public Security report productive information exchange and cooperation mechanisms. The results of this work are discussed in more detail under Principle 10.
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	The CSRC divides inspections between comprehensive inspections and special inspections, depending on the area being considered, and routine and ad hoc inspections depending on whether they are pre-scheduled. Under Article 9 of the *Guidelines for On-site Inspections of Securities Companies (Tentative)*, the CSRC regional offices are required to carry out a routine inspection of the main business activities, financial position and operations of all securities companies and their outlets at least every five years. The Guidelines provide that for companies with higher risks, complex business, or higher numbers of complaints or deficient internal controls, the CSRC should increase the frequency and intensity of inspections. For futures companies, under Article 51 of the *Regulations on the Administration of Futures Trading* the CSRC conducts annual audits of futures companies, and where the relevant risk indicator fails to meet the required standard, shall conduct an inspection within two days. For fund management companies, the CSRC carries out routine inspections at least every three years. The CSRC has established complaint recording and handling procedures pursuant to regulations issued by the SC on complaint handling to ensure that complaints are referred to the relevant operational staff and can be taken into account in planning their inspection work. Under these procedures all complaints regardless of how they are received are referred to a specific Division of the General Office of the CSRC and specific departments in the regional offices. If the complaint is within the CSRC's responsibilities it is referred to the relevant operational department for action and response within 60 days. The period can be extended for complex matters but the extension is not for more than 30 days. In 2008 the CSRC received 4,402 letters, 1,577 personal interviews and answered 13,400 calls. In 2009 these figures were 3,216, 1,072 and 10,248 respectively. The complaints related to matters such as listed companies, securities companies, fund companies, illegal securities trading and delisted companies. This is a reasonable level of complaints in order to provide useful intelligence to the CSRC for its inspection and enforcement activities. The CSRC publishes an inspection program to set out the overall arrangements for annual inspections. During 2008 the CSRC conducted 789 routine inspections and nearly 5,000 ad hoc inspections on the head offices and branches of securities companies, and in 2009 1,250 routine inspections and 2,256 ad hoc inspections, covering areas such as brokerage business, internal audit and risk control systems. These inspections led to further regulatory actions in 2009 in the form of 20 rectification decisions, 10 regulatory warning letters to entities inspected, 30 regulatory interviews and 58 informal talks with responsible officers, and made 235 on-the-spot decisions requiring some form of rectification. On funds, in 2009 the CSRC conducted on-site inspections on 30 fund managemnt companies (out of 60 registered), including 11 comprehensive inspections and 19 thematic inspections. On futures companies, the CSRC conducted thematic inspections in 2008 on net capital, the real name account system, information security, and overdrafts in futures trading, as well as comprehensive inspections on the largest 23 futures companies. In 2009, all registered futures companies were inspected, covering the management of margins, net capital, corporate governance, adoption of the real name account system, risk control and financial management. Regulatory measures such as regulatory interviews and

	rectification orders were imposed with respect to misconduct uncovered in the inspections. In one case, as the risk monitoring indicators were deficient the CSRC revoked one company's futures business license (the Tianhui Futures Brokerage Company). In addition, the CSRC regional offices undertake inspections based on the companies' risk status. For example, the Zhejiang Bureau conducted a thematic review of futures companies in its region on suitability of investors in light of the introduction of stock index futures. Unusual market activity may typically arise from two sources: aberrant market trading indicative of insider trading, market manipulation or other market misconduct; or activity caused by technological failure or force majeure. In relation to the first the stock and futures exchanges are required to (Article 115 of the *Securities Law* and similar provisions in the *Administration of Futures Markets* regulations) and do maintain automatic market surveillance systems which aim to detect unusual transactions. These transactions are analyzed, enquiries are made of the relevant market intermediaries and rectification action taken if necessary. The exchanges are under an obligation, which they observe, to refer significant cases to the CSRC for further action. The exchanges have invested considerable human and technological resources to the development of real-time and ex post surveillance systems, which analyze trading at both the broker and individual account level and which can be adjusted to take into account differing trading patterns or events. The exchanges are required to follow up on instances of unusual activity with the brokers concerned and refer appropriate matters to the CSRC. In 2008 (2009) the CSRC received 98 (110) reports of unusual market activity, initiated 71 (75) informal investigations and filed 13 (14) cases for formal investigation based on these reports. The CFFE noted that in the first month of stock index futures trading it made 100 enquiries of brokers, issued 6 warning letters and made 6 onsite visits but none of the occurrences were serious enough to warrant referral to the CSRC. The majority of instances was established to be errors or testing the system rather than attempts to manipulate the market. Similarly, the SHFE noted that it had considered 24 cases of wash trading in the previous year but had not had cause to refer them to the CSRC, which it suggested was due to the emphasis on initial registration of brokers and the intensity of the surveillance systems. The SSE looked into 506 suspicious trades in 2008 and 590 in 2009, of which it referred about one fifth to the CSRC, and the CSRC acted on 8 cases in 2008 and 12 in 2009. The systems involve real-time monitoring of trading, at the broker and at the individual account level, using data from the exchanges and from the clearing institutions, using pre-set parameters which can be varied to take account of new market developments. For insider trading, the system generates alerts on unusual stock price increases or falls preceding an announcement or unusual concentration of buy and sell orders. For market manipulation, the indicators are built on trading patterns which suggest wash trading, pumping and dumping, or concentrated trading during a particular time period, amongst other indicators. The systems also provide ex post compliance monitoring capacity. For example, the surveillance system incorporates all account opening information of directors and senior officers of a listed company as well as substantial shareholders under surveillance for the purposes of assessing short swing trading. If such accounts are found to have sold within six months or to have bought shares within six months after selling them, an alert will be generated. In 2008, the CSRC received from exchanges 98 reports of unusual market activity, initiated 71 informal investigations and filed 13 cases based on those reports. In 2009, the CSRC received 110 reports and initiated 75 informal investigations and filed 14 cases for formal investigation.

	The CSRC also investigates cases of abnormal trading and market manipulation based on its own enquiries, such as analysis of the internet and public media, tip-offs from members of the public and referrals from other CSRC departments. For example in 2008, the CSRC Enforcement Bureau received more than 270 violations clues, almost 70 of which discovered from the Internet and newspapers. The Enforcement Bureau received 18 referrals from CSRC regional offices for investigation, 66 referrals from the CSRC Letters and Calls Division, 10 unusual trading cases referred by the CSRC internal departments responsible for day-to-day oversight, and more than 10 cases from other sources. After initial examination, the Enforcement Bureau initiated 157 informal investigations of which 86 related to abnormal trading. It filed 107 cases of which 65 related to abnormal trading. In 2009, the Enforcement Bureau received 222 violations clues, including 49 clues from the Internet and newspapers, 28 referrals from the Letters and Calls Division and 35 referrals from CSRC regional offices for informal investigation. In 2008, a total of 135 cases of market manipulation and insider trading were investigated by the CSRC either formally or informally, accounting for just over 50 percent of the total caseload. In 2009 121 new cases were under informal investigation of which 82 were for insider trading or market manipulation, while 85 cases were under formal investigation, of which 39 involved insider trading or market manipulation. In terms of technological failure or force majeure, the CSRC, exchanges and SROs have made significant efforts to improve the technology and systems at the exchanges and in brokers´ offices, particularly in the lead up to the introduction of stock index futures. The CSRC, CFA, and the exchanges, especially CFFE, have established standards and protocols for broker trading and communication systems, and which are being upgraded and required of all brokers licensed to trade in stock index futures. The CSRC and exchanges report that they are constantly upgrading the speed and capacity of systems to cope with increased trading, and maintain a large buffer of up to 90 percent excess capacity. The Administrative Sanctions Committee has had a steady caseload over the last three years, handling between 61 and 89 cases annually. A small number of cases are referred to the Ministry of Public Security for criminal action (see below). The large majority of cases resulted in some form of warnings or fines (around 200 to 300 people per year), and a significant minority received some form of disqualification or ban from participating in the industry (80 in 2009, 77 in 2008). The largest category of cases relate to breaches of information disclosure by listed companies (38 in 2009, 33 in 2008), with some but relatively few (for a market of this size and growth) cases of insider trading (20 in 2009, 6 in 2008) and market manipulation (8 in 2009, 7 in 2008). There were no administrative cases handled concerning illegal investment schemes or securities or futures activity (e.g., Ponzi schemes or bucket shops), or cases of misleading dissemination of information or corporate fraud, though more of these types of cases are referred to the criminal authorities (see below). Commencing in 2006, the CSRC has led a collaborative state-level coordination group to crack down on illegal securities, together with the Ministry of Public Security, the PBC, CBRC, and other entities. The CSRC has also worked in recent years with provincial authorities to hold seminars on case analysis at the regional level. There were some cases of misappropriation of client funds in 2007 (10) and 2008 (12) but none in 2009, perhaps reflecting the effectiveness of the third party custodian requirements dealing with that problem. Since 2006 the CSRC has handled 18 cases involving the freezing of assets totaling some RMB 4 billion (US$0.6 billion).

Concerning referrals for criminal investigation, in 2008 and 2009 the CSRC transferred an annual average of 20 cases of suspected insider trading or market manipulation and more than 200 cases related to illegal operations, consulting or issuance. There have been some very significant criminal prosecutions in recent years with commensurately high penalties being imposed:

- Delong Group manipulation of stock prices in June 2004—the main principal Tang Wanxin was sentenced in April 2006 to 8 years imprisonment and fined RMB 400,000 (around US$60,000);
- Kelong Group false information disclosure in 2005—administrative penalties imposed one year after the investigation commenced, and a sentence of 10 years imprisonment and fines of RMB 6.8million (around US$1 million) imposed in January 2008;
- Zhongguancun insider trading in 2007—sentenced to 14 years imprisonment, a fine of RMB 600 million (around US$90 million) and confiscation of RMB 200 million (around US$30 million); and
- Zhejiang Century Gold illegal operation of gold futures from 2004 to 2006—company and chief executive convicted and fined RMB 71 million (around US$10.7 million), illegal income of RMB 9 million (around US$1.35 million) confiscated, and the company's legal representative sentenced to a 9 year term of imprisonment and fined RMB 1.2 million (around US$180,000).

Further details are at Principle 28.

On capital adequacy, the CSRC has implemented a system of risk based net capital measures and relatively high margin requirements for securities and futures firms, as well as independent third party custodian requirements (see Principle 23). This system seeks to ensure that capital adequacy and segregation of client asset issues are dealt with pre-emptively so that they do not become enforcement issues.

The laws and regulations applying to securities companies, fund management companies and futures companies require them to establish and maintain sound internal control systems and to establish a Chief Compliance Officer (CCO) and independent compliance function with responsibility for supervising the compliance of the business operations and with reporting obligations to the Board and the CSRC (Article 136 of the *Securities Law*, Article 133 of the *Guidelines on Internal Control for Securities Companies*, Article 42 of the *Measures for the Administration of Securities Investment Fund Management Companies* and Article 22 of the *Regulations on the Administration of Futures Trading*). The regulations require that regulated entities report periodically on their compliance performance and report immediately on specific instances of breaches, to both the CSRC and to the Board of Directors. These reports are analyzed by the relevant CSRC department and referred to inspection teams for their regular inspections or special inspections in appropriate cases.

The CSRC has a wide range of remedies it can take to sanction or discipline intermediaries for failure to supervise staff whose activities violate securities laws. The regulations and laws clearly specify that the securities company and funds management company is responsible for the acts of its employees or for inadequate internal controls (Article 146 of the *Securities Law* and related provisions). These remedies include ordering the company to conduct a compliance review and submit related reports, public censure, replacing the directors or senior management, suspension

	of business, bannings or disqualifications, fines, or in serious cases referral to the public security authorities for criminal investigation. The relevant regulations require that the exchanges maintain records regarding transactions and settlement for a minimum of 20 years (Article 92 of the *Measures on the Administration of Futures Exchanges*, Article 37 of the *Measures for the Administration of Stock Exchanges*, and Article 162 of the *Securities Law* with respect to a securities registration and clearing institution). The regulations also require that securities, futures and fund management companies maintain client records including account opening and identity records, instructions, transaction records and the like for a period of not less than 20 years (see, e.g., Articles 140 and 147 of the *Securities Law*). CSRC and exchange inspections periodically check on maintenance of records.
Assessment	Broadly Implemented
Comments	The CSRC oversees a credible and active inspection, surveillance, and investigation system which provides adequate oversight of the market. The level of inquiries and complaints received from the public, while significant, seems small compared to the size of the market and the increase in the number of securities accounts in China. The CSRC should consider means of encouraging investors who have a problem to raise their concerns with the CSRC, both to bolster the market intelligence available from this source and to boost investor confidence in the regulatory framework. The CSRC has a credible enforcement program in place. It has an active program of investigating market-related offences and there have been some very significant administrative and criminal penalties imposed in particular cases, which will bolster the deterrent effect of the market surveillance conducted by exchanges. While there are a significant number of referrals from exchanges which do not result in action by the CSRC, the CSRC has a very active surveillance and inspection program with respect to intermediaries, and pays particular attention to transactions that have greater potential to involve insider trading, which adds to the deterrent effect. That said, there is a need given the growth and the level of retail participation in the market, and the developing standards of corporate governance in the corporate sector, to continue to give very strong attention to insider trading and market manipulation cases, because of the importance of investor confidence in the regulated markets. Specific suggestions are made in this regard in Principle 28. It is less clear that the CSRC is effective in deterring illegal investment activity, such as Ponzi schemes, bucket shops and other illegal securities offers. There were over 200 referrals of such cases to the criminal law enforcement authorities in 2008 and 2009, but there appear to be relatively few criminal or administrative sanctions arising out of this type of activity, considering the size and growth in the Chinese market. In addition, while cases of misappropriation of client funds appear to have been largely addressed by structural changes, principally the third party custodian requirement, the CSRC will need to be vigilant especially as market conditions change and securities companies, fund managers or futures companies come under financial stress. Exchange operators and the CSRC express satisfaction that the systems for detecting abnormal trading on exchanges are advanced and provide an effective deterrent. Significant human and technological resources are devoted, especially at the exchange level, to this work. While this level and intensity of surveillance activity is adequate, the results of the surveillance and the number of resulting investigations and actions appears to be relatively low given the size of the market. The level of unusual trading detected and on which action is taken is not high compared

	to the amount of activity in the market, and some market participants report a perception or rumors of insider trading beyond what is being detected. This suggests a need for the CSRC and the exchanges to redouble their already impressive investments in systems and resources to detect and deter abnormal trading. The CSRC has an extensive program of both routine and ad hoc inspections of regulated entities. However, the significant and continuing growth in China´s securities markets poses a regulatory challenge to maintain and improve standards of competence and business conduct. This is especially important given China´s experiences in the early part of this decade with widespread misappropriation of client funds by securities and funds management companies estimated at some RMB 60 billion (around US$9 billion) for securities firms and RMB 100 billion (around US$15 billion) for funds, which led to the establishment of the Securities Industry Protection Fund to compensate defrauded clients and to liquidate some 31 (of a then registered population of around 130) securities companies which could not be recapitalized. Apart from closing down the worst affected securities companies, the CSRC has instituted a risk-based net capital requirement which provides more rapid and directed monitoring of the financial position of securities companies, a system of third party custodianship to provide strict segregation and safeguarding of client assets, and the requirement for firms to have a CCO with breach reporting obligations to the CSRC. While these measures have apparently resolved the underlying problems which gave rise to misappropriation of client funds, judging from the number of cases reported and from market participants' views, in light of the past problems and the extensive level of retail participation in the market, it is essential that the inspection program keeps pace with the size of the regulatory population.
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	Under Article 185 of the *Securities Law* the CSRC is empowered to enter into information sharing mechanisms with other financial regulatory agencies. The CSRC may, within the scope of its responsibility for the regulation of securities and futures markets, share information on a solicited or unsolicited basis with other domestic regulatory agencies where the information would assist the regulator with the performance of its statutory functions and provided the regulator commits to preserve the confidentiality of the information provided. This includes information on investigation and enforcement matters, authorization or licensing matters, surveillance, market conditions and events, client identification, regulated entities, and listed companies. It has established a MOU with the CBRC and CIRC to institutionalize regulatory and supervisory cooperation between the three commissions. Pursuant to the MOU regular discussions are held on cross sectoral or important matters of regulatory policy or operations, and coordinating the collection of regulatory information from entities under their regulation. It also has arrangements for sharing information with the Ministry of Public Security in respect of referrals of matters for criminal investigation and prosecution, the PBC in respect of anti money laundering matters, and the NDRC in respect of entities registered with the NDRC such as private equity funds. Pursuant to Articles 179 of the *Securities Law* and 66 of the *Regulations on the Administration of Futures Trading* the CSRC is empowered to establish arrangements with foreign securities and futures regulators for supervisory cooperation in relation to cross-border matters. This includes sharing information on investigation and enforcement matters, authorization or licensing matters, surveillance, market conditions and events, client identification, regulated entities, and listed companies. The CSRC is a signatory to Appendix A of the IOSCO MMOU and has signed

	bilateral MOUs on Regulatory Cooperation with regulators from 45 jurisdictions, including Hong Kong and Chinese Taipei. Pursuant to these arrangements the CSRC is able to exchange information on a solicited or unsolicited basis with foreign regulators for regulatory purposes. The CSRC shares non-public information pursuant to these arrangements where the information would assist the regulator in performing its supervisory or regulatory functions and where the regulator agrees to preserve the confidentiality of the information. It is not prohibited from sharing information if there is no MOU in place, but prefers to settle such an arrangement in order to settle procedures and expectations concerning the use of the information. As a signatory to the IOSCO MMOU the CSRC is able to share information with another signatory regardless of whether the alleged conduct is such that it would constitute a breach of Chinese law if it occurred in China. Neither the *Securities Law* nor the *Regulations on the Administration of Futures Trading* require that the conduct needs to be such that if conducted in China it would constitute a breach in order to share information. 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. The CSRC can obtain information and records identifying the beneficial owners of bank accounts and brokerage accounts related to securities and futures transactions. It can share this information with: • Domestic authorities, specifically the Ministry of Public Security in respect of criminal matters, and the CBRC and CIRC in respect of regulatory matters pursuant to the MOU; and • Foreign authorities, pursuant to the IOSCO MMOU.
Assessment	Fully implemented.
Comments	The CSRC has the ability to share: • public and non-public information, • on a solicited or unsolicited basis, • with both domestic and foreign counterparts, and • without other external process, for the purpose of performing regulatory and supervisory functions.
Principle 12.	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	Under Article 185 of the *Securities Law* and Article 66 of the *Regulations on the Administration of Futures Trading* the CSRC may establish information sharing mechanisms with other authorities under the SC. It has established a MOU with the CBRC and CIRC to institutionalize regulatory and supervisory cooperation between the three commissions. Pursuant to the MOU regular discussions are held on cross sectoral or important matters of regulatory policy or operations, and coordinating the collection of regulatory information from entities under their

	regulation. Pursuant to Articles 179 of the *Securities Law* and 66 of the *Regulations on the Administration of Futures Trading* the CSRC is empowered to establish arrangements with foreign securities and futures regulators for supervisory cooperation in relation to cross-border matters. The CSRC is a signatory to Appendix A of the IOSCO MMOU and has signed bilateral MOUs on Regulatory Cooperation with regulators from 45 jurisdictions, including from Hong Kong and Chinese Taipei. 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. In particular, 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. The CSRC became a signatory to the IOSCO MMOU in April 2007. It signed its first bilateral MOU, with the Hong Kong Securities and Futures Commission, in 1993 and has since signed bilateral MOUs with securities and futures regulators in 44 further jurisdictions, the last in November 2009 with the Financial Supervisory Commission of Chinese Taipei. All of the MOUs to which the CSRC is a party are in writing and have been published on the IOSCO (www.iosco.org) or the CSRC websites (www.csrc.gov.cn). For information transmitted to the CSRC for its use, the CSRC has in place legislative requirements and procedures to preserve the confidentiality of the information it receives. This is discussed further under Principle 5. For information transmitted by the CSRC to other authorities, the relevant MOUs provide that the information is provided on the basis that its confidentiality will be preserved.
Assessment	Fully Implemented
Comments	The CSRC has established formal information sharing arrangements with the CBRC and CIRC, and with a large number of foreign securities and futures regulators. In a sectoral regulatory framework as exists in China it is especially important to ensure that functionally similar products and activities are regulated in a similar manner. Given the size and nature of the emerging wealth management business of banks and insurance companies, it is important for the CSRC to use its cooperative arrangements with the CBRC and CIRC to ensure that no regulatory differences arise in practice. Therefore, the CSRC and other domestic regulators should give more consideration to the efficacy of their cooperative arrangements, especially with respect to ensuring that products or activities that have a similar function are regulated similarly to avoid the potential for regulatory arbitrage. Between 2007 and 2009 the CSRC responded positively to 111 requests from foreign regulators for information, of which 89 were from the Hong Kong Securities and Futures Commission. Historically most requests have been responding to inward requests, but accession to the IOSCO MMOU has increased awareness within the CSRC of the ability to make requests and they have a current outward request with the U.S. SEC. As the inter-connectedness of China's capital markets globally grows, the need to use these arrangements effectively to assist in the CSRC's domestic role will also increase, and the CSRC will need to give continued attention to the efficacy of their internal processes for handing these matters.
Principle 13.	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	As a signatory to the IOSCO MMOU, the CSRC has established that it is able to obtain records relating to securities and derivatives transactions including records of funds transferred into and out of bank and brokerage accounts related to those transactions. The CSRC has powers to obtain this information from all entities subject to CSRC regulation, including stock and futures exchanges, securities and futures brokers, and the SD&C, as well as from its own records. The relevant provisions are Article 180 of the *Securities Law*, Article 51 of the *Regulations on the Administration of Futures Trading*, Article 44 of the *Measures for the Administration of Securities Companies*, Article 11 of the *Measures for the Administration of Securities Regulation and Clearing*, and Article 77 of the *Funds Law*. In particular: • the CSRC is able to obtain records relating to securities and derivatives transactions that identify the account holder and others authorized to transact business, and all details related to a particular transaction. The CSRC has powers to obtain this information from all entities subject to CSRC regulation, including stock and futures exchanges, securities and futures brokers, and the SD&C, as well as from its own records. • the CSRC can obtain beneficial ownership information from four sources: ➢ In respect of securities and futures companies, these companies are required to maintain account opening records including client identity information. The CSRC has power to access records of securities and futures companies including the account opening records; ➢ In respect of individual accounts opened with the SD&C, the CSRC can obtain account opening information including client identification information from the SD&C; ➢ In respect of companies and partnerships, the CSRC can access the public information held by the State Administration for Industry and Commerce on the controlling shareholders and de facto controllers of companies, trusts and joint ventures; and ➢ In respect of bank accounts, the CSRC may request and obtain this information directly from securities and futures companies, custodian banks or the SD&C. Pursuant to the IOSCO MMOU the CSRC is able to provide assistance with respect to foreign regulators for a broad range of 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. As a signatory, the CSRC is able to share information with another signatory regardless of whether the CSRC has an independent interest in the matter. Neither the *Securities Law* nor the *Regulations on the Administration of Futures Trading* require that the conduct needs to be such that if conducted in China it would constitute a breach in order to share information. The CSRC is able to require the production of documents at the request of a foreign regulator pursuant to the IOSCO MMOU or a bilateral MOU. The CSRC may obtain personal statements pursuant to its investigation powers under the *Securities Law* and the *Regulations on the Administration of Futures Trading*, and can provide such statements in writing. The concept of taking testimony under oath does not exist in the Chinese legal system and is not available to the

	CSRC. The CSRC is able to provide assistance in respect of judicial matters in accordance with international conventions to which China is a party. The CSRC also 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. Information on the regulatory processes and legislation within China is freely available through the CSRC website and publications. With respect to financial conglomerates, pursuant to the MOU with the CBRC and CIRC the CSRC exercises supervision over financial conglomerates according to what is the principal line of business of the financial holding company. The CSRC can share information on conglomerates within its regulatory responsibility, ie 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.
Assessment	Fully Implemented
Comments	The CSRC is a signatory to the IOSCO MMOU and actively makes and responds to requests for information and assistance with foreign regulators.
Principles for Issuers	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	Article 63 of the *Securities Law* is a general provision requiring the information disclosed by an issuer or public company to be truthful accurate and complete and not contain any false records, misleading statements or major omissions. For IPOs, the specific disclosure requirements are contained in the *Measures for the Administration of IPOs and Listings of Shares*, requiring a prospectus, a sponsoring letter and a legal opinion letter verifying the issuer's compliance with the relevant laws and regulations, the issuer's financial statements and auditor's reports. There is a general requirement under Article 3 of the *Standards concerning the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public* that all information that may materially affect the investor's investment decision be disclosed regardless of whether it is specifically covered by the standards. Similar regulations apply to listing on the GEB. For annual and semi-annual reports, Articles 65 and 66 of the *Securities Law* requires that listed companies release an annual report within four months of the end of the fiscal year, half yearly reports within two months, and quarterly reports within one month. The requirements for such reports are comprehensive, and include financial data and indicators and material non financial information affecting the company's prospects. They are set out in the *Securities Law* or the *Measures for the Administration of Information Disclosure by Listed Companies*. Article 67 of the *Securities Law* requires immediate disclosure publicly, to the CSRC and to the relevant stock exchange, of any material event that has a considerable impact on the share price of a listed company. These events include a major change in the company's business, a major investment, an important contract or the incurring of a major debt, replacement of the directors or

	one third of the managers of the company, a change in the substantial (more than 5 percent) shareholders in the company, or the initiation of an investigation on grounds of a suspected crime by the company. For futures, under Articles 25 and 53 of the *Regulations on the Administration of Futures Trading*, a futures company is required to explain the risks involved in futures trading to clients and have them sign a risk disclosure document prior to entering into a contract with the client. Detailed standard contracts of the listed products are carried on the exchange websites. On advertising of public offerings outside of the prospectus, the CSRC requires that until the prospectus is published according to law, there shall be no promotion of the public offering and false or misleading advertising is prohibited. In addition, there are clear prohibitions and liabilities attaching to false or misleading advertising of an offer (Article 191 of the *Securities Law*). The requirements for fund managers and CIS include a clear prohibition on advertising and promoting the offering outside of the prospectus, but there is no comparable provision restricting advertising of other offers or requiring any advertising to refer potential investors to the prospectus. Prospectuses, which remain in force for six months after the date of their approval by the CSRC, may only refer to financial statements that are not less than six months old as at the date of issuance of the prospectus (see *Measures for the Administration of IPOs and Listings of Shares*). Under special circumstances the issuer may apply for an extension but only for one month. There are substantial mechanisms available to the regulator and the exchanges to help assure the timeliness, accuracy and sufficiency of the required disclosure. The CSRC accepts prospectuses and related documents for IPOs and secondary offerings by listed companies, and reviews them for completeness, sufficiency and timeliness of the information contained therein. The CSRC has set up a Public Offering Review Committee for the Main Board, a GEB Offering Review Committee and a M&A and Restructuring Committee in accordance with Article 2 of the *Measures for the CSRC Offering Review Committee*. Members of the Public Offering Review Committees include professionals within the CSRC and relevant 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. The relevant exchange also reviews the offering for compliance with the listing rules before admitting it. Annual and periodic disclosures by listed companies are reviewed by the exchanges and by the CSRC. The laws and regulations provide a range of sanctions (including a banning from further offerings for a period of up to 36 months) in case of misleading or fraudulent applications or reports. A range of criminal and administrative liabilities apply to issuers, sponsors, and other professionals involved in the making of an offer or a listing. Serious cases of the provision of false or misleading financial or accounting statements carry a criminal penalty of three years' imprisonment and a fine of between 20,000 and RMB 200,000 (US$3,000 to US$30,000) (Article 161 of the *Criminal Law*). Parties involved in cases of misleading statements or major omissions in any corporate disclosure are liable to pay compensation to any person suffering damage (Article 69 of the *Securities Law*), or to have their qualifications as a sponsor or professional revoked or suspended. Finally, the SSE and ShSE may impose penalties 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. Concerning preserving the confidentiality of certain information, as noted above the law requires that the disclosure is truthful accurate and complete and not contain false records, misleading statements or major omissions. However, the CSRC's *Rules on the Contents and Formats of Information Disclosure* provide that where the disclosure may involve state secrets, trade secrets or would infringe on laws protecting confidentiality or cause severe damage to the issuer's interests, the issuer can apply for an exemption to the CSRC. Article 5 of the *Contents and Format of Annual Reports* contains a similar provision enabling the listed company to apply to the stock exchange for an exemption. Listed companies are required to disclose in a timely manner a material event if there is difficulty maintaining its confidentiality, the event has been divulged or a relevant rumor is circulating, or abnormal trading in the company's securities has been observed. The stock exchanges are primarily responsible for decisions to suspend or resume trading in circumstances where there appears to be inadequate disclsoure. Where any information that has not been disclosed by the company 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. Persons with superior information are prohibited from trading in the relevant securities or tipping others pursuant to Article 73 of the *Securities Law*. Persons possessing superior information who trade are liable to orders to divest, confiscation of the gains and a fine of up to five times the gain (Article 202 of the *Securities Law*). At the time of the assessment, no foreign companies have made an offer in China. The CSRC's preliminary planning, if foreign listings are permitted in the future, is to ensure that the foreign issuer at least meets the minimum standards set forth in IOSCO's International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers, regardless of the size of the offering.
Assessment	Broadly Implemented
Comments	The regulatory regime contains detailed requirements and followup mechanisms of the CSRC and exchanges for the disclosure of comprehensive information about financial results and risks of listed companies and other investment offers. On advertising of public offerings outside of the prospectus, the CSRC requires that until the prospectus is published according to law, there shall be no promotion of the public offering. The requirements for fund managers and CIS include a clear prohibition on advertising and promoting the offering outside of the prospectus, but there is no comparable provision restricting advertising of other offers or requiring any advertising to refer potential investors to the prospectus. The CSRC should consider making similar requirements for advertising of IPOs and other securities offerings to those that apply to fund managers and promoters. As noted above, the timeframe for release of periodic reports of listed companies are within four months of the end of the fiscal year for the annual report, half yearly reports within two months, and quarterly reports within one month. These timeframes appear long by the standards in place in other major markets and should be reviewed. Serious cases of the provision of false or misleading financial or accounting statements carry a criminal penalty of three years' imprisonment and a fine of between 20,000 and RMB 200,000

	(US$3,000 to US$30,000 approximately) (Article 161 of the *Criminal Law*). This criminal penalty may prove to be insufficient as the market grows and should be reviewed. In addition, continued attention will need to be given to the development of the private accounting and audit profession in China, to ensure that financial statements are professionally prepared and audited. (This issue is discussed in more detail under Principle 16.)
Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	Under the *Company Law*, the general assembly of shareholders is entitled to elect directors who are not representatives of the company's employees. Shareholders have the right to exercise one vote per share held. (Articles 38, 100 and 104). Listed companies in China do not offer preferred or deferred shares. Shareholders are also entitled to vote on revision to the company's articles, changes in registered capital, mergers, and major asset purchases or sales within one year exceeding 30 percent of its total assets (two-thirds majority), and must be provided with information relevant to those decisions. Shareholders are entitled to 30 days notice of a general assembly meeting, and 15 days for an interim meeting. The *Company Law* explicitly recognizes the validity of proxy voting, and the *Code of Corporate Governance for Listed Companies* provides that a listed company should increase the proportion of shareholders able to attend meetings including by using modern information technologies. Given the size of the retail investor population, and the increasing interest of foreign investors, the CSRC will need to keep this area under review to ensure that it is providing shareholders located remotely from the company's meetings an ability to participate. The *Company Law* requires that companies keep a roster of shareholders. Listed companies are subject to the procedures under the *Measures for the Administration of Securities Registration and Clearing* promulgated by the CSRC in 2006, under which the SD&C preserves complete files of shareholders of listed companies. Under this system the CSRC reports that no equity registration error has occurred to a listed company in China. Generally speaking the regulatory framework does not impose any restriction on the transfer of shares, except for shares held by originators of the company or shares issued before the public issuance which must be held for at least one year, directors and senior officers are subject to some special restrictions, e.g., they may not transfer more than 25 percent of their shareholding in any one year period, and foreign investors with a strategic stake in A shares are not permitted to transfer shares for three years. The *Company Law* makes provision for the distribution of dividends to shareholders in proportion to the shares held by them. There are explicit provisions under the *Securities Law* for mandatory takeovers where 30 percent of the issued shares have been acquired, together with requirements that all shareholders are treated equally. Similar provisions apply to negotiated and indirect acquisitions of control of over 30 percent of the voting rights or over 50 percent of the shares. There are also explicit provisions in the *Company Law* requiring directors and senior managers to act diligently and loyally with respect to the company, and where they commit violations (such as misappropriation of company funds or self-dealing) making them liable civilly. Concerning bankruptcy, the Company Law provides for the distribution of any remaining assets after paying the liquidation expenses, employees' salaries, taxes and debts, to the shareholders. The disclosure requirements for company takeovers are specified under the *Measures for the Administration of Takeovers of Listed Companies* and include a detailed description of the term and price of the acquisition, the funds required and assurance for them, the acquirer's plans on the next 12 months on adjustments to be made to the business, and the percentage of shares

	already held by the acquirer. These provisions appear adequate to enable a shareholder to make an informed decision on the offer. According to Article 90 of the *Securities Law*, the offer must remain open for between 30 and 60 days, and the bidder may not withdraw its offer during that time. The *Securities Law* and the *Measures for the Administration of Takeovers of Listed Companies* provide for shareholders to be given equal and fair access to participate in the offer (including minority shareholders), with appropriate provisions for partial bids requiring proportional take-up. The acquired company's board is required to investigate the bid, prepare advice for shareholders, and seek professional advice from an independent financial advisor, which is published and provided to the CSRC and exchange. During the bid period the company is required to continue to engage in normal business operations. Prospectuses are required to contain full disclosure of the originators, shareholders holding more than 5 percent of the company, de facto controllers and controlling shareholders, as well as related parties (Article 33 of the *Standards Concerning the Content and Formats of Information Disclosure by Companies offering securities to the Public*). Investors reaching more than a 5 percent shareholding are required to lodge a report with the CSRC, exchange and make a public announcement within 3 days (Article 86 of the *Securities Law*). Under Article 66 of the *Securities Law*, the top 10 shareholders must be disclosed in the company's annual report. For listed companies, any shareholder holding 5 percent or more, de facto controllers and controlling shareholders must be disclosed in the annual report. For shareholders holding more than 5 percent, de facto controllers or controlling shareholders, every 5 percent increase or decrease must be reported and announced within 3 days (Article 86 of the *Securities Law*). These requirements explicitly apply to persons acting in concert (Article 67). For this purpose, the shareholdings of the persons acting in concert are added together. As noted above under Principle 14, at the time of the assessment there have been no offerings of securities by foreign issuers in China. The CSRC's preliminary planning, if foreign listings are permitted in the future, is to ensure that the foreign issuer at least meets the minimum standards set forth in IOSCO's International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers, regardless of the size of the offering.
Assessment	Fully Implemented
Comments	The regulatory regime adequately addresses the rights and equitable treatment of shareholders, including with respect to mergers. The CSRC has undertaken substantive reforms with respect to non-tradable shares held by government and semi government shareholders in recent years to improve pricing and transparency in the market, which reforms have been carefully planned and executed and are well received by market participants and listed companies. The compliance framework includes civil, administrative and criminal liability, as well as action taken by the exchanges. The administrative sanctions available to the CSRC include orders to rectify, issuing a warning, fines of up to RMB 600,000 (approximately US$90,000) in certain cases, ordering an acquirer to suspend or terminate the acquisition. The criminal liability in respect of false or misleading activity under Article 161 of the *Criminal Law* is described above under Principle 14, and may prove inadequate for these types of offences as the market grows. The exchanges sanctions for disclosure breaches by a listed company are limited to notice of criticism or public censure. This suite of sanctions places heavy reliance on the CSRC to take actions with respect to breaches, and the level of fines may prove inadequate in the future to deter non-compliance in significant cases.

	While the Law makes adequate provision for the treatment of shareholders and the responsibilities of company officers and directors, the extent to which a private institutional shareholder or group of retail shareholders can practically take action through the Court system appears to be constrained by the cost and by the capacity of the courts. Hence, the practical effect is that market discipline is inadequate to enable enforcement of these rights or compliance with these obligations, which places more burden to deal with cases of non-compliance on the CSRC or the SROs. In addition, the reporting obligations for changes in substantial shareholding (currently only changes of 5 percent need to be reported) should be reviewed, in keeping with the standards in other major markets.
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	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 since its incorporation (Article 14 of the *Interim Regulations on the Administration of the Issuance and Trading of Stocks*, and Article 52 of the *Securities Law*). Listed companies and companies with corporate bonds listed for trading are required to produce an annual report with audited financial statement within 4 months of the end of the fiscal year (Article 66 of the *Securities Law*). The *Accounting Standards for Business Enterprises* (ASBE) require that the financial statements shall include the balance sheet, income statements, cash flow statements and a statement on owners' equity. The CSRC's disclosure requirements for listed companies specify that the financial statements must include comparative data of the current and previous financial periods. CSRC rules stipulate that the financial statements should include comprehensive disclosure notes including accounting policies, errors in the previous period, consolidated financial statements, accounting for asset securitization, related party transactions, contingencies and other material events. Article 14 of the ASBE *Basic Standards* explicitly states that the accounting information should be provided in a way that is easily understood and used by users of financial reports. Article 15 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, so that adjustments are made to the comparative data of the prior accounting period to enable comparison. The Ministry of Finance (MOF) is the authority under the SC responsible for formulating and issuing accounting standards in China. The MOF has established a China Accounting Standards Commission (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 *Process for the Formulation of Accounting Standards*, which provides an open and transparent process of exposure to interested parties directly and to the public through the CASC website. In practice the CSRC reports close communication between the MOF and the CSRC, Chinese Institute of Certified Public Accountants (CICPA) and exchanges in the development of accounting standards. The MOF released a roadmap in September 2009 for continuing and full convergence with IFRS, and a final roadmap on April 2, 2010. The World Bank completed an accounting and auditing ROSC in October 2009, which found that the accounting standards adopted by MOF are of a sufficiently high and internationally acceptable quality, with some reservations about the

	implementation of these standards. In particular, that ROSC found that the stock exchanges' monitoring and enforcement mechanism regarding financial reporting and disclosure needed improvement because of a shortage of highly skilled staff to scrutinize financial statements, and similarly that the CSRC should engage additional qualified staff and train existing staff to bolster the effectiveness of reviews of financial statements and audit practices. Equally, the CSRC notes that companies issuing A shares and H shares concurrently have seen little discrepancy between their financial reports in their home and host jurisdictions, and this could provide evidence of substantial convergence between China's ASBE and IFRS. For example, for Chinese companies issuing stocks simultaneously in China and Hong Kong, the differences have been narrowing. The difference between the two reports 2008 and 2009 in terms of net profit was 2.43 percent and 0.66 percent respectively, and for net assets 0.99 percent and -0.24 percent respectively. Concerning auditing standards, the MOF has promulgated Auditing Standards (the *Practice Standards for Chinese Certified Public Accounts (CPAs)*) which became effective in January 2007. These standards cover nearly all of the items covered in the International Standards of Auditing (ISA). The CICPA develops auditing standards, subject to the approval of the MOF. The Auditing Standards Commission under the CICPA, composed of 31 members from government, academia and the business community, prepares the standards for MOF approval. The process for developing and interpreting auditing standards involves consultation with industry and with regulators including the CSRC. The CICPA and the International Auditing and Assurance Standards Board have signed a joint declaration on convergence to the effect that Chinese standards have achieved substantial convergence with ISA. The accounting and auditing ROSC completed in 2009 found that the auditing standards adopted by CICPA are of a sufficiently high and internationally acceptable quality, but that there is a need for more professional accountants and auditors to provide assurance of a robust accounting framework in practice for listed companies in China. Similar concerns were expressed by the CSRC, CICPA and some market participants, which suggest that ongoing attention will be needed to be given to the professional development of the accounting and auditing profession in China into the future. Under Article 171 of the *Securities Law*, auditors of listed companies (termed "securities service institutions") are required to perform their duties diligently. Where they fail to do so such that there are false entries, misleading material or major omissions, various sanctions can be applied, including revocation of the securities service license, warning or revocation of professional qualification. Details of some actions taken by the CSRC with respect to inadequate audit practices are discussed below. Concerning audit independence, there are provisions in the practice standards and code of ethics issued by the CICPA which stipulate that auditors must be independent in form and substance from the entities which they audit. In addition, *Regulations on the Regular Rotation of Signing CPAs in Securities and Futures Auditing Services* have been promulgated by the CSRC to provide for audit rotation with respect to those companies and apply to "listed companies, companies which make IPOs of securities, organizations which trade in securities and futures, securities and futures exchanges, securities investment funds and their management companies, securities registration and settlement organizations." Under these Regulations, any CPA who is a signatory to the above-mentioned entities may not continue to provide auditing services to the relevant entity for a term of more than five years.

	The accounting standards apply to annual, semi annual or quarterly reports so that they have to be prepared in accordance with ASBE. Annual reports are, in addition, subject to external audit. The CSRC has issued a notice concerning the appointment and replacement of auditing firms by listed companies that requires that the issue of the appointment or replacement of an auditor of a listed company must be brought to the general assembly of shareholders for resolution and disclosed according to the rules governing resolutions. In addition under this notice the company is required to disclose the issue publicly, provide reasons for the proposed replacement or appointment where necessary, and file a report with the CSRC and CICPA. The *Code of Corporate Governance for Listed Companies* specifies that an audit committee should be responsible for recommending the appointment or replacement of auditors.
Assessment	Partly Implemented
Comments	The Chinese regulatory regime has adopted a clear set of accounting and auditing standards which are well advanced in the process of converging with IFRS and IAS and which are of high and internationally acceptable quality. As noted above under Principle 10, in the early part of this decade China experienced widespread misappropriation of client funds by securities and funds management companies estimated at some US$9 billion for securities firms and US$15 billion for funds, which led to the establishment of the Securities Industry Protection Fund to compensate defrauded clients and the liquidation of some 31 (of a then registered population of around 130) securities companies which could not be recapitalized. While the regulatory response to this problem has been impressive, it strongly suggests that ethical and professional standards not only in the firms themselves but also amongst the auditing profession needed to be improved. Similar concerns were expressed by the CSRC, CICPA, and some market participants, to provide assurance of a robust accounting and auditing framework in practice for listed companies in China. In addition, the accounting and audit ROSC completed in October 2009 noted that while users of financial statements of listed companies appear to be reasonably satisfied with the quality of financial reporting by listed companies, there is some variation in the quality across the country and depending on the size of the accounting and audit firm involved. The CICPA is responsible for monitoring professional standards of Chinese CPAs and taking disciplinary action where standards are not complied with. The CICPA undertakes inspections for firms over a five year cycle for firms performing general audits (about 6000 firms) and a three year cycle for firms auditing public companies (the 54 firms currently authorized by the CSRC for this purpose). The disciplinary actions taken by the CICPA are mostly private or public censures. The CICPA advises that they have disciplined 169 firms and 288 individuals by public censure, and 524 firms and 715 individuals by private censure within the profession, mostly over failures to perform sufficient audit checks (on, e.g., recognition of revenues or correspondence of receivables). With respect to the accounting firms that provide audit services for listed companies, securities companies and for other securities market purposes, the CSRC has established a professional qualification system under which only accounting firms that obtain the qualification for securities and future business can engage in such audit business. Among the more than 7,000 accounting firms in China, only 54 firms with a large size, superior quality and excellent practice competence have obtained the qualification for securities and future business. These 54 accounting firms have on average 347 CPAs and 708 staff members, while the 7,400 accounting

	firms nationwide averagely have 13 CPAs and 27 staff members. Starting from 2007, the CSRC has undertaken onsite inspections of accounting firms over a three-year cycle, not only on their quality assurance system, but also on their practice quality regarding specific engagements. CSRC inspections and CICPA feedback suggest that the professional competence and practice quality of accounting firms are steadily on the rise. The CSRC is responsible for taking compliance action with respect to these firms. Over the period 2007–2009, the CSRC fined or gave warnings to 13 firms and 39 individuals. In relation to securities companies which were implicated in the misappropriation of client funds described above, the CSRC imposed administrative regulatory measures on 11 accounting firms and relevant CPAs that provided auditing services to 12 securities companies. In 2003, a criminal case was brought against the signing CPAs and partners of Shenzhen Zhongtianqin resulting in terms of imprisonment of over two years, for providing materially false documents over the provision of false documents with respect to significant overstatement of profits by a public company from 1998 to 2001. In 2002, the CSRC revoked the licences for conducting securities and futures related audit business of five firms which failed to pass the quality standards in their annual inspection. The CSRC also took action against the then biggest accounting firm in China, Hainan Zhonghua, suspending its qualification to conduct securities related audits for six months and banning the relevant signing CPAs for three years, for failing to uncover fabricated profits and an inflated capital reserve of over RMB 500 million (around US$75.3 million) in the 1996 annual report of the Hainan Minyuan Modern Agriculture Development Co Ltd. While these matters indicate steady and serious attention being given to professionalism of audits, the numbers appear low given the significant problems experienced with the collapse of securities companies earlier in this decade. In addition, attention has been paid at the level of the listed companies themselves to improving the quality of financial statements and information. Firstly, the board of directors and audit committee of listed companies are required to include members with professional accounting background to enhance the management's responsibilities for the quality of accounting data. For instance, the *Code of Corporate Governance for Listed Companies* promulgated by the CSRC provides that an audit committee shall at least have a professional accountant as its independent director. Secondly, listed companies are required to disclose in their periodic reports the establishment and operation of their internal controls, and conduct self-assessments on the internal controls and issue assessment reports. CPAs are required to issue auditor's reports on the establishment and operation of the internal controls relevant to financial reports and assure the operating effectiveness of internal controls. Thirdly, the CSRC regularly reviews the reports issued by listed companies in an effort to discover potential problems in a timely manner and require the companies and accountants concerned to make adjustments, to ensure the effective implementation of the accounting and auditing standards. As noted above, in cases of serious infractions, the CSRC can also take disciplinary action against firms and individual CPAs. The accounting profession plays a critical role in the capital markets by providing professional services in the preparation and audit of financial statements as well as providing other compliance related advice services. China's accounting profession is growing but market participants perceive a need for an improvement in both the number and professionalism of accountants and auditors. There is a need to continue to develop the size and experience of the accounting and audit profession in China, given the significant role that accountants and auditors play in providing assurance on the accuracy and completeness of financial statements of listed companies and other investment vehicles.

Principles for CIS	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a CIS.
Description	The regulatory regime in China has extensive and targeted requirements for the eligibility and regulation of those who wish to market and operate a CIS. There are two types of CIS business in China: securities investment funds managed by fund managers, and collective asset management business conducted by securities companies. Both types of business operate as a contractual arrangement between the investor and the relevant fund or fund manager. As of December 2009, securities investment funds under management reached US$0.4 trillion, while the collective asset management schemes of securities companies stood at US$22.3 billion. **Regulatory requirements for marketing and operating a CIS** For securities investment funds, the relevant requirements for marketing a CIS are set out in the *Measures for the Administration of the Sale of Securities Investments Funds* (Articles 9 to 13). Such funds may be marketed by a commercial bank, securities company, securities investment advisory institution or a professional fund sales institution, which must apply to the CSRC for a fund distribution business qualification. As at the end of 2009 there were 118 registered fund distribution institutions, comprising 33 commercial banks, 84 securities companies and 1 securities investment advisory institution. The qualifications required escalate according to the entity seeking the qualification, but all include having a dedicated department, suitably trained and qualified staff of which at least half must have at least two years experience in the funds business or five years experience in securities or futures business, and has secure technical facilities to handle fund sales and redemptions. There are varying capital requirements depending on the entity concerned. For collective asset management business conducted by securities companies, the relevant regulations require that such business can only be marketed by a securities company itself or a depository bank that it appoints (Article 16 of the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies*). The eligibility requirements are the same as those that apply generally to securities companies under Article 124 of the *Securities Law* and related regulations, and to depository banks of client funds under the *Measures for the Administration of Clients' Transaction Settlement Funds*. Securities investment fund managers are required to seek approval of the CSRC under Article 12 of the *Fund Law*. The eligibility and ongoing regulatory requirements are set out primarily in the *Measures for the Administration of Operations of Securities Investment Funds* and the *Measures for the Administration of Securities Investment Fund Companies*. For collective asset management business operated by a securities company, the general provisions that apply to the approval of a securities company under the *Securities Law* apply. In addition, the *Tentative Measures for the Client Asset Management Business of Securities Companies* include specific eligibility requirements for securities companies engaging in asset management business, including net capital requirements and requirements going to risk management and having a clean compliance record. In terms of specific eligibility requirements, the regulations require that the company's client asset management personnel have no record of misconduct and at least five of them have three or more years experience in proprietary securities

	business, asset management or securities investment fund management. There are general requirements under the *Fund Law* and *Securities Law* which require securities companies, fund managers and fund custodians to act honestly, in good faith, diligently and prudently, to avoid conflicts of interest and to protect the legitimate rights and interests of clients. In addition, there are specific eligibility requirements disqualifying those entities which are subject to some proceeding or investigation in respect of a securities violation or have been subject to a penalty in the last year from applying. On human resources there are specific provisions which require funds management companies to have senior management and other personnel dedicated to research, investment, valuation and marketing and that at least 15 have obtained qualifications for funds management business, and for securities companies conducting collective asset management business to have client asset management personnel who have securities business qualifications, no record of misconduct and at least three or more years experience in proprietary securities business, asset management or securities investment fund management. On technical resources there are requirements for the entities to have operational premises and systems to ensure robust risk management and control. In terms of financial capacity, there are requirements which vary according to the nature of the entity. Fund management companies must have registered capital of not less than RMB 100 million (around US$15 million), and securities companies operating collective asset management business at least RMB 300 million (around US$45.2 million). Article 19 of the *Fund Law* and Articles 18 to 21 of the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies* set out specific powers and duties of operators. They include raising funds in accordance with the law, separately managing and accounting for client assets, and handling risk and information disclosure related to the funds business. On internal management processes, the requirements for fund managers include requirements to establish a sound internal control system with scientific rationale and rigorous control to ensure compliance, effective checks and balances and reasonable incentives and constraints to safeguard the interests of investors, and setting up a sound investment management system covering authorization, decision making and evaluation to ensure that the various fund properties and client assets under their control are treated fairly (Chapter V of the *Measures for the Administration of the Sale of Securities Investments Funds)*. Similar provisions for securities companies engaging in collective asset management business apply under the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies* and the *Guidelines on Internal Control for Securities Companies*, including requirements to establish an independent asset management department and internal control systems specifically taking into account the risks involved in asset management business. Where the fund manager has an overseas shareholder, under the *Measures for the Administration of Securities Investments Fund Management Companies* the CSRC will seek relevant information about the overseas shareholder from the home jurisdiction and requires that the home regulator has signed a cooperation agreement and maintains effective cooperation with the CSRC. Under the *Tentative Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institutional Investors* (QDIIs), QDIIs may engage an overseas investment advisor or custodian only on certain conditions including that the home regulator has signed a cooperation agreement with the CSRC. In addition, the CSRC has specified that where funds or collective schemes hold assets listed on a securities market with which the CSRC does not have a cooperation agreement, the amount of those assets held by a single scheme or fund shall not exceed 10 percent of the net value, and the amount held in any one such jurisdiction shall not exceed 3 percent of the net value.

	Powers and functions of the CSRC with respect to CIS The CSRC is responsible for the initial approval and ongoing monitoring of eligibility standards for fund managers, custodians and securities companies operating collective asset management business. With respect to registration of a CIS, the *Fund Law* and the *Regulations on the Supervision and Management of Securities Companies* are specific in providing authority to the CSRC with respect to the authorization of funds, fund managers, custodians and securities companies wishing to conduct collective asset management business. The CSRC has clear powers with respect to inspection of CIS operators. Under Articles 55 and 60 of the *Measures for the Administration of Securities Investment Fund Companies* and Article 62 of the *Tentative Measures for the Client Asset Management Business of Securities Companies*, the CSRC is empowered to inspect on a periodic or random basis, both off-site and onsite, to ensure compliance. The CSRC also has clear powers with respect to the investigation of suspected offences in relation to CIS. Articles 76 and 77 of the *Fund Law*, and Article 62 of the *Tentative Measures for the Client Asset Management Business of Securities Companies* provide for the CSRC to supervise and regulate this activity, and provide inspection and enforcement powers with respect to it. The *Fund Law* and the *Securities Law* provide a full range of administrative sanctions and civil liability with respect to breaches or defaults, and the *Criminal Law* provides criminal liability for serious offences in respect of illegal operation of a CIS. The range of administrative sanctions includes orders to rectify, suspension of the operator's qualification to operate the fund or other related business, warnings, revocation of qualifications of the company or senior staff, and fines with maxima from RMB 100,000 to RMB 1million (US$15,000 to US$150,000 approximately) may be imposed. For example, misappropriation of client assets carries a maximum fine of RMB 500,000 (US$75,000 approximately). The level of fines available for securities companies in respect of breaches in relation to collective asset management business are comparatively lower (maximum of RMB 100,000 or US$15,000 approximately for executing at variance with the clients' entrustment), which suggests that these penalties and provisions may need to be reviewed to prevent regulatory arbitrage. The *Fund Law* and *Tentative Measures for the Client Asset Management Business of Securities Companies* enable and empower the CSRC to conduct ongoing monitoring of funds, fund managers and securities companies conducting collective asset management business, and empower the CSRC to take action in the event that the entity fails to continue to comply with the eligibility, licensing and authorization requirements. Fund managers are required to submit an annual report including audited financial statements, an annual audited evaluation report on internal controls, and quarterly and annual compliance reports. The custodian bank is required to provide an opinion on the financial report and the annual report of the fund. Fund managers are also subject to immediate reporting requirements to the CSRC for matters such as a change in the shareholders, registered capital or capital contribution ratio of the members, or amendments to its articles of association. Securities companies conducting collective asset management business are required to provide a quarterly report on that business, and conduct an annual and separate audit of each collective scheme it conducts. They are also required to provide an annual compliance review report to the CSRC. The CSRC regional offices analyze the reports submitted by funds managers and securities companies in their region, and the CSRC Department of Intermediary Supervision independently

	conducts monthly off-site inspections and prepares analytical reports on the risks detected and rectification actions taken. It has established a regulatory information system to combine media reports, investor complaints and reports submitted by firms, on the basis of which the CSRC is able to launch special inspections or investigations. For example in one case the regulatory system showed that one fund was pulling stock prices up towards the close, so the CSRC launched a special investigation and determined that the fund manager was engaging in manipulative trading, banned him from the market and confiscated the illegal gain. The CSRC conducts on-site inspections of fund management companies, custodians and securities companies which conduct collective asset management business. In 2009, the CSRC conducted on-site inspections of 30 funds management companies (11 comprehensive and 19 thematic) and on eight custodian banks. As a result of these inspections, the CSRC took administrative action against 4 companies including rectification orders, and against 14 officers ranging from talks, warnings and entries of demerits on credit files to a fine and banning in one case. Between 2005 and 2009 the CSRC conducted comprehensive onsite inspections of all registered funds management companies. **Reporting and business conduct of CIS operators** Fund managers are required to report to the CSRC and investors annually, with the audited financial statements, an audited annual report on the internal controls of the company, which includes changes in management, organization and by-laws. In addition, there is a continuing obligation to report to the CSRC for approval changes in the shareholders or capital contribution ratio, any amendment to the articles of association and any major events impacting on the operation of the company (Articles 17 and 58 of the *Measures for the Administration of Securities Investment Fund Companies).*Similar reporting requirements apply to securities companies conducting collective asset management business. The *Fund Law* and the *Securities Law* respectively require that fund managers, custodians, and securities companies conducting collective asset management companies maintain records of the operations of schemes, including account books, transaction information and client files for not less than 20 years. A fund manager or custodian may not mix its own assets with those of a client, and may not use fund assets to contribute to the capital of the fund manager or custodian (Articles 20 and 59 of the *Fund Law*). In relation to other related party transactions, there are explicit requirements for the company to ensure that it protects the interests of investors and shall establish rigorous procedures to prevent improper related party transactions, including a requirement for interested directors to abstain from voting. Related party transactions must also be disclosed in the annual report of the fund. For securities companies conducting collective asset management business, there is a requirement for the client to give consent to any transaction investing their assets in the securities company or custodian and to inform the stock exchange, and the funds invested by a single scheme in securities of the securities company or custodian may not exceed 3 percent of the net asset value (NAV) of that scheme (Article 38 of the *Tentative Measures for the Client Asset Management Business of Securities Companies)*. The requirement to seek best execution and for appropriate trading and timely allocation of transactions is achieved through general requirements on fund managers and securities companies to observe principles of fair trading and strengthen control of transaction execution, as well as the exchanges' own electronic auction and matching system. In addition, the annual internal control evaluation report required of fund managers is required to include an independent

	evaluation by an accounting firm of the company's implementation of the fair trading system. To avoid churning, fund managers and securities companies are subject to a specific requirement not to conduct excessive buying and selling of securities via brokers, and to avoid concentrated allocation of trading to affiliated brokers, and fund managers are required to disclose in the periodic reports the volumes allocated through rented trading seats including affiliated brokers. On underwriting, apart from specific rules governing sales and distribution agents, the primary rules are the general disclosure requirements which are described under Principle 18. For QDII fund operations, it is common for domestic fund management companies to engage an overseas investment advisor to undertake investments, and for domestic custodians to entrust custody business to overseas custodian banks. Securities companies conducting collective asset management business are required to sign an agreement with securities registration and clearing institutions appointing them to act as the registration institution for the collective scheme units. Securities investment funds are permitted to engage fund distribution agents to sell and distribute their products, which themselves are subject to registration and other regulatory requirements as noted above. However, these powers to delegate functions fall well short of being able to transform the domestic fund manager or securities company into an empty box. Pursuant to the general law relating to contracts and agency in China, the operator is equally responsible for the acts or omissions of any party to whom it delegates a function. These general requirements are buttressed by specific requirements which require: • A fund manager to supervise and accept liability for sales agents which it contracts; and • A custodian who has authorized an overseas custodian to act on its behalf to be liable for any losses caused by the fault or negligence of the overseas custodian, unless the agreement specifies otherwise. There are requirements which ensure that any delegations are disclosed to investors. Specific requirements apply to disclosure of sales agents, registrars and foreign investment advisors engaged by a QDII. The general provisions related to disclosing, avoiding or otherwise managing conflicts of interest are set out above. There are additional specific requirements applying to overseas investment advisors appointed by QDIIs which require the investment advisor to comply with the laws and regulations of China as well as put the interests of the investors first.
Assessment	Broadly Implemented
Comments	There are clear regulatory requirements for those that wish to operate or market a CIS, which provide reasonable entry requirements, ongoing eligibility and conduct rules, and requirements aimed at managing conflicts of interest. The provisions related to the professional qualifications and experience of fund managers appear reasonable given the relatively recent development of the CIS industry within China. However, the CSRC may need to upgrade its qualification requirements in terms of the experience of relevant personnel and the nature of risk management controls as the industry develops and grows. The CSRC capital requirements for fund managers appear more than adequate. In light of experience with significant levels of misappropriation of client funds by securities companies in the early part of this decade, the CSRC has instituted strict third party custodian

	practices and a number of fund and securities companies were closed. Nevertheless, this episode underscores the importance of remaining vigilant with respect to the ongoing supervisions and monitoring of CIS business. Ponzi schemes or other fraudulent offers of securities are categorized and investigated as fraudulent offerings of securities under the criminal law. The Ministry of Public Security, CSRC, SAC and fund companies all report that they see relatively little illegal investment or Ponzi scheme activity, though some matters are referred for criminal investigation. In a market as dispersed, with such high retail participation, and growing as quickly as China's, the level of enforcement activity and complaints with respect to illegal investment scheme activity seems low throwing some doubt on the extent to which illegal CIS scheme activity is detected and deterred. The CSRC should be wary of the potential for unlicensed CIS activity, such as Ponzi schemes, to arise in the Chinese market and give attention to detecting and deterring it. Concerning delegations, as noted above pursuant to the general law relating to contracts and agency in China, the operator is equally responsible for the acts or omissions of any party to whom it delegates a function. These general requirements are buttressed by specific liability requirements. The regulatory system does not currently clearly specify that the CIS operator must retain sufficient resources in order to monitor the activity of any delegate, except in the specific case of sales agents or QDIIs. However, the general law does provide that any operator can terminate a delegation and make alternative arrangements for the delegated function. As the market develops and delegations become more frequent, the CSRC has indicated that it is planning to amend the *Guidelines on Internal Control for Securities Investment Fund Companies* to make provisions relating to delegations clearer, in particular the requirement for the delegator to maintain sufficient resources to monitor the performance of the delegate. In practice this does not appear to be an issue as there is little delegation other than to sales agents and through QDIIs and those delegates are themselves required to be registered with the CSRC, but as the industry develops and becomes more specialized delegations will become more common.
Principle 18.	The regulatory system should provide for rules governing the legal form and structure of CIS and the segregation and protection of client assets.
Description	As noted above under Principle 17, there are two types of CIS business in China: securities investment funds managed by fund managers, and collective asset management business conducted by securities companies. Both use a contractual model for defining the rights and obligations of investors, fund managers and other relevant parties. Article 3 of the *Fund Law* provides that the rights and obligations of fund managers, custodians and unit holders shall be specified in the fund contracts. Fund managers and custodians accept responsibilities as trustees for the funds. For collective asset management business conducted by securities firms, the securities companies are required to establish a collective asset management scheme, enter into a collective asset management contract with clients, transfer the custody of the assets to a custodian bank, and provide asset management services via an asset management contract (Article 13 of the *Tentative Measures for the Client Asset Management Business of Securities Companies).* **Legal form and structure** For funds, there are requirements for information on the legal form and type of the fund (open or closed-end) to be published prior to the offering of units, and that all information that will have a significant influence on the investment decision of investors as well as the risks of the fund investment must be disclosed in the prospectus in order to assist investors make an informed investment decision (Article 11 of the *Standards for Contents and Formats of Information*

	Disclosure by Securities Investment Funds). For securities firms conducting collective asset management business, they are required to enter into an asset management contract with clients explicitly stating the rights and obligations of the parties, the type and amount of client assets, the scope of authority, and the various types of risks involved with the asset management services being provided (Article 27 of the *Tentative Measures for the Client Asset Management Business of Securities Companies)*. In addition, Article 12 of the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies* specifies that risk disclosure in the asset management contract should cover market risk, management risk, liquidity risk and the risk of failure to perform duties by reason of bankruptcy etc. For collective asset management business conducted by securities companies, as these are private contracts with the rights and obligations stipulated in the contract changes cannot be made without the agreement of the investor. For funds, for matters that do not need prior approval of a general meeting of investors, the fund manager needs to release a provisional report on the matter to the general public and must update the prospectus every half year for any material matters. All documents released by the fund are publicly available through websites and newspapers designated by the CSRC. Under Article 71 of the *Funds Law*, important matters such as the expansion of the fund size or extension of the term of the contract, change in the type of fund or increase in the fee paid to the fund manager or custodian are subject to approval by the general meeting of fund unit holders. These material changes which require unit holder approval (as set out above) must be notified to the CSRC for authorization and for record within five days of the unitholder approval (Article 71 of the *Funds Law*). For securities companies operating collective asset management business, all modifications of the asset management contract must be notified to the CSRC for record, and some must be lodged for approval, including the compensation level for the manager and custodian, change in the upper limit of the size or investment ratio of the scheme, or change in the fund manager or custodian (Article 44 of the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies)*. **Segregation and safekeeping of assets** As noted under Principle 10, in the early part of this decade China experienced problems with widespread misappropriation of client funds by securities companies estimated at some US$15 billion for asset management companies and US$9 billion for securities companies, which led to the establishment of the Securities Industry Protection Fund to compensate defrauded clients and to liquidate some 31 (of a then registered population of around 130) securities companies which could not be recapitalized. Apart from closing down the worst affected securities companies, the CSRC has instituted a risk-based net capital requirement which provides more rapid and directed monitoring of the financial position of securities companies, a system of third party custodianship to provide strict segregation and safeguarding of client assets, and the requirement for firms to have a CCO with breach reporting obligations to the CSRC. The specific provisions are contained in the *Funds Law* and the *Tentative Measures for the Client Asset Management Business of Securities Companies* and provide that assets of a fund or CIS must be placed with custodian, which must be a commercial bank. The fund assets must be segregated from those of the fund manager and the custodian, and in case of bankruptcy of the custodian or fund manager the regulations specify that the property will not be considered part of the liquidation. There are therefore very clear regulatory requirements governing the safekeeping of client assets for both funds and securities companies conducting collective asset management business, which

	must be placed in the hands of an independent third party custodian which is a commercial bank. Additional regulatory requirements apply to commercial banks which seek a custodian qualification, including capital requirements and setting up a separate fund custody department with independent security and technology systems suitable for custody business. With respect to overseas investment of funds by QDIIs, there are also specific requirements for overseas custodians, which include a paid up capital of at least US$1billion, and that it is established in a jurisdiction under the authority of a local securities regulatory authority with which the CSRC has a cooperation agreement. Articles 19 and 29 of the *Fund Law* require the fund manager and the custodian separately to keep accounts of the assets under management, and in that respect shall preserve accounting vouchers, books, financial reports and relevant accounting files of the fund. The *Measures for the Administration of the Sale of Securities Investment Funds* require that fund managers and fund distribution agents must establish sound mechanisms for keeping the accounts of unit holders, including fund deposits and withdrawals. The records must be kept for at least 15 years. For securities companies, the general record keeping provisions under the Securities Law require records of client account opening, instruction records and transaction records to be kept for at least 20 years. The *Tentative Measures for the Client Asset Management Business of Securities Companies* specifically require the securities company and custodian to keep the account books of the client asset management business including the contracts and transaction records. Fund managers are required to produce independently audited financial statements annually, together with an annual evaluation report provided by an external CPA on the soundness of the manager's internal controls. In addition, when a fund manager or custodian terminates their duties, they are required to appoint an independent firm to audit the assets of the fund. Similarly, securities companies are required with their annual report to provide an audit of the client asset management business and provide a report on each scheme. Articles 67 to 69 of the *Fund Law* cover the termination of a fund, requiring the preparation of a liquidation report which is audited by an accounting firm and a legal opinion from a law firm, after which any proceeds are distributed to unit holders in proportion to the units they hold. The requirements for the liquidation of a CIS conducted by a securities firm are similar but do not require an independent audit. In addition, as mentioned above the Chinese regulatory framework dealt in the early part of this decade with some significant rationalization of securities firms and fund management companies. The SIPF was established to provide and manage a fund to assist with disposal of insolvent firms and compensate investors for any losses caused by misappropriation.
Assessment	Fully Implemented
Comments	The regulatory regime adequately provides rules governing the legal form and structure of CIS. Segregation and protection of client assets is assured through a mandatory system of third party custodianship. The CSRC is responsible under the *Fund Law* and the *Securities Law* for the supervision of securities investment funds, registration of funds, and for approval of any collective scheme established by securities companies. However, as noted above under Principle 1, there are substantial wealth management activities undertaken by banks and insurance companies which are subject to regulation by the CBRC and CIRC respectively. Given the substantial size of these activities further consideration needs to be given to the regulatory requirements applying to the form and structure of those activities to avoid potential regulatory arbitrage.

Principle 19.	Regulation should require disclosure, as set forth under the principles for issuers, 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.
Description	The general disclosure requirements are set out under Principle 18. In addition, there are ongoing requirements for disclosure related to the value of an investor's interest and other material changes that might affect the value of the fund. Articles 13 to 17, and Article 23 of the *Measures for the Administration of Information Disclosure of Securities Investment Companies* provide for the disclosure by a close-end fund at least weekly of its NAV and net unit value, and by an open-end fund on the day following the open transaction day of its NAV and net unit value as of the open transaction day. For open-ended funds the prospectus must be updated every six months. Similar requirements apply to CIS promoted by securities companies, under Article 62 of the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies*. The *Standards for Contents and Formats of Information Disclosure* require that: the effective date of the fund contract; the legal basis for the establishment of the fund and type of fund; all information relevant to whether investors should invest in the fund; information about the manager custodian and its key officers; information about the valuation of the fund and pricing of units; procedures for the purchase and redemption of units; the investment objective scope and strategies; information on risks involved including but not limited to market risk liquidity risk and management risk; the procedures for offering funds and the sales distribution agents; and fees related to fund operations and sales; be listed in the prospectus. The minimum rights of unit holders in a fund are specified in the Standards which are publicly available. Relevant audited financial statements of the year are required to be provided with the annual report. QDIIs are required to disclose in the prospectus any foreign investment advisor or custodian which they engage. For collective asset management business conducted by securities companies, the contract comes into effect on the date it is signed by the investor, securities company and custodian. There are requirements (in the *Regulations on the Supervision and Management of Securities Companies* and the *Tentative Measures for the Client Asset Management Business of Securities Companies*) for the company to designate personnel to explain the relevant business rules, risks related to the investment and contract contents to clients, and for the contract to stipulate: • the investor's rights, especially the method and authority for the management of the client's funds and the rights and obligations of the parties, • the identity and related details of the company and custodian, • the manner and price on which participation in the scheme may be withdrawn, • the investment scope, investment ratio and term and fees of management, • risks involved in the investment including market and liquidity risk, and • management fees and the method of calculating them. The audit report (including the audited financial statements) is required to be provided to clients within 90 days after the end of each year.

	In the event that the offering document does not in fact conform to the laws and regulations, e.g., that it contained information that was false or misleading, if the securities have not been issued the CSRC can revoke its decision. If the securities have been issued the CSRC may revoke its authorization and require the issuer to refund the subscription plus interest. The CSRC may also order the fund manager to make rectification of the breach and may suspend its applications for other funds or products for a period. In respect of securities companies conducting client asset management business the CSRC may suspend the company's client asset management business, require rectification, or make other disqualification or banning orders in more serious cases. Advertising material is defined to include publications, posters and outdoor advertisements, and TV and internet information. Under the regulations fund publicity and promotional material must be truthful and accurate and in particular must not contain any false or misleading material or predict the performance of the fund. Specific terms, like "excellent performance" and "among the best" are also banned. For securities companies offering collective asset management services, it is prohibited to advertise these services in general public media, the promotional materials made available by securities companies must be concise, and the prospectus and asset management contract must be in the same terms as approved by the CSRC. There are specific requirements for fund managers and securities companies conducting asset management business to prepare annual, semi annual and quarterly reports of the fund covering its financial performance and issues relating to the operation of the fund. For securities companies, the regulations also provide for monthly statements to be provided to clients, and for the NAV to be disclosed at least once a week. The reports are to be provided to clients and the custodian in accordance with the timeframes set out in the client asset management contract or prospectus. Following the decision by MOF to issue the ASBE and require its implementation by listed companies from 1 January 2007, the CSRC has required securities companies and fund managers to use ASBE for their financial statements as of July 1 2007. As noted in Principle 14, the ASBE have been assessed as being of high quality and internationally acceptable, given the convergence process under way with IFRS.
Assessment	Fully Implemented
Comments	There are comprehensive disclosure requirements for CIS which provide the information necessary to enable a prospective investor to evaluate the suitability and prospects of the scheme. However, given the high level of retail participation in the market, it is very important that all information should be provided in clear and simple language, and the CSRC will need to monitor this closely. There are adequate provisions governing valuation requirements to enable an investor to determine the value of their investment.
Principle 20.	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.
Description	The regulations require that the assets of funds and CIS are valued in accordance with the ASBE, based on a fair value measurement model as far as possible. As noted in Principle 19, Articles 13 to 17 and Article 23 of the *Measures for the Administration of Information Disclosure of Securities Investment Companies* provide for the disclosure at least weekly of the NAV and net unit value of a fund, the disclosure of the calculation methods for purchase and redemption in the fund contract and prospectus, and the disclosure of any material events relating to the fund within

	two days of the event. There are periodic reporting requirements for the provision of statements of client accounts on a quarterly and annual basis. Similar requirements apply to CIS promoted by securities companies, under Article 62 of the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies*. Article 32 specifies that securities companies, overseen by the custodian, should carry out these valuations. For open-ended funds, the valuations are required each trading day and the announcement of the NAV the next day, and for closed end funds the valuation each trading day and disclosure once a week. QDII funds are required to calculate and disclose NAV once a week and disclosure is required within two days of the valuation, while QDII funds that invest in derivatives are required to calculate and disclose NAV each trading day. For securities companies, the requirement is to calculate NAV on the basis set out in the asset management contract and disclose it at least once a week. As noted above, valuations are required to be carried out in accordance with ASBE, and the fund's annual audit includes an audit of valuations. There are detailed regulatory requirements (the *Guiding Opinions on Further Regulating the Valuation Business of Securities Investment Funds* and the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies)* in respect of fair valuation where market prices are not available. For investment products with an active market but no market price on the valuation date and there have been no major changes in the economic environment, the latest trading price is used. If there have been major changes such that the impact on the fund's previous NAV would be over 0.25 percent, the fair value shall be adjusted by reference to the prevailing market price of similar investment products. For investment products without an active market, if the potential valuation adjustment has a potential impact of more than 0.25 percent on the NAV of the fund, a valuation method that has proven to be reliable by reference to previous actual trading prices shall be used. Fund management companies are also required to keep their valuation policies and practices under review, and if there is any change in them notify them through periodic reports to investors and the CSRC. Custodian banks are also required to review the valuation and calculation of NAV. Finally, the Fund Valuation Task Force of the SAC organizes and published research on asset valuation methods, which fund managers use or disclose why they do not use them. Article 55 of the *Fund Law* prescribes generally that the purchase and redemption of open-ended funds shall be calculated on the basis of the NAV on the day of purchase or redemption, less any expenses. For securities companies operating open-ended collective asset management business, the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies* require that the collective asset management contract stipulate the timing and frequency of clients' entry to and exit from the fund. The *Fund Law*, the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies* and related regulations provide for handling pricing errors. Fund managers and securities companies conducting collective asset management business are required to correct pricing errors without delay and take corrective and preventive action, including paying compensation. If the pricing errors reach 0.25 percent of NAV the fund manager is required to promptly report to the CSRC, and if they reach 0.5 percent to make a public announcement and file a report with the CSRC for the public record. Under Article 23 of the *Measures for the Administration of Operations of Securities Investment Funds*, if the fund manager receives redemption requests exceeds 10 percent of the fund units, the fund manager shall honor no less than 10 percent and defer other redemption requests,

	according to the requirements of the prospectus. In addition, if the stock exchange relating to the fund investment is not trading, force majeure makes valuation unreliable, or the fund manager believes it is in the interests of investors to delay valuation, the fund manager may suspend redemptions. For securities companies conducting collective asset management business, the contract is required to specify the circumstances for suspensions. Article 53 of the *Fund Law,* the *Measures for the Administration of Operations of Securities Investment Funds* and the *Implementing Rules Governing the Collective Asset Management Business of Securities Companies* require the CSRC to be informed of any action to suspend or defer redemptions, within two days of the event or the same day in the case of force majeure or the suspension of trading of the relevant stock exchange. In cases of failure to accept redemptions in accordance with the law and regulations, the CSRC has power to require the fund manager or securities company to undertake redemptions. In cases where ongoing redemption would threaten the interests of investors or where valuation is unreliable, the CSRC can order the suspension or delay of redemptions.
Assessment	Fully Implemented
Comments	There are detailed regulatory requirements governing the valuation of CIS assets including audit requirements. There are also specific requirements concerning the pricing of subscription to or redemptions from funds. In particular, the basis on which valuations are required to be made is clearly set out in regulations, fund managers and securities companies are responsible for ensuring assets are valued at fair value, and the processes are subject to review by the fund custodian and the annual audit. The CSRC also checks on valuation methods and procedures as part of its inspections. Finally, the SAC has established a Fund Valuation Task Force to advise industry on best practice with valuation methods. However, the efficiency of the valuation process is tied to the availability of a liquid market for the underlying investment products, and so this issue is tied to the broader issue of the depth and liquidity of Chinese capital markets. In relation to asset valuation and pricing, the CSRC is able to order rectification, require more internal compliance audit, or order suspension of the fund management business. For criminal cases, the CSRC can refer the matter to the Ministry of Public Security. There is evidence of actions taken by the authorities with respect to asset valuation. In 2009 two funds made errors of over 0.5 percent on NAV. The fund manager and custodian reported the errors to the CSRC in a timely manner and made a public announcement and compensated investors with their own capital. The CSRC followed up with an inspection and required the managers and custodians to improve internal control processes, strengthen employee training and imposed regulatory measures against the senior executives.
Principles for Market Intermediaries	
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	Securities and futures companies are required to obtain a license from the CSRC on order to operate business in China (Article 122 of the *Securities Law* and 15 of the *Regulations on the Administration of Futures Trading)*. Securities companies can be licensed to engage in some or all of the following types of business: securities brokerage, securities investment consultancy, financial advising, securities underwriting, proprietary trading, and asset management business. Futures companies can engage in trading of commodity or financial futures.

	Securities companies and futures companies are required to meet requirements concerning the company's articles of association, registered capital, qualifications of the directors and senior officers, risk management and internal control procedures, business premises and facilities, and its major shareholders having sustainable profitability, creditworthiness and compliance record: see Article 124 of the *Securities Law* and Article 16 of the *Regulations on the Administration of Futures Trading.* Commercial banks are not permitted to engage in securities business. The minimum registered capital for securities companies is RMB 50 million (around US$7.5 million) for companies engaged in brokerage, consultancy and financial advising activity, RMB 100 million (around US$15 million) for companies underwriting, asset management or proprietary trading, and RMB 500 million (around US$75 million) for companies engaging in two or more of underwriting, proprietary trading and asset management (Article 127 of the *Securities Law*). For futures companies, the minimum registered capital is RMB 30 million (around US$4.5 million) for those with intermediary business only, RMB 45 million (around US$6.8 million) for those with transaction settlement business, and RMB 90 million (around US$13.55 million) for those engaging in comprehensive settlement business (Articles 19 to 21 of the *Interim Measures for the Administration of Risk Control Indicators of Futures Companies*). There are also ongoing net capital requirements (see Principle 22). Concerning qualifications of senior staff and de facto controllers, the regulations require that securities companies have three or more who have served as senior managers in the securities business for at least two years. These requirements may need to be made more stringent as the industry develops. Fit and proper requirements apply to senior staff, and de facto controllers and significant shareholders are required to have a good compliance record for the previous three years and have assets in excess of 50 percent of paid-up capital. Similar requirements apply to securities companies. Concerning internal controls and risk management, apart from adequacy of these systems being one of the prerequisites to obtaining a licence, there are some specific requirements. Under Article 23 of the *Regulation on the Supervision and Administration of Securities Companies*, a securities company shall appoint a compliance officer who is responsible for supervising legal and regulatory compliance and reporting breaches. The *Measures for Risk Control Indicators of Securities Companies* requires securities companies to establish a risk control indicator system which is sued to adjust the ongoing net capital requirement. The *Tentative Regulations on Compliance Management of Securities Companies* requires securities companies to develop and implement internal compliance management systems and cultivate a compliance culture. Similar requirements apply to futures companies under the *Regulations on the Administration of Futures Trading* and related regulations. The CSRC, as an administrative organ of the Chinese Government, is required to apply these licensing standards consistently and equitably. Article 38 of the *Administrative Licensing Law* requires that, where an applicant meets the statutory requirements and standards for a license, the administrative organ shall make a written decision approving the license, and where it decides to disapprove an application, it is required to inform the applicant, provide an explanation and the applicant is entitled to apply for administrative reconsideration. The CSRC may disapprove an application for securities or futures license, and when it does so is required to inform the applicant, provide an explanation, and provide for administrative reconsideration if requested by the applicant. Principle 5 deals with the nature and practice of review of CSRC administrative decisions. The CSRC as an administrative organ is required to and does publish its decisions on licensing via its website and publications. In addition, securities and futures companies are required to publish information about their license and permitted business activities, and the SAC

	and CFA and the stock and futures exchanges carry websites with such information. The CSRC may suspend or revoke approval of a securities or futures license or impose conditions on it in a range of circumstances, including where there is a change in control or some failure to meet ongoing requirements. If a shareholder withdraws the required level of capital, the CSRC can also order the shareholder to make rectification. If the company fails to continue to meet the risk-based net capital requirement the CSRC can impose a range of conditions and orders, including rectification orders, restrictions on dividend distribution or property transfers in order to improve the capital position, or suspension of parts or all of the securities or futures business (Article 150 of the *Securities Law* and Article 70 of the *Regulations on the Administration of Futures Trading*). The CSRC also has the ability to order the company to replace senior officers or directors or restrict their rights if the net capital is not maintained at a sufficient level or their conduct threatens the interests of clients. The CSRC also has powers to ban people from the industry or revoke their qualifications (delegated to the SAC and CFA) if they are involved in serious contraventions. The relevant requirements and powers are contained in the *Securities Law*, *Measures for the Administration of Futures Practitioners*, and related specific regulations. The SAC and CFA are responsible for the accreditation, registration and management of qualifications for individual securities and futures practitioners. The CSRC supervises the activities of the SROs in this regard, including by promulgating the regulations for the qualification requirements and carrying out annual examinations on the operation of the SROs. In addition, the CSRC separately receives, monitors and refers complaints about individual practitioner's and firm's conduct. The CSRC has a regulatory information system (Comprehensive Intermediaries Supervision Platform (CISP)) which updates in real time information provided by securities and futures companies. Each licensee has its own client port through which it submits information electronically. There are specific reporting obligations under the *Securities Law*, *Measures for the Administration of Risk Control Indicators of Securities Companies* and *Regulations for the Administration of Futures Trading*, with respect to changes in registered capital, replacement of significant shareholders, a de facto controller or director, or where the net capital position or any other risk control indicator changes by 20 percent or more from the previous month. Where the net capital or other risk indicator reaches the early warning level this shall also be reported. Securities and futures companies are required to report monthly and annually. They are also required to report immediately any material event that might affect the business operations, financial status or risk control indicators. As noted in Principle 10, the CSRC publishes an inspection program to set out the overall arrangements for annual inspections. During 2008 the CSRC conducted 789 routine inspections and nearly 500 ad hoc inspections on the head offices and branches of securities companies, and in 2009 1250 routine inspections and 2256 ad hoc inspections, covering areas such as brokerage business, internal audit and risk control systems. These inspections led to further regulatory actions in 2009 in the form of 20 rectification decisions, 10 regulatory warning letters to entities inspected, 30 regulatory interviews and 58 informal talks with responsible officers, and made 235 on-the-spot decisions requiring some form of rectification. On futures companies, the CSRC conducted thematic inspections in 2008 on net capital, the real name account system, information security, and overdrafts in futures trading, as well as comprehensive inspections on the largest 23 futures companies. In 2009, all registered futures companies were inspected, covering the management of margins, net capital, corporate governance, adoption of the real name account

	system, risk control and financial management. Regulatory measures such as regulatory interviews and rectification orders were imposed with respect to misconduct uncovered in the inspections. In one case, as the risk monitoring indicators were deficient the CSRC revoked one company's futures business license (the Tianhui Futures Brokerage Company). In addition, the CSRC regional offices undertake inspections based on the companies' risk status. For example, the Zheijang Bureau conducted a thematic review of futures companies in its region on suitability of investors in light of the introduction of stock index futures. Under Chinese regulatory requirements, financial advising is conducted as a securities investment consultancy service. This service cannot include trading on behalf of clients or keeping client assets in custody. CSRC requirements explicitly state that investment consultants shall not make commitments to break even or profits on their recommendations. Moreover, the CSRC is in the course of amending its rules on securities and futures investment consultants to require such consultants to disclose in detail to clients their personal backgrounds and career records, working experience, compliance record, investment strategies and fee structure.
Assessment	Fully Implemented
Comments	The Chinese regulatory regime requires that market intermediaries must be licensed with the CSRC, and are subject to initial and ongoing capital and experience and qualifications requirements. Following the collapse of a large number of securities companies in the early part of this decade, significant regulatory effort has been applied to the implementation of a risk-based net capital requirement (see Principle 21 for more details) and to internal controls to provide ongoing monitoring of risks. This, together with the closure of several securities companies, has led to a more stable industry with little evidence of substantial solvency or liquidity difficulties encountered during the recent financial crisis by intermediaries. The CSRC should consider amending its rules on securities and futures investment consultants to require such consultants to disclose in detail to clients their personal backgrounds and career records, working experience, compliance record, investment strategies and fee structure, as the development of an independent financial advising capacity can be an important part of market infrastructure. With the rapid growth of the Chinese market, the CSRC is strongly encouraged to develop these rules as the development of an independent financial advising capacity can be an important part of markets with significant levels of retail participation, as is the case in China.
Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	For initial capital requirements, see Principle 21. In addition the following ongoing net capital requirements apply. For this purpose, net capital is determined by taking the net assets of the company and deducting risk adjustments for the financial assets, other assets and contingent liabilities. The risk adjustments take into account the business scope of the particular company and the perceived riskiness of aspects of that activity, together with the liquidity of its assets and liabilities. For securities companies, under the *Measures for the Administration of Risk Control Indicators of Securities Companies*: • The net capital for a securities company engaging in securities brokerage business shall not be less than RMB 20 million (around US$3 million); • The net capital for a securities company engaging in one of the following businesses shall

not be less than RMB 50 million (around US$7.5 million): securities underwriting and sponsorship, proprietary trading, securities asset management or other securities businesses;

- The net capital for a securities company engaging in securities brokerage and in one of the businesses, i.e., securities underwriting and sponsorship, proprietary trading, securities asset management and other securities businesses, shall not be less than RMB 100 million (around US$15 million); and

- The net capital for a securities company engaging in two or more of the businesses of securities underwriting and sponsorship, proprietary trading, securities asset management and other securities businesses, shall not be less than RMB 200 million (around US$30.1 million).

For futures companies, Article 18 of the *Interim Measures for the Administration of Risk Control Indicators of Futures Companies* states that a futures company shall consistently meet the following standards for ongoing risk supervision: the net capital shall not be less than RMB 15 million and shall not be less than 6 percent of the total equity of clients; the average net capital per business branch shall not be less than RMB 3 million; the ratio of net capital to net assets shall not be less than 40 percent; the liabilities-net assets ratio shall not be more than 150 percent; and the company shall meet requirements for minimum settlement reserves.

The minimum and risk-based net capital requirements are specifically designed to take account of the risk involved in the different business scopes of the company. For example, for proprietary trading the total amount of proprietary equity securities and derivatives may not exceed 100 percent of the net capital; the total amount of proprietary fixed income securities may not exceed 500 percent of the net capital; the cost of a single variety of equity securities held may not exceed 30 percent of the net capital; and ratio of the market value of a single variety of equity securities held to the total market value of all equity securities may not be more than 5 percent. In addition, the CSRC has requirements for risk reserves calculated on the basis of management competencies, competitiveness and ongoing compliance status. The purpose of this system is to encourage the development of good compliance cultures and performance and to better allocate regulatory resources to riskier firms.

The CSRC has issued detailed instructions on how calculations should be done regarding net capital and risk capital reserves for different assets. For example, the discounts for government bonds, common listed stocks and ST stocks incorporated into net capital are 1 percent, 15 percent and 50 percent respectively, while the discounts for secured and unsecured corporate bonds are 5 percent and 10 percent respectively.

For futures companies, under the *Trial Measures for the Administration of Risk Control Indicators of Futures Companies*, a futures company is required, based on the classification, liquidity, age, and recoverability, to make risk adjustments to its assets in different proportions. A futures company shall also, in the notes to its net capital statement, fully disclose its closing contingencies (pending litigation, pending arbitration, external guarantees, etc.) with regard to their nature, amounts involved, causes and progress, expected losses and the accounting treatment for the expected losses, and shall deduct a certain proportion of the liabilities in the calculation of net capital. Also, a future company's capital, scale of operations and risk levels is pegged together, so that the net capital shall not be less than 6 percent of the total equity of clients, while the average net capital per business branch (net capital/ number of business branches) shall not be less than RMB 3 million (around US$450,000). The CSRC is required to analyze these indicators, requesting a futures company to conduct sensitivity testing of its risk

	control indicators prior to any decision that may have a material impact on the company's net capital, such as expansion of operations or distribution of profits to shareholders. Securities companies are required to conduct sensitivity analyses of their risk control indicators prior to their business operations and profit distributions in order to determine the appropriate maximum scale of relevant businesses and distribution of profits. They are also required to establish a mechanism for stress testing of the company's risk control indicators in a timely manner according to the moves on the market. Reserves of a securities company are to be accrued for impairment of assets in the calculation of its net capital. The CSRC may, on the basis of the development of the market, adjust the standards for calculating net capital, risk capital reserves and business scales. With regards to a new product or business for which proportions for risk adjustments or risk capital reserves calculations are not stipulated, the securities company shall, prior to investing in the product or launching the business, report to the CSRC and its regional office for approval. The CSRC, based on the characteristics and the risk profile of the company's new product or business and opinions solicited from the industry, decides appropriate proportions for risk adjustments and risk capital reserves calculations. The CSRC, under the *Regulations on the Supervision and Administration of Securities Companies* and the *Measures for the Administration of Futures Companies*, has prescribed five categories of ongoing reports required to be submitted by securities and futures companies through the CISP system, covering core monitoring indicators such as capital adequacy, financial monitoring reports, business monitoring reports, and management and control monitoring reports. The financial reports in particular cover assets and liabilities, profits, changes in owners equity and impairment provisioning. These reports are required on a monthly basis. The annual reports of securities and futures companies must contain financial statements audited by an independent auditor. In addition, an assessment report on internal controls provided by an accounting firm is also required annually. These reports are reviewed by the CSRC and are the subject of further enquiries as part of the scheduled inspection program or may be used to trigger a special inspection or themed inspection of a group of firms. The business scope of securities and futures companies is subject to the approval of the CSRC, and the CSRC takes into account the financial status of any significant shareholder initially and on an ongoing basis in conducting its supervision. In calculating net capital, any external equity investment and any contingent liabilities arising from external guarantees or guarantees to subsidiaries is deducted in full from net capital. The risk-based net capital system applies to all aspects of the securities or futures companies' business, including that of affiliates under its control or other members of the same group of companies. For securities companies, the net capital requirements cover all the business of a securities companies and all the assets and liabilities (including contingent liabilities) in its balance sheet. Securities companies in China are not able to invest in any industry without obtaining approval, pursuant to Article 26 of the *Regulations on the Supervision and Administration of Securities Companies*. According to the net capital calculation rules, in the calculation of net capital external equity investment by a securities company shall be deducted in full. Taking into account the off balance sheet risk, the *Measures for Risk Control Indicators of Securities Companies* require a securities company to deduct in full the contingent liabilities arisng from external guarantees or guarantee undertakings to its subsidiaries in the calculation of net capital. For futures companies, futures companies are only allowed to engage in futures brokerage business, financial futures transaction clearing business and financial futures transaction full clearing business. For any new business to be undertaken by a futures company, the CSRC will

	impose appropriate capital requirements. If, in the future, the CSRC permits futures companies to engage in any other business, it states that it will release relevant supporting standards for risk control indictors such as the net capital to regulate such activities. At present, futures companies have no off balance sheet operations and relevant regulations require them to fully disclose the impact of contingencies on net capital. Article 15 of the *Interim Measures for the Administration of Risk Control Indicators of Futures Companies* provides that a futures company shall fully disclose its contingent liabilities such as pending litigation and pending arbitration as to their nature, amounts involved, causes and progress, expected losses and the accounting treatment for the expected losses, and shall deduct a certain proportion of the liabilities in the calculation of net capital. According to the net capital calculation rules for futures companies, external equity investment by a futures company is deducted in full in the calculation of net capital. This avoids the risk that the capital framework fails to cover unlicensed affiliated entities.
Assessment	Broadly Implemented
Comments	The regulatory regime in China provides appropriate prudential controls with respect to market intermediaries and that relate to the risks involved in the particular businesses that market intermediaries undertake. The initial registered capital requirements and the ongoing risk-based net capital requirements provide a significant level of prudential buffer in respect of risks. As noted above in Principle 10, the Chinese securities market suffered significant defalcations and misappropriations in the early part of this decade, leading to some 31 securities companies being closed down and a further 5 being merged. As a consequence, the system of risk control indicators was overhauled. During the recent global financial crisis, Chinese securities companies were not affected to the same degree as securities firms in more developed markets. Nevertheless, given the history of significant conduct problems with securities and futures companies, it is important that the CSRC remains vigilant with respect to firms' compliance with the risk indicator regime and keeps it under review to ensure that it remains current with market trends and risks. In particular, as the system of risk-based net capital is relatively new, the CSRC should continue to monitor it carefully to ensure that it captures all relevant risks. The CSRC has an extensive inspection program which includes scheduled comprehensive reviews of securities companies once every five years and more regularly for futures companies (see Principle 10 for details). The monthly submission of financial monitoring reports through CISP provides a capacity to monitor the solvency of firms on an ongoing basis. In addition, the CSRC has established early warning standards for various risk level indicators. A failure to remain 20 percent above or below the required level, as the case may be, triggers an early warning, which prompts the CSRC to issue a warning and require rectification. Where the rectification is not effective, the CSRC may require the company to restrict its business or revoke its license. The CSRC has power to restrict a licensee's business activities or make adjustments to the risk thresholds in the event that the risk indicator reaches the early warning level described above or based on further analysis of the risks involved in the company's business. For example, for companies engaging in proprietary stock trading, the required proportion of risk capital reserves are 12 percent, 16 percent, 20 percent and 40 percent respectively for companies belonging to classification types depending on the riskiness of their business. Where a securities company holds financial assets beyond the allowed proportion, the CSRC and its regional offices may require the company to raise its risk-adjusted ratio in the calculation of net capital, and may, under the *Regulations on the Supervision and Administration of Securities Companies*, require the company to increase the frequency of internal compliance reviews and submit reports

	accordingly. The relevant regulatory instruments were extensively applied during the overhaul of securities companies from 2004 to 2007, and were later institutionalized in the form of legal provisions. During the three year overhaul, 50 persons were banned from market. 328 clues involving criminal offenses were transferred to public security organs, and 190 people were dismissed or removed from their original posts in securities companies as ordered by the CSRC. As the experience in the early part of the decade shows, this type and intensity of surveillance and use of regulatory powers is needed and continued attention will need to be provided to it. However, the more recent evidence suggests that the introduction of the risk based net capital requirement and more stringent risk controls has been beneficial in restoring solvency to firms and avoiding solvency problems during the recent global financial crisis.
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.
Description	Articles 18 and 27 of the *Regulations on the Supervision and Administration of Securities Companies* set out the requirements for securities companies to have a sound organizational structure, clearly defined functions of decision making, execution and monitoring bodies and adequate risk management and internal control systems. The CSRC has formulated the *Provisional Code of Corporate Governance for Securities Companies and the Guidelines on Internal Control for Securities Companies*, which spell out specific requirements for management and organizational structures and internal control mechanisms, including the responsibilities of senior management. Under Article 139 of the *Guidelines on Internal Control for Securities Companies*, the board of directors is responsible for supervising, inspecting and assessing the formulation and implementation of internal control systems of securities companies, and is ultimately responsible for their effectiveness. Article 45 of the *Measures for the Administration of Futures Companies* requires a futures company to put in place appropriate functional departments, define the responsibilities of the trading, settlement, risk management and finance positions, give priority to the control of key positions and operations, and make sure that the front office, middle office and back office operations are segregated from each other. Article 46 of the *Measures* stipulates that a futures company shall set up a compliance supervision department or relevant positions to examine and verify the compliance of the company's business operations and management. Securities companies are required to conduct an audit of their risk control statements annually (together with the financial statements), and boards are responsible for conducting an annual review of the company's internal controls which they may engage an external professional agency to undertake. In addition, under Article 7 of the *Measures for the Administration of Risk Control Indicators of Securities Companies* a securities company is required to engage an accounting firm with appropriate qualifications to audit its annual statements on net capital, risk reserves and the monitoring of risk control indicators. Securities and futures companies are required to make arrangements for resolving customer complaints. The relevant regulations require that a sound system or separate department be established to handle complaints, that complaint concerning violations or non-compliance be handled by the CCO, and that the complaints and their resolution be recorded. Whether complaints are adequately handled is an important factor in the CSRC's classification of the

	riskiness of securities and futures companies. **Safekeeping of client assets** The Chinese regulatory regime provides strict requirements for third party custodians to hold client property and funds for securities companies. Securities companies are required to have dedicated accounts with a commercial bank for client funds, and individual accounts are opened for each client (Article 139 of the *Securities Law*). Securities companies may not use client funds or property as part of their own assets, and in case of broker bankruptcy there is specific provision that the clients' funds for trade settlement and clients' securities are not part of the bankruptcy property. There are more specific provisions in the *Regulations on the Supervision and Administration of Securities Companies* which deal with the segregation of client funds and property in the hands of the custodian commercial bank. Securities companies are also prohibited from providing financing or guarantees to individuals using client assets. The custodian banks are under obligations to safeguard client assets and to reject any application to use them beyond the scope authorized. The Supreme Court has issued opinions that establish the legality and enforceability of Article 139 of the *Securities Law* and similar provisions: see the *Circular of the Supreme People's Court on Relevant Issues Concerning the Freeze and Transfer of Funds in the Clearing Accounts of Stock or Futures Exchanges (1997)*. In the bankruptcy case of Minfa Securities, the insolvency administrator had proposed that RMB 75 million worth of clients' transaction settlement assets it had secured should be regarded as property in the liquidation (around US$11.3 million). The Supreme People's Court ruled that such funds did not belong to the liquidation and should be used to cover the shortfall in clients' transaction settlement funds. For futures companies, under the *Measures for the Administration of Futures Companies*, the futures margin under the custody of the futures company is specified to be the property of the client and is not subject to be deemed to be part of the futures company's assets in the event of a bankruptcy. Futures margins are also subject to monitoring by the exchanges and the China Futures Margin Monitoring Center (CFMMC), which monitors the financial position of futures companies and individual clients. The CFMMC has responsibility for maintaining real-time surveillance and early warnings of any aberrations in the client margin system. The CFMMC verifies customer equity of futures companies based on the day-to-day data submitted by futures exchanges, custodian banks and futures companies after the closing of the market. It gives an early warning when any abnormal activity is discovered, and, on the same day, refers this issue to the CSRC regional office for review and handling. No significantly risky incident has occurred since the introduction of this system. **Services to clients, "Know-your-Client" and related requirements** Securities and futures companies are required to maintain comprehensive records of the customer's identity, transaction records and account data. For both securities and futures companies there is a requirement for the contract to specify the terms on which the securities or futures services are being provided, and for the contract to be signed before any trading accounts are opened in the client's name (Article 30 of the *Regulations on the Supervision and Administration of Securities Companies*, and Article 52 of the *Measures for the Administration of Futures Companies*). Under the *Measures for the Administration of Futures Companies*, futures companies are subject to an explicit obligation to explain the risks of futures trading to a client and have the client sign

	a declaration to that effect. Under the *Code of Conduct for Practitioners of Futures Industry (Revised)*, before providing services to investors, futures practitioners are required to get to know the financial status, investment experience and objectives of the investors, and inform the investors with prudence, good faith and objectivity the features and potential risks of futures trading. In respect of financial futures, the recently released *Regulations on Establishing the Regime for Suitability of Investors of Stock Index Futures (Tentative)* requires selection of suitable investors for participation in stock index futures trading based on the investor's risk perception and risk tolerance and testing the investors' knowledge of the product. Securities companies which conduct asset management business, margin trading, or distribution of financial products are required to make enquiries of the client's property, income status, investment objectives and risk appetite and record and maintain such records. Based on that knowledge the company is required to recommend suitable products to the client. Securities companies are required to provide information about the securities company, its business scope, and information about its senior management. Until recently as discussed below, they have not been required to provide information about the securities being offered or sought, in order that the customer can make an informed investment decision. Futures companies are required to provide information about the general risks involved in futures trading as well as information about the futures company itself. As noted above in respect of stock index futures, there is a requirement to fully explain the product and associated risks. In 2010 the CSRC released the *Regulations on Enhancing the Management of Securities Brokerage Business*, which enhance the requirements for securities companies to know their customers. When signing the initial securities transaction brokerage agreement with clients, securities companies are required to conduct a primary risk tolerance assessment for clients based on their financial and income status, knowledge of and experience in securities investment, risk appetite and their ages, and to undertake a subsequent assessment at least every two years. Securities companies are required to expressly notify clients in advance of the risk profile of the services and products to be provided and offer the services or products appropriate for client's risk tolerance. The risk profile of the services and products as well as the notification is required to be recorded and kept in written or electronic form. If securities companies believe that a certain service or product is not appropriate for a client or beyond their judgment capability, they are required to alert the client to the situation and leave the choice of such service or product to the client. Securities companies and futures companies are required to provide regular statements of account to their clients covering trading and transactions, futures companies on transaction settlement, and securities companies which offer asset management and margin trading on a monthly basis. Fund management companies and securities companies offering CIS are required to stipulate the management fees payable in the prospectus and fund contract, futures companies are required to disclose fees paid to intermediaries through daily settlement reports, and securities companies are required by Article 46 of the Securities Law to publicly disclose their fees. However, there are no requirements for securities companies to provide information about the fees received by the intermediary for services provided. For securities companies, Article 147 of the *Securities Law* requires them to maintain accounting data, entrustment and transaction records of its clients and data relating to internal management and business operations, and preserve it for not less than 20 years. Under more detailed regulations, the accounting system is required to have a well-established transaction reporting mechanism and have strong preservation and backup of electronic data in order to ensure the completeness and accuracy of the accounting records. For futures companies, Article 27 of the

	Tentative Measures for the Administration of Risk Monitoring Indicators of Futures Companies provides that futures companies shall keep written risk monitoring statements which include the balance sheet, income statement, cash flow statement, summary statement of risk monitoring indicators, and other information relating to clients' equity and positions. Article 67 of the *Measures for the Administration of Futures Companies* requires backup systems for trading, settlement and financial data and the maintenance of other records (such as client account records). **Compliance, internal controls and conflicts of interest** Securities companies are required to designate a person as the CCO, appointed by the board and approved by the CSRC, who is responsible for supervision of the firm's internal compliance systems, AML and Chinese Wall systems. Futures companies are subject to an obligation to set up a department or position dedicated to compliance review of the company's operations, and to establish a Chief Risk Officer who is to supervise and verify the compliance of the business with legal and regulatory requirements. Securities and futures companies are required to establish appropriate internal control and customer protection systems. Under Article 13 of the *Guidelines on Internal Control for Securities Companies*, securities companies are required to establish explicit and rational organizational structures taking into account their external environment and operational characteristics. A dual structure is required such that each key frontline job is generally assumed by two persons performing the same duties and bearing the same responsibilities, while posts exercised by a single person are subject to enhanced monitoring. Positions involving direct access to funds, securities, business contracts and information system security shall be assumed by two persons bearing the same responsibilities. An independent supervision and inspection department is also required to conduct overall monitoring, inspection and feedback in respect to the various business lines, departments, branches and posts. Article 21 of the *Guidelines* stipulates that a securities company must establish clear and efficient information exchange channels, major event reporting systems and information feedback mechanisms for employees and clients in order to ensure accurate transmission of information, keep the board of directors, board of supervisors, managers and the supervision and inspection departments informed of the securities company's operations and risks, and properly address all complaints, suspicious events and internal control deficiencies. Under Article 22 of the *Guidelines* a securities company must keep records of its businesses in a truthful, comprehensive and timely manner, and must establish complete business ledger systems to prevent unlisted operations or ambiguous transactions through cross-checking of business ledger and accounting systems. Article 29 of the *Guidelines* requires that a securities company establish confidentiality mechanisms for client information and other contents entered in securities transaction systems and properly maintain client data concerning the opening of accounts, transactions and other information, and complaint resolution in order to ensure clients' timely and full access to the information on their accounts and funds as well as trading and settlement activities. The *Trial Provisions for the Compliance Management of Securities Companies* require a securities company to develop and implement compliance management systems and mechanisms, foster a culture of compliance and guard against compliance risks. For futures companies, Article 53 of the *Measures for the Administration of Futures Companies* requires a futures company to sufficiently disclose to the client the risks of futures trading, make available on its business premises relevant regulations on futures trading and business rules of the futures exchange, and make public relevant business processes of futures brokerage,

	qualifications of relevant practitioners and other materials. Article 49 of the *Measures for the Administration of Futures Companies* requires that a futures company shall act under the principle of good faith and diligently and professionally execute the entrustments of clients, and safeguard the legitimate rights and interests of clients. A futures company must avoid conflicts of interest with clients, and, where such conflicts prove inevitable, give priority to the clients' interests. Article 29 of the *Regulations on the Administration of Futures Trading* provides the basis for the margin system. Margins collected from clients by a futures company are deposited in a special account separate from the company's proprietary account, are owned by the clients and are not to be used for other purposes. Under Article 67 of the *Measures for the Administration of Futures Companies*, a futures company shall establish backup systems for trading, settlement and financial data. Article 27 of the *Trial Measures for the Administration of Risk Control Indicators of Futures Companies* stipulates that a futures company shall submit risk control reports, which include financial records, in accordance with the requirements of CSRC. A futures company shall maintain its risk control reports in writing, which shall be signed by relevant principals and affixed with the company's seal. Under Article 48 of the *Measures for the Administration of Futures Companies* a futures company shall establish and effectively implement rules and procedures for risk management, internal controls and futures margin depository, maintain risk management thresholds and standards that are sound and consistent with CSRC requirements, and ensure clients' trading security and asset security. Finally, under Article 45 of the *Measures for the Administration of Futures Companies*, a futures company shall put into place appropriate functional departments, well define the responsibilities of the trading, settlement, risk management and finance positions, give priority to the control of key positions and operations, and make sure that the front office, middle office and back office operations are separate from each other. For securities companies, Article 136 of the *Securities Law* requires a securities company to maintain a comprehensive system of internal controls and adopt effective measures against conflicts of interest between the company and clients and among different clients. A securities company is required to conduct brokerage, underwriting, proprietary trading and securities asset management separately rather than in combination of any of them, using a Chinese wall system shall be established to segregate major business departments. Under Article 13 of the *Trial Provisions for the Compliance Management of Securities Companies*, a securities company's compliance department and its CCO is responsible for the implementation of the Chinese wall systems. For futures companies, Article 49 of the *Measures for the Administration of Futures Companies* requires that, under the principle of good faith and diligence, a futures company must avoid conflicts of interest with clients, and, where such conflicts prove inevitable, give priority to the interests of the clients.
Assessment	Broadly Implemented
Comments	The regulatory regime requires market intermediaries to have an internal risk management function and controls to protect the interests of clients. There are extensive and detailed requirements for internal compliance systems, managing or avoiding conflicts, for reviewing internal compliance arrangements, and for managing customer complaints. There are extensive suitability and "know your client" requirements for traders enabling investors to trade in stock index futures and to an extent in asset management, but less strict requirements elsewhere. New regulations have been introduced in 2010 to require securities companies to undertake a risk tolerance assessment of clients and notify clients if they believe a particular

	product is not consistent with the client's risk tolerance. Added emphasis has been given to risk disclosure and the "know-your-client" requirements for futures companies. The implementation of these recently introduced regulations should be carefully monitored to ensure that they are resulting in securities companies having a meaningful understanding of the persons for whom they will be acting, and investors being able to make better informed investment decisions, given the growth of the market and the level of retail participation in it. The CSRC should consider whether the concept of suitability included in the requirements for trading in stock index futures should be more generally applied to commodity futures trading and securities trading, in light of the broad retail participation in Chinese capital markets and the need for investors to be informed about the risks of products appropriate to their circumstances. The margin requirements for futures trading appear to have worked well to enable the market to operate efficiently, and it is notable that the CFMMC has not had to notify any significant risky incident has occurred since the institution of this system. Indeed, following the global crash in stock and commodity futures markets in October 2008, no material risk event occurred in the commodity futures markets, even though all of the commodities then traded fell to their daily trading limit and the major commodities fell to that limit for three consecutive days. The CFMMC system has been adopted and implemented following analysis of a range of potential systems, and it has stood the test of the market falls since 2008. In stress testing, the CFMMC has since tested the pressure on the floating loss exceeding margin on various futures clients, companies and the market as a whole, and such data can only be reliably generated by an entity such as the CFMMC. However, in light of the apparent effectiveness of the third party custodian requirements for securities firms and fund management companies in preventing problems of misappropriation of client assets, the CSRC should keep under review, in the medium term, whether some form of third party custodianship or other changes to clearing arrangements should be made to safeguard client margins currently held by futures companies.
Principle 24.	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	The CSRC has clear plans for and recent experience in dealing with a securities company's failure. As noted above in Principle 10, the Chinese securities market suffered significant defalcations and misappropriations in the early part of this decade, leading to some 31 securities companies being closed down and another 27 companies managed to continue their operation after receiving fund injections from the government or conducting equity restructuring. High risk companies were handled through having business operations suspended for rectification, being placed under the custody of or being taken over by another organization, being revoked, going into bankruptcy and liquidation, or being restructured. In the process, 11.53 million accounts were resolved and, as a result, the deficiencies totaling RMB 26.4 billion (around US$3.8 billion) of clients' transaction settlement funds (guarantee funds for the settlement of Stock Exchange transactions) and individual debt claims totaling RMB 12.1 billion (around US$1.8 billion) were made up for; more than seven million clients were transferred; and 17,800 employees were replaced. As a consequence, the system of risk control indicators was overhauled, the SIPF was established to assist in the risk disposal process by acquiring creditors' rights and to compensate investors whose funds may have been misappropriated, and the system for dealing with the failure of a market intermediary was tested and improved. A strict system of third party custodianship was introduced to deal with the problem of misappropriation on client funds.

	Securities companies Article 153 of the *Securities Law* stipulates that where a securities company conducts business against law or incurs risks which severely undermine the order of the securities markets or jeopardize the interests of investors, the CSRC may take such regulatory measures as ordering the company to suspend business operation for rectification, putting the company under the custody of, or having it taken over by, a designated institution, or terminating the company. Directors and senior officers' property may also be frozen. The *Regulations on Handling of Risks of Securities Companies* enacted in April 2008 improved the legal framework for handling the risks of securities companies, by better defining the conditions and measures for risk handling and empowering the CSRC to order rectification where early warning triggers for the risk measures are triggered. This rectification power is important, because a failure to rectify within the prescribed time period triggers a range of other powers including suspension or putting in custody the business of the securities company. The *Regulations* define the authorities and supervisory and coordinating responsibilities of the CSRC and other relevant parties in handling the risks of securities companies. Article 51 of the *Regulations* stipulates that if the securities company being handled or its associated client is likely to transfer or conceal the illegal funds or securities, or the securities company is likely to pay off debts to individual creditors in violation of the Regulations, the CSRC may prohibit the transfer of funds and securities from the relevant capital account and the securities account. These measures ensure proper management of the assets of a securities company that is in the process of risks disposal. With regard to providing information to the market, according to Article 14 of the *Regulations* any decision made by the CSRC ordering a securities company to suspend business for rectification, putting a securities company into custody, taking over a securities company or conducting administrative restructuring shall be announced to the public, and the document of announcement shall be posted at the business premises of the securities company. The decision must describe the measures being taken for risk handling, reasons and coverage of such handling measures. **Futures companies** Article 21 of the *Regulations on the Administration of Futures Trading* requires a futures company, before its business license is revoked, to settle relevant futures business and return to the clients their margins and other assets. The branches of a futures company are required to terminate their business operations and properly handle their clients' assets before their licenses are revoked. According to Article 60 of the *Regulations on the Administration of Futures Trading*, where a futures company engages in any business in violation of the law or causes a material risk to arise within, thus severely disrupting the order of the securities markets or jeopardizing the interests of its clients, the CSRC may take such regulatory measures as ordering the company to suspend its business for rectification or appointing another institution to exercise guardianship over or take over the company. With the approval of the CSRC, the following measures may be taken against the directors, supervisors and senior managers who are in charge and the other persons who are directly responsible: Notifying the border control authorities to prevent by law these persons from leaving the country, or applying to the judicial organs to prohibit them from transferring or alienating their property or disposing of the property by other means, or creating other interests on their property. The measures are provided in Articles 51 and 59 of the *Regulations*.

	According to Article 30 of the *Measures for the Administration of Futures Companies*, where a futures company is to be dissolved or goes bankrupt, it shall give priority to properly handling the margins and other assets of the clients and shall settle the futures business. **Actions available to the regulator** As noted above under Principle 22, the CSRC has established early warning standards for various risk level indicators. A failure to remain 20 percent above or below the required level, as the case may be, triggers an early warning, which prompts the CSRC to issue a warning and require rectification. Where the rectification is not effective, the CSRC may require the company to restrict its business or revoke its license. As noted in Principle 10, the CSRC has an extensive inspection program which includes scheduled comprehensive reviews of securities companies once every five years and more recently for futures companies. In addition, the monthly submission of financial monitoring reports through CISP provides a capacity to monitor the solvency of firms on an ongoing basis. As the experience in the early part of the decade shows, this surveillance is needed and continued attention will need to be provided to it. However, the more recent evidence suggests that the introduction of the risk based net capital requirement and more stringent risk controls has been beneficial in restoring solvency to firms and avoiding solvency problems during the recent global financial crisis. As noted above under Principle 22, the CSRC has power to restrict a licensee's business activities or make adjustments to the risk thresholds in the event that the risk indicator reaches the early warning level described above or based on further analysis of the risks involved in the company's business. For example, for companies engaging in proprietary stock trading, the required proportion of risk capital reserves are 12 percent, 16 percent, 20 percent, and 40 percent respectively for companies belonging to classification types depending on the riskiness of their business. Where a securities company holds financial assets beyond the allowed proportion, the CSRC and its regional offices may require the company to raise its risk-adjusted ratio in the calculation of net capital, and may, under the *Regulations on the Supervision and Administration of Securities Companies*, require the company to increase the frequency of internal compliance reviews and submit reports accordingly. Where the net capital level or other risk control thresholds of a securities company is not in conformity with the specified level, the CSRC can order the company to rectify within a specified time limit. If the company fails to do so at the expiration of the time limit, or its behavior severely threatens the steady operation of the company or jeopardizes the lawful rights and interests of the clients of the company, the CSRC may take the following measures: impose restrictions on the business activities of the company, order it to suspend part of its businesses, or withhold approval with respect to its application for new businesses; impose restrictions on the profit distribution of the company, or on the compensation payments or benefit availabilities to its directors, supervisors or senior managers; impose restrictions on the alienation of the property of the company, or the creation of other rights on its property; order the company to replace its directors, supervisors or senior managers, or to impose restrictions on their rights; order the controlling shareholders to divest their interests in the company or to impose restrictions on the exercise of the shareholder rights of relevant shareholders; or revoke relevant business licenses. Where the company's business has been suspended, the CSRC can require that the company transfer its brokerage business to another securities company recognized by the CSRC. Where a securities company is to be dissolved, a group of professional intermediaries (law firms and

	accountants) shall be formed to perform the administrative settlement of the company. Similar provisions apply in respect of futures companies under the *Regulations on the Administration of Futures Trading*. Under Article 14 of the *Regulations on Handling of Risks of Securities Companies*, any decision made by the CSRC on ordering a securities company to suspend business for rectification, putting a securities company into custody, taking over a securities company or requiring a securities company to conduct administrative restructuring shall be announced to the public, and the document of announcement shall be posted at the business premises of the securities company. Similar requirements apply to futures companies, which must publish such information in public media designated by the CSRC. The CSRC's domestic and international communication processes in these types of cases have been informed by recent experience. Under Article 3 of the *Regulations on Handling of Risks of Securities Companies*, the CSRC will establish coordination and quick response mechanisms in conjunction with the PBC, Ministry of Public Security and other financial regulatory agencies under the SC, as well as provincial governments. The CSRC's bilateral and multilateral arrangements for information sharing with the CBRC, CIRC and with foreign regulators would also apply in these cases. **Customer protection funds** For the securities industry the SIPF was established in September 2005 to acquire the individual claims of bankrupt securities companies and compensate investors for deficiencies in their settlement accounts. Since then the SIPF has played an important role in the risk disposal of bankrupt securities companies. Around RMB 20 billion (US$3 billion) was used by the SIPF to purchase creditors' rights with respect to failed securities companies, and it now heads the creditors' committees of 19 companies going through liquidation. The SIPF which was originally established with RMB 10 billion (around US$1.5 billion) from the PBC, now stands at RMB 36 billion (around US$5.4 billion), with annual revenue of RMB 8 billion (around US$.2 billion) coming from transaction fees on the stock exchanges, interest on "frozen funds" during an IPO, and fees paid by securities companies based on their risk classification according to the CSRC. For the futures industry a Futures Industry Protection Fund managed by the CFMMC is in place, financed by futures companies through charges by the exchange on its members and commissions charged by the futures companies themselves, for the purpose of compensating investors in case of losses of margins paid to futures companies. Each exchange also maintains its own risk fund in the event of failure of a client or broker to meet a margin call. The futures exchanges transfer 20 percent of processing fees and futures companies 5 percent of transaction fees to the risk reserve fund. In addition, futures companies are required to guarantee a minimum of RMB 2 million (around US$300,000) to be paid to each exchange as their settlement reserve, to be used in the event that margins held do not prove sufficient.
Assessment	Fully Implemented
Comments	The Chinese regulatory regime makes adequate provision for dealing with the failure of an intermediary, building on experience with significant failures of securities companies in the early part of this decade. These requirements include requirements for safekeeping of client assets,

	early warning signals of solvency or operational difficulties, a suitable range of regulatory remedies, and ultimately segregation of client assets and back-up customer protection funds in the event of failure of the intermediary. The scale of the problem with securities companies in the early part of this decade demonstrates both the resolve of the CSRC and other authorities, and the size of the challenge ahead as the Chinese market continues to grow. It heightens the critical importance of sound monitoring and surveillance systems, on top of a much better compliance culture at firms, to avoid a recurrence of this type of problem and ensure that market intermediary failure remains an isolated rather than a systemic event. The authorities might consider altering the threshold for taking over the business of a securities company in the *Securities Law* and the relevant regulations, in the absence of having failed to rectify in response to one of the early warning indicators, that the failure "severely threaten the order" of the market, to ensure that the CSRC can act promptly before the problem becomes too large.
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	The establishment of a stock exchange (or an alternative trading system similar to a stock exchange) requires the approval of the SC following the examination and verification of the CSRC: Article 102 of the *Securities Law* and Article 6 of the *Measures for the Administration of Stock Exchanges*. The establishment of a futures exchange requires the approval of the CSRC: Article 4 of the *Regulations on the Administration of Futures Trading*. Under these requirements the Shanghai and ShSEs have been approved by the SC, and the SHFE, the Dailan Commodity Exchange, the ZCE and, most recently in 2006, the CFFE have been approved by the CSRC. There are no alternative trading systems currently operating on the Chinese mainland. **General requirements** The CSRC has imposed a range of ongoing obligations to ensure the appropriate operation of stock and futures exchanges. These include requirements for the exchanges to provide a fair open and equitable environment for the market, membership qualifications which apply to all applicants for membership, rules with respect to the listing of companies and trading of securities or futures on the exchange, and controls on business conduct aimed at prohibiting illegal or aberrant trading. There are clear regulatory requirements which require stock and futures exchanges to have arrangements in place, including published membership, trading and listing rules and surveillance and supervision arrangements, to ensure efficiency, transparency and fairness, and compliance with the legislation. In particular, the exchanges devote substantial human and technological resources to real-time surveillance of trading at both the broker and individual client level to detect patterns of aberrant trading and seek to rectify them. In the case of futures exchanges, the risk surveillance systems of the futures exchanges are connected to the CFMMC, which exercises monitoring over the futures market and reports to the CSRC upon the discovery of risks and irregularities. The CFMMC is in the process of establishing a futures market surveillance and monitoring system to realize real-time surveillance of trading activities on the whole futures market. See Principle 26 below for more detail. Applications to establish a stock exchange must be submitted to the CSRC for examination and verification, under the *Securities Law* and the *Measures for the Administration of Stock Exchanges*. Such applications need to contain the following documents:

- The constitution of the exchange and draft rules for business;
- Descriptions on the venue, facilities and availability of funds;
- Information on the recommended managers; and
- A list of candidates for the board of directors.

Under the *Regulations on the Administration of Futures Trading*, a futures exchange is required to establish rules to strengthen risk control over the trading activities and regulation of members and staff, including a margin system, daily mark to market, a price and position limit system, and large position reporting. The executives of a futures exchange are nominated or appointed by the CSRC.

For stock exchanges, the regulatory system has provided for dematerialization of securities and a centralized and unified registration and clearing of trades through the SD&C. In 2001 the SD&C took over the registration and clearing house function from the two exchanges, and administers a range of risk monitoring and management measures to prevent and resolve risks involved in securities registration and settlement. These include settlement collateral arrangements, a settlement reserve fund and a mutual guarantee fund which are controlled by the SD&C but funded by market participants and adjusted according to the amount of purchases of securities by the participant.

Under Article 116 of the *Securities Law*, each stock exchange has a stock exchange risk fund, managed by the board of directors and funded from membership fees, transaction fees and seat fees. The purpose of the funds to cover material losses and prevent material risks to the operation of the exchange. For SSE and ShSE, the respective risk reserve fund balances stand at close to RMB 1 billion (around US$0.15 billion) and have been at that level for over three years in each case. In the past five years, SSE used RMB 111 million (around US$16.7 million) from the risk fund in January 2009 to make up a capital shortfall resulting from the return of individual clients' bonds that had been misappropriated by securities companies who were handled in the three-year "comprehensive overhaul." The ShSE risk reserve fund has not had any expenditure or claims from 2005 to 2009.

The exchanges have power to suspend trading in certain stocks in the case of unexpected events that impact on normal trading, such as force majeure, or for the purpose of maintaining normal trading of stocks.

For futures markets, the CSRC has prescribed a series of prudential and related requirements to reduce the risk of non-completion of transaction, including a margin system for futures brokers and their clients, a futures risk reserve system whereby the exchange accrues 20 percent of its revenues as risk reserves and held in a separate account to be applied in the case of losses or to prevent material risks to the exchange, a settlement reserve paid by members, a daily price control mechanism by which trading is suspended for the day if a change of a particular percentage is seen within a day, a position limit and large position reporting system, and a clearing membership classification system which enables clearing rights to assist in coping with the risk of default by members.

The CFFE also has a settlement guarantee fund which is funded according to the membership level of the clearing member. As of May 25, 2010 the total fund was RMB 900 million (around

	US$135.5 million) deposited at banks. To date this fund has not had a claim. **Trading infrastructure** For the securities markets, the CSRC and exchanges are responsible for resolving trading disputes and irregularities. According to the general administrative law applications for administrative reconsideration can be made in respect of administrative decisions (see further discussion under Principle 5). In addition, the trading rules prescribe in detail the mechanisms for resolution of trading disputes and irregularities, supervision of trading activities and disciplinary actions, and reporting procedures for breaches of trading rules. In addition, according to Article 62 of the *Securities Law*, where a company objects to a decision of the stock exchange that denies, suspends or terminates its listing, it may apply for reconsideration. The exchanges have established and improved technical standards and procedures dealing with operational failure. Trading systems undergo multiple simulations before they are put online. Stock exchanges have established internal and remote backup systems and databases. In addition, the *Preliminary 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 market suspension of the securities/futures exchange, thus mitigating the adverse effects of technical failures on the capital market. The Plan defines the categories of, and identification threshold for, material technical failures (e.g., a situation where over 10 percent of the members of an exchange cannot conduct normal trading constitutes a technical failure) and provides that the procedural arrangements for dealing with material technical failures shall include classified management, emergency reporting and appropriate resolution. One of the mechanisms for dealing with disorderly trading is a daily price limit system. The amount by which shares or mutual funds are allowed to rise or fall within one day in 10 percent of the previous trading day's closing price, or 5 percent for those with non-tradable shares or under a delisting warning. If the price limit is hit within a day, trading is allowed to continue but only at or within the price limit until the close. Under Articles 44, 140, 147, and 162 of the *Securities Law* and Article 37 of the *Measures for Administration of Stock Exchanges*, the stock exchanges, securities registration and clearing institutions and securities companies conducting brokerage business shall properly preserve the trading, clearing and agency records and maintain them for not less than 20 years. Securities clearing and settlement is conducted by the SD&C rather than by the stock exchanges. Under Articles 84 and 115 of the *Securities Law*, stock exchanges must exercise real-time monitoring of securities trading and report suspected irregularities. In the event of abnormal trading or emergencies, the stock exchange may impose the following measures: issuing oral or written warnings, imposing trading restrictions on certain accounts, trade suspension or market suspension, requesting the CSRC to freeze accounts, and reporting to the CSRC for investigation and regulatory action. Stock exchanges have also enacted the *Detailed Rules for the Resolution of Trading Irregularities*, which specify three major categories of irregularities, i.e., force majeure, accidents and technical failures,where trading is not able to continue and reinforcing the measures that stock exchanges may take to handle the irregularities. In addition, China currently implements a price limit system (noted above) for securities trading as a measure to guard against abnormal trading activities. For futures exchanges, Article 88 of the *Measures for the Administration of Futures Exchanges*

	defines the circumstances wherein trading irregularities can be declared to have occurred, and Articles 104 and 105 enable the CSRC to adjust margins, or suspend, resume or cancel trading. Under the trading rules of the exchanges, similar powers are also vested in the general manager of the exchange. The CSRC has developed technical standards for futures trading systems, requiring that all futures exchanges establish a disaster recovery center to record and preserve the system data and clearing and settlement records. In addition, the *Preliminary 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 similar to those described above for securities markets. In the introduction of stock index futures, the CSRC collaborated with the CFA and the CFFE to upgrade the technical requirements for financial futures traders and has conducted joint inspections with the CFFE to ensure implementation of the upgraded standards. In terms of records management, Article 42 of the *Regulations on the Administration of Futures Trading* and Article 92 of the *Measures for the Administration of Futures Exchanges* require the maintenance of futures trading, clearing and settlement records for not less than 20 years. With respect to the reporting of suspected non-compliance, the surveillance center (CFMMC) and the futures exchanges perform real-time monitoring of futures trading and report to the CSRC any suspected noncompliant and irregular behavior in trading activities. For securities and futures exchanges, there are adequate order routing and execution processes in place to ensure fairness for investors. For stock exchanges, Article 113 of the *Securities Law* requires that stock exchanges ensure fairness of the centralized trading of securities. The Trading Rules of the exchanges contain general conduct related provisions for securities trading to ensure fairness, including trading via a sole broker, agency trading, auction, and block trade requirements. Chapter IV of the Rules provide for matters with respect to the opening and closing prices, listing, delisting, suspension and resumption, ex-rights and ex-dividends, etc. In addition, the business rules of the stock exchanges and the electronic trading system ensure the fairness of trade order execution procedures. Securities companies themselves are subject to requirements to strictly maintain Chinese walls between their proprietary and brokerage business, and there are prohibitions on employees of securities companies and exchanges directly holding or trading in shares in their own or an assumed name. There are no cross-listed stocks currently in China, so there is only one market price at any time. Concerning best execution, the trading systems use an electronic auction and matching system matched by price and time priority to provide best execution. For futures exchanges, the *Regulations on the Administration of Futures Trading* provide requirements on all aspects of futures trading, including opening accounts, issuing trade orders, trading methods and settlement and clearing. The trading rules of the futures exchanges define the requirements for executions. Auction trading after the opening observes the principle of price/time priority, with the settlement price based on the Volume-weighted Average Price (VWAP). China has implemented paperless (i.e., electronic) securities and futures trading and has developed trading rules with price and time priority to ensure fair and efficient trade matching and execution algorithms of the trading systems. **Listings of products** New securities or futures products and listings, and the rules governing admission, require the

	review and approval of the CSRC, taking into account product design and market conditions. Article 50 of the *Securities Law* requires that where a company applies to the stock exchange for listing, its shares must have been issued in a public offering approved by the CSRC. In practice, the exchanges also play a role in assessing new products with respect to likely demand, technical feasibility and risk management, amongst other things, although legally their role is to consider and approve applications for listing of the shares under the listing rules. **Fairness and transparency in trading and market access (see also Principle 27)** The CSRC's power to review the rules of exchanges extends to membership rules. There is an overriding requirement that exchanges facilitate market development in an open, fair and transparent manner, and the Membership Rules of the exchanges apply to all applicants for membership. Persons aggrieved by a membership can apply for administrative reconsideration if they believe they have been treated unfairly. The market rules and operating procedures under the regulations and the trading and business rules of the stock and futures exchanges are publicly available and provide equitable access to similarly situated market participants. Concerning transparency of prices and trading, Article 113 of the *Securities Law* provides that a stock exchange shall release free real-time quotes and prepare and publish daily trading information. Articles 31 and 32 of the Measures and Chapter V of the Stock Exchange Trading Rules explicitly 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. For futures, Article 28 of the *Regulations on the Administration of Futures Trading* requires a futures exchange to release, in a timely manner, the following regarding a listed futures contract: trading volume, trading price, position, price limits and opening and closing prices, and shall release other real time information and ensure their truthfulness and accuracy. Article 90 of the *Measures for the Administration of Futures Exchanges* provides that a futures exchange shall publish rankings of its members in terms of their trading volumes, positions as well as other information prescribed in futures exchange trading rules and implementing rules; where physical delivery of commodities is involved, the amount of standard warehouse receipts and available capacity shall be disclosed. In addition, under the futures trading rules, a futures exchange shall adopt effective means of communication and establish synchronous quotation and real-time trade confirmation systems. At the same time, the exchanges and clearing institutions are required to preserve the confidentiality of individual client records and trade secrets. Concerning audit trails, the record keeping requirements for stock and futures exchanges clearly require complete trading, settlement and clearing records to be kept and maintained for not less than 20 years. The CSRC reports that it has full access to these records for the purpose of reconstructing trading activity for enforcement and surveillance purposes.
Assessment	Fully Implemented
Comments	The Chinese regulatory regime makes adequate provision for authorization and oversight of entities which wish to operate a stock or futures exchange, covering the exchanges themselves, admission of products to trading, trading information and execution procedures. The CSRC conducts on-site and off-site inspections of the futures exchange and an annual audit

	of the stock exchanges, under which it assesses the exchange's operational arrangements on an ongoing basis. However, while CSRC staff maintain regular dialogue with the stock exchanges especially on listed company disclosure and trading issues, it does not conduct formal inspections of the stock exchanges, as the exchanges are closely affiliated with the CSRC and the CSRC appoints as the Chairman of the exchange a CSRC vice chairman-level leader in order to strengthen front-line administration of the exchanges. As this system also implies a very high level of Government backing for the actions of an exchange, it raises potential moral hazard issues and the CSRC should consider instituting a formal program whereby it conducts regular comprehensive on-site inspections like for other exchanges. The CSRC should also consider providing more autonomy to the stock exchanges in choosing its Chief Executive.
Principle 26.	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.
Description	The CSRC has established departments to focus on the supervision of exchanges, intermediaries and listed companies. For more information on the monitoring of market participants, please see the Principles on Market Intermediaries section. **Monitoring of trading** The stock and futures exchanges are responsible for day-to-day monitoring of securities trading and for reporting irregularities in trading to the CSRC. Articles 84 and 115 of the *Securities Law*, Article 39 of the *Measures for Administration of Stock Exchanges* and the Stock Exchange Trading Rules provide that the stock exchanges must establish IT systems in line with the needs of market regulation and real-time monitoring, set up departments responsible for securities market supervision, and conduct real-time monitoring of transactions of exchange-traded securities. For this purpose, the stock exchanges have established a purpose-built market monitoring system, with capacity for real-time data processing and ex-post analysis. The system monitors the securities market and multiple securities and conducts integrated analysis of trading, settlement, issuance, information disclosure and other business information, using mainstream information analysis technologies. With respect to unusual trading patterns, the stock exchanges analyze and decide on the main causes leading to abnormal stock price moves, and impose measures, including investigation, intraday phone alerts, written warnings, interviews, trading restrictions on certain accounts, and trading suspension. The stock exchanges submit market trading information to the CSRC on a daily basis and report material abnormal trading activity to the CSRC to assist in handling improper trading activities and managing market risks. For example, the SSE advises that it detected 545 suspicious trades in 2007, 506 in 2008, and 590 in 2009, and referred around 70 to 100 cases per annum to the CSRC (about one case every three trading days on average). On these referrals the CSRC imposed administrative sanctions in 6 cases in 2007, 8 cases in 2008 and 12 cases in 2009. For futures exchanges, the CFMMC performs the market monitoring function. The CFMMC is responsible for establishing and improving mechanisms for futures margin safekeeping and surveillance. It detects problems affecting the safety of futures margins and reports them to the regulatory authority. The CFMMC verifies the day-to-day data submitted by the exchanges, margin depository banks and futures companies. Currently, the surveillance systems of all the exchanges are connected to the CFMMC, which monitors nationwide daily securities trading, collects and analyses trading data, and reports possible irregularities to the CSRC. In addition, the CFMMC is in the process of establishing a system for futures market surveillance and

	monitoring in order to realize real-time monitoring of the entire futures trading. The system is expected to be operational in 2012. Rather than rely on reporting by exchanges, the system will use multiple data sources in real-time including transaction data from exchanges, and data from banks and futures companies. As for now, each futures exchange is equipped with a department of supervision and a monitoring room which employs a specialized risk surveillance system to conduct real-time monitoring and risk management over trading activities for timely detection and submission of abnormal trading activities to the regulatory authority. **CSRC operations** The CSRC maintains close operational contact with the stock and futures exchanges to oversee their functions with respect to the integrity of the market. As noted in Principle 25, the CSRC conducts on-site and off-site inspections of the futures exchanges and an annual audit of the stock exchanges, under which it assesses the exchange's operational arrangements on an ongoing basis. However, although CSRC staff maintain regular dialogue with the stock exchanges especially on listed company disclosure and trading issues, it does not conduct formal inspections of the stock exchanges, as the stock exchanges are closely affiliated with the CSRC and the CSRC appoints as the Chairman of the exchange a CSRC vice chairman-level leader in order to strengthen front-line administration of the exchanges. As this system also implies a very high level of Government backing for the actions of an exchange, it raises potential moral hazard issues and annual inspections like for other exchanges should be considered. The CSRC has full access to both pre- and post-trade information available to market participants, on request. Stock and futures exchanges and clearing institutions are required to seek the approval of the CSRC to amendments to the constitution, listing, trading or business rules, pursuant to the *Securities Law, Measures for the Administration of Stock Exchanges* and *Regulations on the Administration of Futures Trading*. For stock exchanges, according to Articles 7, 8, 102, 179, and 180 of the *Securities Law* and Chapters VI and IX of the *Measures for Administration of Stock Exchanges*, the CSRC has the power to review the self regulatory practices of the stock exchanges. Where a breach of regulatory requirements is detected, the CSRC has the power 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. According to Article 102 of the *Securities Law*, the dissolution of an exchange shall be subject to the decision of the SC. For futures exchanges, Article 104 of the *Measures for the Administration of Futures Exchanges* stipulates that the CSRC may adjust the standards for the collection of margins by the futures exchanges to reflect market conditions, may suspend, resume or cancel the trading of a futures product, and under Article 106 it may give warnings to the executives of the futures exchange. Under Article 19 of the Measures, a futures exchange will be ordered to suspend its operation for rectification if any of the following circumstances occurs: changing the name or registered capital without approval, establishing any branch or any other trading venue without approval, allowing its members to conduct futures trading with insufficient margins, either directly or indirectly, engaging in businesses unrelated to futures trading or misconduct, committing violations in the collecting of margins or misappropriation of margins, non-compliance with the requirements for the offsetting of margins by negotiable securities, failure to comply with relevant provisions concerning inspections of members, failure to establish or implement a trading coding system or a margin management system, or non-compliance of trading and

	settlement systems or activities with regulations. In other serious circumstances, the futures exchange in question may be ordered to suspend its operation for rectification or have its authorization withdrawn by the CSRC.
Assessment	Fully Implemented
Comments	The CSRC and exchanges have implemented systems for the ongoing surveillance and supervision of trading, to ensure market integrity. Membership and trading rules of the exchanges are subject to approval by the CSRC.
Principle 27.	Regulation should promote transparency of trading.
Description	Under Article 113 of the *Securities Law* and Articles 31 and 32 of the *Measures for the Administration of Stock Exchanges*, exchanges are required to ensure fair trading of listed securities. In practice, the stock exchanges enter into licensing contracts with end users through information agents, communication services providers, institutional information users and members, thereby building relatively standard and controllable transmission channels for trading information. The *Measures for the Administration of Securities and Futures Market Data* require that the CSRC shall formulate and publish uniform standards which ensure market participants' equitable access to securities trading information. Under Article 28 of the *Regulations on the Administration of Futures Trading*, a futures exchange shall release, in a timely manner, the following regarding a listed futures contract: trading volume, trading price, position, highest and lowest prices, opening and closing prices, as well as other real time information that needs to be disclosed; while ensuring their truthfulness and accuracy. Article 90 of the *Measures for the Administration of Futures Exchanges* provides that a futures exchange shall publish the rankings of its members in terms of their trading volumes, positions and other kinds of information that are required to be disclosed according to the trading rules of the exchange. Where physical delivery of commodities is involved, the amount of standard warehouse receipts and available capacity shall be disclosed. In addition, pursuant to the trading rules of futures exchanges, exchanges shall adopt effective means of communication and establish synchronous quotation and real-time trade confirmation systems. Exchanges are required to provide members, clients and the public with futures trading information on a real-time, daily, weekly, monthly and yearly basis. The trading rules stipulate in detail the contents that shall be disclosed of real-time and daily information as well as information to be released on a weekly, monthly and yearly basis. The real-time trading information at futures exchanges is sent to trade 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. The CSRC has not authorized any stock or futures exchange to permit derogation from the objective of real-time transparency.
Assessment	Fully Implemented
Comments	The regulations require the provision of pre- and post-trade information to market participants on a timely basis, including requirements to provide such information to all participants on an equitable basis.
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading

	practices.
Description	Articles 63, 73–84 of the *Securities Law* explicitly prohibit market manipulation, the provision of misleading information, insider trading, and other fraudulent practices, and in particular prohibiting securities companies and their employees from damaging clients' interests. Articles 3 and 43 of the *Regulations on the Administration of Futures Trading* prohibit similar activity with respect to futures. The regulatory approach involves the exchanges, the SD&C and CFMMC, and the CSRC, as well as the Ministry of Public Security in criminal cases, to detect and deter such conduct. The exchanges are primarily responsible for real-time monitoring of trading to detect and take initial action with respect to abnormal trading. If the issue is not resolved or raises more serious issues, the matter is reported to the CSRC. The CSRC undertakes investigations on a formal or informal basis depending on the nature of the evidence available, and refers criminal matters to the Ministry of Public Security. A wide range of remedies is available both to exchanges and to the CSRC, including warnings, revoking licenses to trade or banning orders, rectification and confiscation orders, and suspension of trading. The exchanges collect and analyze trading data on a real-time basis with the aim of surveillance of the market, detecting abnormal trading, and providing a deterrent to potential insider trading and market manipulation. Where the matter meets the parameters set by the exchange, which can be varied according to market trends and intelligence, the exchange makes enquiries through the broker to determine whether there is an explanation. This action is usually taken on the same day and may be taken in such time as to stop the relevant trade or reverse it. If the matter is unresolved and is serious the exchanges can refer the matter to the CSRC for further investigation. In addition, the CSRC has begun to pilot a registration system for persons who may possess inside information, stock exchanges have a routine inspection program for listed companies making material disclosures focusing on the interests of insiders, and there are special inspection programs with respect to mergers and acquisitions. The Shanghai and Shenzhen exchanges have entered into information sharing and joint regulatory systems for the purpose of joint investigation of cross-market misconduct. They have also strengthened regulatory cooperation with the Hong Kong Stock Exchange in respect of dual listed companies. They have also signed an MOU with CFFE to improve regulatory coordination with respect to regulation of the spot and futures markets. For futures exchanges, the question strictly does not arise as a futures product cannot be listed on more than one market in China. Nevertheless, the futures exchanges have agreed to share transaction data in the CFMMC to enable consolidated surveillance to occur. The CSRC is a signatory to the IOSCO MMOU and has signed 45 bilateral arrangements with foreign counterparts which may be used for cooperation with respect to these matters. The Shanghai and ShSEs have signed MOUs with 37 and 25 foreign exchanges respectively.
Assessment	Fully Implemented
Comments	The CSRC has a reasonable record in imposing administrative sanctions in respect of these types of matters, and there have been some significant criminal cases which resulted in heavy penalties, for example: • Since January 2006 the CSRC has handled 18 cases involving administrative orders freezing

	assets totalling RMB 4 billion (around US$0.6 billion); • Delong Group manipulation of stock prices in June 2004—the main principal Tang Wanxin was sentenced in April 2006 to 8 years imprisonment and fined RMB 400,000 (around US$60,000); • Kelong Group false information disclosure in 2005—administrative penalties imposed one year after the investigation commenced, and a sentence of 10 years imprisonment and fines of RMB 6.8million (around US$1 million) imposed in January 2008; • Beijing Shoufang Investment Consulting market manipulation in 2008—in October 2008 the CSRC imposed administrative penalties on the principal of disgorgement plus RMB 251 million (around US$37.8 million) in fines, having successfully frozen RMB 180 million (around 27 million) in accounts under the principal's control during the investigation; • Zhongguancun insider trading in 2007—sentenced to 14 years imprisonment, a fine of RMB 600 million (around US$90 million) and confiscation of RMB 200 million (around US$30 million). On the other hand the number of matters on which action is taken is relatively small compared to the number of matters detected as suspicious by the exchanges. The SSE advises that it detected 545 suspicious trades in 2007, 506 in 2008, and 590 in 2009, and referred around 70 to 100 cases per annum to the CSRC (about one case every three trading days on average). On these referrals the CSRC imposed administrative sanctions on 6 cases in 2007, 8 cases in 2008 and 12 cases in 2009. The CSRC notes that many of the referrals do not warrant informal or formal investigation or referral for criminal action. There is little evidence of significant actions needing to be taken with respect to abusive futures trading. This may be because manipulation of a broad based instrument like the stock index futures contract is difficult, or that the exchange monitoring acts quickly enough to head off many cases. Concerning action taken by the CSRC or exchanges with respect to futures trading: • During the first month of stock index futures trading, the CFFE made 110 warning calls, issued 6 risk alert letters and 12 regulatory warning letters, sent staff to 6 companies for front-line verification, interviewed 4 executives and issued warnings, restricted one client from opening new positions, and referred one case to the CSRC. • In April this year, the DCE identified 30 cases of unusual trading through its routine surveillance, including 20 wash sales, 4 self trading cases and 6 cases where clients placed orders with unusual quote prices and were later found to be erroneous. In these cases the exchange dealt with these matters in such a way as to prevent any impact on the market. • During 2010 to date, the CSRC has issued warnings and fines to three persons, held a regulatory interview with one company, issued a correction order to one company, gave a warning to one futures company and restricted the business of one company in respect of futures market misconduct. The statistics on the level of resources devoted by the CSRC to insider trading and other market manipulation cases bear out that the CSRC regards this category of activity as very serious and a high priority for action: just over half the cases investigated in 2008 related to insider trading and market manipulation. There are some notable cases mentioned above which have been successfully completed and in which significant penalties have been imposed, and the

	investigation and hearing times are well within acceptable timeframes by international standards. However, as noted above there are a large number of referrals from exchanges which do not result in any action by the CSRC, which suggest that more resources and action may be needed. As noted above under Principle 26, significant human and technological resources are devoted to the surveillance systems to provide a deterrent. At the same time, given the size of the market, its rapid growth, and the enormous interest generated by new listings, the number of abnormal trades detected and on which action is taken seems low. It may be that the surveillance systems are sufficiently robust as to deter potential market abuse, but this seems unlikely given that many would-be insider traders are not active traders but may take advantage of an opportunity when it arises. It seems more likely that the level of abusive trading is higher than is being detected, and hence extra and continuing efforts need to be made. These efforts could be directed at: • Educating company officers, officers of securities and futures companies and related parties that insider trading and other market manipulation is a criminal offence; • Educating prosecutors and judges about the impact that insider trading has on investor confidence in the market; • Redoubling efforts at investigating suspicious trading around events likely to involve it, like IPOs and merger announcements, and lowering the thresholds for investigating or making enquiries; • Considering whether special rules should be developed to suspend or quarantine the proceeds of suspicious trades, including considering lowering the threshold of the level of suspicion (for freezing or quarantining actions) or altering the definition of abusive or suspicious trades to facilitate taking civil or disciplinary action; and • Considering measures related to product design, especially in relation to futures products, to make them sufficiently broad-based that it is difficult for insider trading or market manipulation to be successful.
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	China's securities market operates under a system where securities are mainly held directly rather than indirectly. Because of the dematerialization of securities and its electronic bookkeeping system, the SD&C possesses direct information on the securities accounts, positions and trading details of clearing participants and their clients, and does not need to access the clients' position information through market participants. This arrangement allows the SD&C and the CSRC to easily and conveniently obtain information on investors' positions from a centralized data source, facilitating more timely, accurate and continuous risk monitoring and evaluation. To monitor and manage the risks associated with clearing participants, a settlement reserve fund mechanism, settlement collateral mechanism and mutual guarantee fund mechanism have been adopted, whose amounts are adjusted in line with the amount of the securities purchased by clearing participants. In addition, under Article 56 of the *Measures for the Administration of Securities Registration and Clearing*, the SD&C may, based on the risk profile of the clearing participant, adopt risk control measures such as requiring the participant to provide settlement collateral. Article 39 of the *Rules of the SD&C for the Administration of Clearing Participants* defines measures specifically targeted toward high-risk clearing participants, such as raising the ratio of the minimum settlement reserve fund or requiring these participants to provide other collaterals

	consistent with the SD&C's requirements. For the futures market, Article 11 of the *Regulations on the Administration of Futures Trading* requires large position reporting. Exchange members and their clients must report to the futures exchange once their speculative position exceeds the 80 percent limit stipulated by the futures exchange. Futures exchanges may adjust the position reporting standards based on market risks. The risk control measures of the futures exchanges set out in detail the materials that should be provided by members and clients reaching the limit allowed. Each futures exchange has in place a department specialized in real-time monitoring of large positions, and sanctions apply for failure to report, including mandatory closing of positions. The CSRC is the regulatory body with authority with respect to most products (stocks, bonds, futures, funds, warrants). It has arrangements for consulting with other bodies such as the SD&C, the exchanges and securities and futures companies, and has coordination arrangements with other government authorities which may be relevant (the CBRC, CIRC, and PBC amongst others). For foreign regulators, see Principle 28. The *Measures for the Administration of Securities Registration and Clearing* provide in detail for default procedures of clearing participants which define the procedures that may be adopted, the assets of clearing participants that may be used and the detailed resolution procedures to be taken. In addition, the securities companies and custodian banks required to check on the availability of client funds and/or securities before transmitting the order to the exchange for processing. For futures trading, the *Regulation on the Administration of Futures Trading* requires margins to be used to cover trading defaults by exchange members. If the margin is insufficient the exchange bears the liability through its risk reserves. Where a client is in default the futures company should use its risk reserve and own funds to assume the liabilities and take recourse against the client subsequently. Futures exchanges have developed processes for handling defaults, including use of margins, margin calls intraday and overnight, risk reserves and settlement reserves. In practice the level of the margin is set out one and a half times the level of a single day's permitted price movement, which suggests that the margin should always be sufficient within the day. The *Measures for the Administration of Securities Registration and Clearing* provide in detail for means to isolate the problem by withholding the securities, using the supplementary funds or settlement collaterals, or retaining or transferring the clearing participant's proprietary securities. Article 7 of the Regulations on Handling the Risks of Securities Companies provides the CSRC with power to order a company to close some or all of its business if its risk indicators fail to conform. The company must then entrust its client brokerage business to another company registered with the CSRC. Where client funds are found to have been misappropriated the SIPF is available to make up the loss to the client. Futures companies in China may not engage in proprietary trading. However, the relevant regulations provide that where a futures company is in debt or bankruptcy, the assets in the margin account shall not be frozen or transferred for the benefit of debtors of the company, preserving the margin for the benefit of clients.
Assessment	Fully Implemented
Comments	The regulatory regime provides for market authorities to monitor the risk of large and open

	positions that pose a risk to the market or clearing. In the event of default, there are procedures in place to ensure that the problem is isolated and does not affect other market participants, and for apportioning any loss appropriately.
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	Not assessed. Please refer to the separate CPSS/IOSCO assessment of payment, clearing and settlement systems.
Assessment	Not Assessed.
Comments	