
COMPETITION IN CHINA'S SECURITIES MARKET: REFORM OF CURRENT REGULATORY SYSTEM

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I. Introduction

The recently amended Securities Law in China took effect on January 1, 2006.¹ While the amended law could be stronger, it goes a long way in making amendments to more than 100 articles concerning “expansion of the scope of the securities under regulation, separate regulation for different financial sectors among the banking, insurance, and securities industries, public offering, forward trading, money and stock lending/financing, permitting State-owned enterprises and banking funds to enter the stock market, and better protection of investors.”²

The amended law provides a platform for liberalizing and developing China's securities market, however implementation of most of these reforms is left to the direction of the State Council to enact specific regulations.³ Much needs to be done to bring the regulatory function of the Chinese securities market in line with international competitors.

This article looks at the regulatory framework of the Chinese securities market and exchanges, paying particular attention to issues concerning securities exchanges and the current role of the China Securities Regulation Commission (“CSRC”). This article argues that China's securities exchanges should be given more autonomy to practice effective self-regulation and promote market competition. It further argues that direct government control over the securities market and exchanges should be reduced to the level of general supervision only. To demonstrate this, the paper will first consider the background to the emergence of today's securities regulatory regime, before turning to the regime itself in more detail. The article concludes with speculation on further reform that would enhance the competitiveness of the Chinese market.

II. An Overview of China's Securities Market and Regulation

China's participation in economic globalization was marked by its entry to the World Trade Organization (“WTO”) in 2001, which triggered further change to

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¹ Yang Tiecheng, Alan Xu, & Allen Zhong, *Steady as She Goes—China's New Securities Law*, 12/01/05 P.R.C. L. & PRAC. 16, Dec. 2005, at 16.

² *Id.*

³ *Id.*

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China's securities market.⁴ Changes mandated by the WTO's General Agreement on Trade in Services ("GATS")⁵ included the liberalization of competition in China's financial markets and the development of China's securities market.⁶ Since then China has made efforts to foster a fairer and more competitive environment for participants in its securities market, to respond to both the WTO requirements and increasing globalization of capital markets, as well as strong economic pressure for domestic reform. For example, in December 2002 it launched the Qualified Foreign Institutional Investor ("QFII") scheme, which opened up China's domestic shares market to overseas investors.⁷ By the end of 2003, ninety-three domestic companies listed overseas, raising \$27.1 billion.⁸ Additionally, two joint venture securities companies and eight joint venture fund management companies were established.⁹

There were 1,287 companies listed on the Shanghai and Shenzhen Securities Exchanges by the end of December 2003.¹⁰ The total market capitalization was 4,245.8 billion yuan with a market capitalization of tradable shares of 1,317.9 billion yuan.¹¹ The total trading volume of 416.3 billion shares, with a total turnover of 3,211.5 billion yuan, was 14.74% higher than the year 2002.¹² There were 133 securities companies with total assets of 561.8 billion and 69.93 million yuan individual investment accounts.¹³ China's securities market now offers seven types of securities including A shares,¹⁴ B shares,¹⁵ treasury bonds, treasury bond repurchases, corporate bonds, convertible bonds, and securities investment funds.¹⁶

To further develop capital markets, China's State Council issued the *Guidelines on Promoting Reform, Opening-up and Steady Development of China's*

⁴ Chen Jinhua, *Looking Ahead Past WTO Entry*, in CHINA: ENABLING A NEW ERA OF CHANGES 165 (Pamela C.M. Mar & Frank-Jurgen Richter eds., 2003).

⁵ See John H. Jackson & Alan O. Sykes, *Introduction and Overview*, in IMPLEMENTING THE URUGUAY ROUND 1, 4 (John H. Jackson & Alan O. Sykes eds.) (1997). The GATS, which came into effect with the ratification of the WTO Agreement, addresses trade in three types of services: (1) services supplied in one WTO Member state for consumers in another, (2) services provided by a service-providing entity of one member in the territory of another member, and (3) services provided by nationals of one member in the territory of another member. *Id.* at 15.

⁶ See World Trade Organization, Protocol on the Accession of the People's Republic of China, WT/L/432 (Nov. 10, 2001), available at http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm.

⁷ CHINA SEC. AND REGULATORY COMM'N, *China's Securities and Futures Markets*, April 4, 2004, available at <http://www.csfc.gov.cn/cms/uploadFiles/introduction2004edition.1087888443500.doc> [hereinafter *China's Markets*]. QFII licenses were granted to twelve overseas financial institutions with a total investment quota of \$1.7 billion, and eleven banks (four are overseas banks) were licensed as the QFII's custodians. *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.* at 3.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 4.

¹⁴ A shares are shares denominated in renminbi yuan. *Id.* at 3.

¹⁵ B shares are domestically listed shares quoted in U.S. dollars or H.K. dollars. *Id.*

¹⁶ *Id.*

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Capital Market on February 1, 2004. Despite these reforms, the development of China's securities market and exchanges is still at an early and crucial stage. The major goals for the development of China's securities market in light of its WTO commitments are efficiency, transparency, and liquidity.¹⁷ Efficiency is defined as allowing markets in healthy competition to freely allocate resources through pricing.¹⁸ Where market competition has not been fully developed, as in China, government regulation usually addresses market failures and transaction costs.¹⁹ For example, government intervention in the form of financial and operational assistance for troubled state-owned companies could save them from failure, thus avoiding devastating social and economic consequences. If regulatory intervention is less costly than the failure, then some efficiency may be achieved.²⁰ Ultimately, efficiency will largely be defined by effectiveness of market competition.

In the Chinese context, however, the CSRC continues to play an active and interventionist role in regulation. The CSRC essentially delivers direct government control over securities markets and exchanges.²¹ The CSRC clearly demonstrated that government intervention, and not free competition, still determines the trajectory of reform in these markets. As a result, securities exchanges still have little independence in enhancing the efficiency, transparency, and liquidity of the securities markets, although this will likely change in the future.

Greater transparency could be achieved in China's markets by mandatory and continuous disclosure of information, something that is still a "work in progress" today.²² Liquidity depends on the efficient operation of securities exchanges and transferability of shares of listed companies. The Chinese government has adopted a cautious approach in reforming these aspects of the market, largely because the State fears losing its controlling shareholder status in most listed

¹⁷ *Id.* at 5.

¹⁸ See Joel P. Trachtman, *The Applicability of Law and Economics to Law and Development: The Case of Financial Law*, in EMERGING FINANCIAL MARKETS AND THE ROLE OF INTERNATIONAL FINANCIAL ORGANIZATIONS 29, 45 (Joseph J. Norton & Mads Adenas eds., 1996).

¹⁹ *Id.*

²⁰ *Id.* at 46.

²¹ *China's Markets*, *supra* note 7, at 3.

²² The previous and amended Securities Laws set down continuous disclosure requirements for listed companies, but in practice, misleading and/or deceptive information disclosure by listed companies has always been a great concern for investors and securities watchdogs. The CSRC has issued a series of implementation rules and measures to enhance the compliance level of listed companies' information disclosure. It also used its enforcement and investigative power to crack down and punish companies engaged in malpractice. For example, one of the biggest fraudulent disclosure cases in corporate China—Yinguangxia case—was exposed in 2001. Yinguangxia company inflated its 2000 export income to Germany in its annual report as high as DM 180 million whereas the actual figure was less than \$30,000. Serious and widespread practice of false disclosures or major omissions in listed companies' disclosure documents prompted the CSRC to conduct a vigorous campaign in 2001, naming that year as the year of the Regulation Storm. Statistics indicated that about fifty listed companies received an inspection, warning, criticism and fine from the CSRC, SETC, and other regulatory bodies. See *gong si zhi li zhong chuang wei gui gong si, gu shi jian guan jin ru shou gong jie duan* [Corporate Governance Measures on Noncompliance Issues of Companies as the Discipline of Securities Market Enters the Final Stage], CAN JIN SHI BAO [FINANCIAL TIMES], October 25, 2002. See also BUS. & FIN. REV., Aug. 2001, Beijing.

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companies if state shares are freely traded.²³ While the CSRC will remain a key actor in administering securities law and supervising the securities market, the development of a healthy market requires the support of other actors such as exchanges, securities firms, and investors. The development of securities markets and financial intermediaries are correlated;²⁴ no single mechanism or technique is effective in all circumstances. The entire structure must operate in unison.

Hence, securities exchanges can only play a more important role in efficiency, transparency, and liquidity enhancement if tight government control over the securities market continues to loosen. Government intervention in markets and business operation has deep roots.²⁵ Therefore, a brief historical account is necessary to explain how securities regulation in China has developed into its current form and how the changes in economic environments have contributed to the development of the securities market and its regulation.

III. Development of Securities Market and Exchanges

The first stock exchange in Chinese history, the Shanghai Stock Exchange (*Shanghai Gupiao Jiaoyisuo*), was the largest in Asia before 1941.²⁶ It was established in 1905 following the formation of the Shanghai Stock & Stockbrokers' Association²⁷ in 1898. This exchange boomed in cotton and rubber share trading but also experienced highly speculative share trading, with sharp rises and falls, as a result of political and social unrest from the 1911 Revolution until 1929.²⁸ Political uncertainty and military activities in and around the International Settle-

²³ See Ben Dolven, *Capital Drought*, July 11, 2002 FAR E. ECON. REV. 30, July 11, 2002, at 30. There is much rhetoric about reducing state ownership and there have been attempts to sell state shares, not only to balance the ownership structure of listed companies, but also to fund the social security system. *Id.* Political concern for social stability and an engrained risk-averse approach have, however, halted the state's share reduction strategy. *See id.* The suspension of state share sales and the CSRC's tight control on new listings indicates that the state's influence over the stock market is still strong and it wants the market to function so as to allocate capital in ways that it prefers and controls. *See id.*

²⁴ See Asli Demirgüç-Kunt & Ross Levine, *Stock Market Development and Financial Intermediaries: Stylized Facts*, 10 WORLD BANK ECON. REV. 291, 293 (1996).

²⁵ See generally Chenxia Shi, *Commercial Development and Regulation in Late Imperial China: An Historical Review*, 35 H.K.L.J. 481 (2005).

²⁶ See WILLIAM A. THOMAS, *WESTERN CAPITALISM IN CHINA: A HISTORY OF THE SHANGHAI STOCK EXCHANGE*, (2001).

²⁷ See generally William C. Kirby, *China Unincorporated: Company Law and Business Enterprise in Twentieth Century China*, 54 THE J. OF ASIAN STUDIES 43 (1995); THOMAS, *supra* note 26; CONARD SCHIROKAUER, *A BRIEF HISTORY OF CHINESE CIVILIZATION* (Harcourt Brace Gap College 1991). The demand for company securities started well before the Qing government officially introduced the company system to China through the promulgation of the First Chinese Company Regulation in 1904. Chinese merchants subscribed to the shares of foreign insurance companies and banks as early as the 1830s. After the treaty of Nanjing, Chinese investment in foreign companies increased because of the greater gain of share trading and the limited liability protection of their investment which was not available to indigenous Chinese enterprises until 1904. The increased volume of transactions created a need for standardization of practices and regulation of price, which justify the establishment of a formal body. The Stock & Stockbrokers' Association had forty-seven members at the time of its establishment.

²⁸ See THOMAS, *supra* note 26, at 145-72, 187-208 (discussing a politically and militarily eventful period which disturbed the share market and exchange). The 1911 Revolution brought down the Qing dynasty, soon after the country was torn apart by war between powerful warlords. *See* SCHIROKAUER,

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ment in Shanghai in the 1930s shook the "security and economic integrity of China's premier port and financial center," and resulted in a long period of share market depression.²⁹ Although this was momentarily relieved by the surge in price of rubber and other commodities, 1941 saw the closure of the share market and the stock exchange.³⁰ After the Sino-Japanese War, the Shanghai Securities Exchange (*Shanghai zhenquan jiaoyisuo*) was opened in 1946, but its membership was limited to Chinese citizens.³¹ It was closed when the Communist Party defeated the Nationalist Government in 1949.³²

When the People's Republic of China was founded, the government nationalized all types of private ownership and abolished capitalist economic systems such as securities markets and exchanges in order to pursue a socialist economy characterized by public ownership.³³ Socialist economic development, aimed at achieving "common wealth," was interrupted in the 1950s and early 1960s by the political campaigns of "the Three Antis" (*San fan*),³⁴ "the Five Antis" (*Wu fan*),³⁵ and "the Great Leap Forward" (*Da yue jing*)³⁶ and was totally halted between 1966 and 1976 by the Cultural Revolution.³⁷

It was only in the 1980s that the development of the securities market became an important goal for the Chinese government, as a result of its economic reform and liberalization program.³⁸ Unlike stock exchanges in Western countries, which emerged from a long history of development of securities markets,³⁹ current Chinese securities exchanges emerged after only ten years of economic reform aimed at restructuring and developing the national economy in the wake of

supra note 27, at 306-27. This was followed by the May Fourth Movement in 1919 and the northern expedition (*Bei fa*) in 1926. *Id.* at 314-15, 24.

²⁹ See THOMAS, *supra* note 26, at 211.

³⁰ *Id.*

³¹ *Id.* at 233. After the Nationalist Government took full control of Shanghai, in the spirit of finally getting rid of the occupation of foreign powers, it indicated that the foreign interests would be subservient to Chinese needs and subject to the regulation of 1946 Company Law. *Id.* The old Shanghai Stock Exchange would not be re-opened. *Id.*

³² *Id.*

³³ See Kirby, *supra* note 27, at 56.

³⁴ See Jan-Erik Nilsson, *The People's Republic of China, 1949—Today*, <http://www.gotheborg.com> (follow "Chinese History" hyperlink under "Home", then follow "PROC 1949" hyperlink). The "Three Antis" (*San fan*) campaign "was directed against the evils of corruption, waste and bureaucratism, its aim was to eliminate incompetent and politically unreliable public officials and to bring about an efficient, disciplined, and responsive bureaucratic system." *Id.*

³⁵ See *id.* The "Five Antis" (*Wu fan*) campaign aimed at "eliminating recalcitrant and corrupt businessmen and industrialists, who were in effect the targets of the Party's condemnation of tax evasion, bribery, cheating in government contracts, thefts of economic intelligence, and stealing of state assets." *Id.*

³⁶ See generally SCHIROKAUER, *supra* note 27, at 360-62.

³⁷ See generally *id.* at 365-69.

³⁸ See THOMAS, *supra* note 26, at 275.

³⁹ See generally RANALD C. MICHIE, *THE LONDON STOCK EXCHANGE: A HISTORY* 15-36 (1999). The London Stock Exchange was established in 1801 after over 100 years of a gradual development of securities markets. *Id.* at 35-36. See generally Stuart Banner, *The Origin of the New York Stock Exchange, 1791-1860*, 27 J. LEGAL STUD. 113 (1998). The New York Stock Exchange also emerged after a long history of share trading in practice. *Id.* at 114.

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the ill-conceived economic policy failures and political disruptions of the previous decades.⁴⁰

China's modern experience with securities started with the national treasure bond issued by the State Council in 1981.⁴¹ The People's Bank authorized the opening of the first over-the-counter market in Shengyang in 1986.⁴² The Shanghai Securities Exchange was set up in December of 1990, and the Shenzhen Securities Exchange was established in July of 1991.⁴³ A fair and competitive market needs a well-structured and functional regulatory framework which provides adequate protection for investors and maintains their confidence in the markets. These institutional developments were an integral part of building up a securities market.

IV. Regulatory Framework for Securities Market and Exchanges

Generally, the purpose of regulating securities markets is to safeguard the designed functions of the markets, including: (1) providing a mechanism for companies to offer securities to raise capital and providing a means for investors to buy and trade shares; (2) establishing a share pricing system that assists in monitoring companies and allocating resources; (3) diversifying investment risks; and (4) correcting managerial failure through the creation of markets for corporate control.⁴⁴ The regulatory framework of securities, however, varies from country to country because of the different historical, social, and economical environments within which each developed.

Legal development has lagged behind economic development in China. The shaping of the regulatory framework for the Chinese securities market has been a gradual process as it takes time and experimentation for legal development to catch up with economic development. The State Council issued a number of decrees and regulations regarding the Shanghai and Shenzhen Securities Exchanges in the early 1990s.⁴⁵ In 1999, the Securities Law was promulgated to deal more broadly with issues concerning the securities market.⁴⁶

China has many current laws and regulations which govern different areas of securities operation, promulgated by different regulatory agencies, and encompassing different goals and policies. Currently in place, these laws and regulations include listing rules of both the Shanghai and Shenzhen Securities Exchanges, the Securities Law of People's Republic of China ("Securities

⁴⁰ LI CHANGJIANG, *THE HISTORY AND DEVELOPMENT OF SECURITIES MARKETS IN CHINA* 61 (1998).

⁴¹ *Id.*

⁴² *Id.*

⁴³ THOMAS, *supra* note 26, at 280-81.

⁴⁴ See Colin Mayer, *Stock-Markets, Financial Institutions, and Corporate Performance*, in *CAPITAL MARKETS AND CORPORATE GOVERNANCE* 179, 179 (Nicholas Dimsdale & Martha Prevezer eds., 1994).

⁴⁵ See Jinhua, *supra* note 4, at 71.

⁴⁶ The Securities Law of the People's Republic of China (adopted by the Sixth Session of the Ninth Nat'l People's Cong., Dec. 29, 1998) (P.R.C.) [hereinafter 1998 Securities Law].

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Law”)⁴⁷ (promulgated by the National People's Congress on December 29, 1998, amended slightly in 2004, and again amended significantly in 2005), Company Law of People's Republic of China⁴⁸ (“Company Law”) (promulgated by the National People's Congress on December 29, 1993, amended slightly in 1999, and amended significantly in 2005), Guidance on Implementation of the “Provisional Measures on the Sponsor System for Issuing and Listing of Securities” (issued by the CSRC on December 31, 2004), Administrative Regulation on Securities Exchanges (issued by the SCSC on November 30, 1997), and the Circular on Further Strengthening Macro-Management of the Securities Markets (issued by the State Council on December 17, 1992) just to name a few.

Under the current regulatory framework, all issuer-related matters and trading matters are largely regulated by the relevant government agencies.⁴⁹ As the major rule-maker for listed companies, the CSRC enforces the rules concerning listing standards and the suspension and termination of a listing.⁵⁰ The securities exchanges thus have very little control over an individual company's listing or termination of listing.⁵¹ This is a major difference from the regulatory role of, for example, the U.S. Securities and Exchange Commission (“SEC”), which has authority over exchanges in the limited area of non-issuer-related matters, such as trading rules.⁵² China's system is also vastly different from the British securities regulatory practice where the self-regulation of the London Stock Exchange plays a very significant role in securities regulation.⁵³ The powerful position of the CSRC in regulating China's securities markets effectively limits the role and functions of the Chinese securities exchanges.

⁴⁷ Securities Law of the People's Republic of China, Order [2005] No. 43 (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (P.R.C.), *available at* <http://www.fdi.gov.cn/resupload/epdf/e04453.pdf> [hereinafter 2005 Securities Law]. The securities law mainly regulates the establishment and operation of stock exchanges and stock intermediaries, issuing and trading of securities, and securities registration and clearing institutions. *See id.* The securities law does not apply to overseas share listing of Chinese companies, such as the listing of B shares, H shares, L shares, and N shares. It also does not apply to government bonds. These two areas are regulated by the specific regulations of the CSRC and the State Council.

⁴⁸ Company Law of the People's Republic of China, Order [2005], No. 42 (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (P.R.C.), *available at* <http://www.fdi.gov.cn/resupload/epdf/e04457.pdf> [hereinafter Company Law]. While the Securities Law applies to the issuing and trading of shares, bonds, and other forms of securities as recognized by the State Council, relevant provisions of the Company Law and other laws and regulations act as default rules for the issuing and trading of shares, bonds and other securities that are not covered by the Securities Law.

⁴⁹ 2005 Securities Law, *supra* note 47; *See also* Company Law, *supra* note 48.

⁵⁰ China Sec. and Regulatory Comm'n, About Us: Welcome to the CSRC Website, http://www.csrc.gov.cn/en/homepage/about_en.jsp (last visited Mar. 29, 2006).

⁵¹ According to Shenzhen Securities Exchange listing rules, a company may apply for listing its shares on the securities exchange after the issue is verified by the CSRC and upon the examination and approval by the exchange. This means the CSRC actually holds the key to the listing door of the securities exchange. *See* Rules Governing Listing of Stocks on Shenzhen Stock Exchange, <http://www.szse.cn/UpFiles/Attach/1396/2005/03/17/0850271250.doc> [hereinafter Shenzhen Listing Rules].

⁵² *See generally* U.S. Sec. and Exch. Comm'n, About the SEC, <http://www.sec.gov/about.shtml> (last visited Aug. 11, 2006).

⁵³ MICHIE, *supra* note 39, at 568.

V. Role and Functions of Chinese Securities Exchanges

The Securities Law is the key instrument regulating the operation of exchanges. It contains articles dealing with securities exchanges and defines a "securities exchange" as "a legal person that provides venue and facilities for securities trading, organizes and supervises trading of securities and practices self-regulation."⁵⁴ The amended Securities Law, however, still does not give an exact definition of what constitutes securities.⁵⁵

Prior to the promulgation of the 1998 Securities Law, the State Council Securities System ("SCSC") issued the *Measures on the Administration of Securities* ("Measures") to regulate securities and exchanges, and the Securities Law largely endorsed the Measures. According to the Measures, the objective of Chinese securities exchanges is to maintain a fair and orderly market.⁵⁶ Both stock exchanges may formulate business rules and supervise their members and listed companies.⁵⁷ The securities exchanges shall formulate listing rules in accordance with relevant laws and administrative regulations.⁵⁸ So, for example, the exchanges set the prerequisites for the listing of securities and the procedures for listing application and approval.⁵⁹ They also set specific rules regarding registration, internal supervision, the reporting obligations of listed companies, and a code of conduct for listed companies, as well as a penalty system for breaches.⁶⁰ In addition, the securities exchanges regulate the trading activities of listed companies and inspect listing companies' financial performance and internal risk control.⁶¹ Securities exchanges are required by the law to announce their decisions on suspension or termination of listed companies in a timely manner and lodge decisions with the securities regulatory authorities.⁶²

⁵⁴ See 2005 Securities Law, *supra* note 47, art. 102. This is different from the definition of 1998 Securities Law where a stock exchange was simply defined as a nonprofit organization with legal personality that provides a venue for the trading of securities.

⁵⁵ *Id.* art. 2. According to Article 2 of the 2005 Securities Law, the law applies to the issuance and transaction of stocks and corporate bonds, as well as any other securities lawfully recognized by the State Council within the territory of the People's Republic of China. Where there is no such provision in the law, the provisions of the Company Law and other relevant laws and administrative regulations shall apply. Any listed trading of government bonds and shares of securities or investment funds shall be governed by the law. In case there is any special provision in any other law or administrative regulation, the special provision shall prevail. The measures for the administration of issuance and transaction of securities derivatives shall be issued by the State Council in accordance with the principles of the law. 2005 Securities Law, *supra* note 47 art. 2. Applicability of the new Securities Law to any new categories of securities is still subject to separate identification by the State Council. *Id.*

⁵⁶ See Measures for the Administration of Stock Exchanges (promulgated by the Securities Comm. under the State Council, Dec. 10, 1997) (P.R.C.), art. 10. The statutory objectives and major functions of Chinese stock exchanges are not very different from those of other countries. The differences lie in the extent and degree of self-regulation of the exchanges.

⁵⁷ *Id.* art. 11.

⁵⁸ *Id.* art. 51.

⁵⁹ *Id.*

⁶⁰ *Id.* art. 40.

⁶¹ *Id.* arts. 45, 46, 47, 48.

⁶² See 2005 Securities Law, *supra* note 47, art. 72.

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In reality, the monitoring functions of securities exchanges and those of CSRC are not clearly divided. In most cases the CSRC has the final say in regulating markets and listed companies. Although securities exchanges set listing requirements, a company must obtain CSRC approval to be listed in the exchanges.⁶³ Securities exchanges are charged with the responsibility of supervising information disclosure by listed companies,⁶⁴ but lack the real power to investigate and punish wrongdoings. Therefore, they are unable to fulfill a disciplinary role in sanctioning companies engaged in malpractice with regard to information disclosure. The CSRC, in fact, has considerable power to enact rules regarding information disclosure and to investigate misconduct. It supervises listed companies' annual reports, half-year reports, and interim reports, as well as companies' announcements in relation to distribution or allocation of new shares and controlling shareholders.⁶⁵ The paramount influence of the CSRC's interventionist role in securities regulation has overshadowed the securities exchanges' capacity to practice self-regulation, as mandated by law.

VI. Development of a National Securities Regulatory Authority

The Shanghai and Shenzhen Securities Exchanges were regulated initially by both the local governments and local provincial branches of the People's Bank of China ("PBOC").⁶⁶ Later, the regulatory role of the PBOC was largely taken over by the State Council Securities Commission (the predecessor of the CSRC). The State Council then restructured the Securities Commission into the CSRC in 1998, in a bid to provide a single and uniform regulatory body for securities markets.⁶⁷

The Securities Law states that the CSRC is the sole regulatory body and reports directly to the State Council.⁶⁸ The CSRC has been empowered to implement centralized and unified regulation of the securities market nationwide in accordance with the law, effectively limiting the PBOC's powers over securities.⁶⁹ For example, previously the PBOC had the power to issue a business

⁶³ See Shenzhen Listing Rules, *supra* note 51.

⁶⁴ See 2005 Securities Law, *supra* note 47 art. 115.

⁶⁵ *Id.* art. 70.

⁶⁶ See THOMAS, *supra* note 26, at 287.

⁶⁷ CARL E. WALTER & FRASER JT HOWIE, *PRIVATIZING CHINA: THE STOCK MARKET AND THEIR ROLE IN CORPORATE REFORM*, 9 (2003).

⁶⁸ 2005 Securities Law, *supra* note 47, art. 7.

⁶⁹ CSRC's regulatory functions include:

(1) formulating the relevant rules and regulations on the supervision and administration of the securities market and exercising the power of examination or verification according to law; (2) carrying out the supervision and administration of the issuance, listing, trading, registration, custody and settlement of securities according to law; (3) carrying out the supervision and administration of the securities activities of a securities issuer, listed company, stock exchange, securities company, securities registration and clearing institution, securities investment fund management company or securities trading service institution according to law; (4) formulating the standards for securities practice qualification and code of conduct and carrying out supervision and implementation according to law; (5) carrying out the supervision and examination of information disclosure regarding the issuance, listing, and trading of securities; (6) offering guidance for and carrying out supervision of the activities of the securities industrial association according to law;

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license to securities firms, but this power now lies with the CSRC.⁷⁰ Regulatory bodies, however, tend to retain vested interests through protecting and consolidating their interests in the face of economic liberalization,⁷¹ this has been true for the PBOC as well. The PBOC has long been resistant to internal pressure to let the CSRC supervise the securities market; it therefore took a number of years before the CSRC could gain control.⁷² Under the supervision of the State Council, however, the CSRC has vigorously enforced its role in regulating the securities market, particularly through its tight control over the exchanges and listed companies. For example, the CSRC retains the power to de-list poorly performing companies, and directly regulates the general meetings and information disclosure of listed companies.⁷³ The Securities Law reinforced the CSRC's position by requiring securities exchanges to report to the CSRC any abnormal trading in a timely manner, or to seek approval for formulating rules concerning listing, trading, and membership administration.⁷⁴

By comparison, the regulatory bodies of the securities markets in the United States, the United Kingdom, and Australia play a less (sometimes non-) interventionist role in the regulation of stock exchanges and listed companies. Although the United States has a strict securities regulation regime, the SEC, as a central regulatory authority with broad supervisory and investigative power, has a limited role in regulating the listing of companies and the internal operation of stock exchanges.⁷⁵ The SEC's authority largely relates to trading rules, and it does not directly interfere with issuer-related matters.⁷⁶ By contrast, the listing rules and trading rules of Chinese securities exchanges must be approved by the CSRC.⁷⁷ Moreover, while the SEC is duty-bound to ensure "a fair competition among exchange market and markets other than exchange markets,"⁷⁸ the CSRC has never played such a role. The listing of a company is allocated by the CSRC to

(7) investigating into and punishing any violation of any law or administrative regulation on the supervision and administration of the securities market according to law; and (8) performing any other functions and duties as prescribed by any law or administrative regulation.

2005 Securities Law, *supra* note 47, art. 179.

⁷⁰ *Id.* art. 122. Article 122 states: "The establishment of a securities company shall be subject to examination and approval by the securities regulatory authority under the State Council. No one may engage in securities business without approval of the said authority."

⁷¹ BERNARD M. HOEKMAN & MICHAEL M. KOSTECKI, *THE POLITICAL ECONOMY OF THE WORLD TRADING SYSTEM: THE WTO AND BEYOND*, 140 (Oxford Univ. Press, 2nd ed. 2001) (1995).

⁷² ZHU SANZHU, *SECURITIES REGULATION IN CHINA 188-192* (2000).

⁷³ *Id.* at 51. *See also* PEOPLE DAILY, *Poor Performers Face Delisting*, http://english.people.com.cn/english/200103/22/eng20010322_65672.html (Mar. 22, 2001). *See also* CHINA SEC. REGULATORY COMM'N, *Suggestions on Regulating the General Meetings of Listed Companies*, art. 3 (2000) (on file with author).

⁷⁴ *See* 2005 Securities Law, *supra* note 47, arts. 115, 118.

⁷⁵ U.S. Sec. and Exch. Comm'n, *How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, <http://www.sec.gov/about/whatwedo.shtml> (last visited Aug. 11, 2006).

⁷⁶ *Id.*

⁷⁷ *See* 2005 Securities Law, *supra* note 47, art. 118.

⁷⁸ Securities Exchange Act of 1934 §11A(a)(1)(c) (1934), <http://www.sec.gov/divisions/corpfin/34act/sect11a.htm> (last visited Sept. 7, 2006) [hereinafter Exchange Act].

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either the Shanghai or the Shenzhen Securities Exchange.⁷⁹ Thus, there is no incentive for the exchanges to create a more attractive regulatory environment for investors through self-regulation.

Self-regulation has certainly proved to be an effective regulatory mechanism following the deregulation of securities markets and demutualization of stock exchanges in some Western countries. For example, both the New York Stock Exchange ("NYSE") and the American Stock Exchange ("AMEX") are self-regulatory organizations.⁸⁰ The London Stock Exchange was also given substantial regulatory power and has developed a set of well-received rules governing self-regulation.⁸¹ Under the supervision of the Australian Securities & Investments Commission, the Australian Stock Exchange ("ASX") also has discretion in formulating its listing rules and other business rules.⁸² The scope for self-regulation of the Shanghai and Shenzhen Stock Exchanges is, however, limited by the dominant regulatory role of the CSRC. Although the listing rules of both exchanges set minimum standards for listed companies, they are too general and ambiguous to be effectively enforced, a characteristic of Chinese legislation and rules in the current era of reform and development.⁸³ Further, competition between the two exchanges may have lowered their listing standards to secure the listing of companies, thereby weakening their regulatory functions.⁸⁴

VII. Current Regulatory Issues and Developments

While China's system of control over the securities markets quickly and forcefully promoted the development of the securities market and the Shanghai and Shenzhen Securities Exchanges, excessive government interference has been problematic, limiting the self-regulation role of the market and securities exchanges to a minimum. Moreover, regulating China's securities market is still more or less in a trial and error phase after a decade of development. Gaps in legislation and enforcement difficulties, unclear demarcation of roles between the CSRC and the stock exchanges, and overlapping functions of the regulatory bodies of listed companies, among other things, have contributed to certain regulatory issues.

⁷⁹ See *China's Markets*, *supra* note 7.

⁸⁰ See Exchange Act, *supra* note 78.

⁸¹ See London Stock Exch., Rules of the London Stock Exchange, <http://www.londonstockexchange.com/en-gb/global/H/Search?query=rules> (last visited Sept. 7, 2006).

⁸² See Austl. Stock Exch., How ASX Supervises the Market, http://www.asx.com.au/supervision/ppoach/how_asx_supervises.htm (last visited Sept. 7, 2006).

⁸³ For example, the Securities Law does not provide civil remedies to victims of insider trading. See 2005 Securities Law, *supra* note 47, art. 183.

⁸⁴ STEPHEN GREEN, CHINA'S SUPERMARKET: A GUIDE TO ITS PROGRESS, PLAYERS AND PROSPECTS, 24-30 (2003). Changes were made to remedy this problem by further defining the roles of the two exchanges. For example, the Shanghai Securities Exchange took over the main board of the Shenzhen Exchange, while the Shenzhen Securities Exchange set up a Growth Enterprise Market intended to bridge the gap for "high risk/high return" enterprises which had great aspirations but could not fulfill the profitability/track record requirements of the main board.

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A. Operating Issues for Securities Exchanges

Chinese securities exchanges operate in accordance with the Securities Law and the other relevant regulations, under the supervision of the CSRC.⁸⁵ They must, for example, adopt articles of association approved by the CSRC,⁸⁶ and the CSRC appoints their Chief Executive Officers (“CEO”).⁸⁷ Securities exchanges are required to issue trading rules and administrative regulations and to have them approved by the CSRC.⁸⁸ Securities exchanges are also empowered to suspend, terminate, and to allow the resumption of trading in shares and company bonds, subject to procedures laid down by the CSRC.⁸⁹ Before an application can be made to the securities exchange for the listing of shares, an application must first be submitted to the CSRC.⁹⁰ Further, securities exchanges must report abnormal trading to the CSRC.⁹¹ The CSRC thus plays a significant role in the operation of securities exchanges as it not only appoints the CEOs of the two exchanges and regulates how exchanges should operate, but also interferes in the issuance and trade of securities with its power of approval.

The CSRC has, moreover, exercised continuous control over the exchanges through a reporting system. Rules governing the reporting system of the exchanges require that various matters be reported to the CSRC.⁹² There are three main forms of reporting.⁹³ The first covers the requirement that securities exchanges must report to the CSRC for approval matters concerning personnel, financial accounts, fees, new listings, and other required matters.⁹⁴ The second form of reporting covers requirements that exchanges must report to the CSRC for record keeping purposes. These matters include the appointment and dismissal of personnel that do not require approval, documents that do not need to be approved by the CSRC, the change of major facilities for trading, settlement or communication, and the performance assessment of department managers and over-budget expenditures.⁹⁵ The third form of reporting requires that exchanges

⁸⁵ See generally 2005 Securities Law, *supra* note 47.

⁸⁶ *Id.* art. 103.

⁸⁷ *Id.* art. 107.

⁸⁸ *Id.* art. 118.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.* art. 115.

⁹² See CHINA SEC. AND REGULATORY COMM'N, Zhongguo Zhengquan Jiandu Guanli Weiyuanhui guanyu fabu “Guanyu Zhongguo Jiaohu Baogao Zhidu de Ruogan Guiding” de Tongzhi [CSRC Circular Concerning the Rules on the Reporting System of the Stock Exchanges], (Nov. 19, 1997) (P.R.C.) (on file with author) [hereinafter CSRC Circular on Reporting].

⁹³ See *China's Markets*, *supra* note 7.

⁹⁴ See CSRC Circular on Reporting, *supra* note 92. The stock exchanges must receive CSRC approval for the appointment and dismissal of assistant managers, chief inspectors and deputy inspectors, the manager of the human resources department or finance department, the managers of the securities registration, and settlement bodies of stock exchanges. They must also get CSRC approval for the budget and final accounts of the exchanges and those of the securities registration and settlement bodies before presenting to the members' meeting for consideration. All kinds of fees charged by the stock exchanges and new listing of securities must also be reported to CSRC for approval. *Id.*

⁹⁵ *Id.*

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must provide information regarding all decisions and operations of the exchanges, except those that have already been reported for approval or record keeping purposes.⁹⁶ The CSRC may also require that the exchanges report any matter it deems necessary, and it retains a broad power to intervene in the operation of the exchanges.⁹⁷

This direct control by the CSRC over the two securities exchanges tightly limits their capacity for self-regulation and thus has constrained their independent operation. A cautious and gradual liberalization has begun but is still a work in progress. Since 2002, for example, the CSRC has taken steps to grant more autonomy to the exchanges, abolishing some administrative rules and approval systems.⁹⁸ Today it is still the case, however, that the two exchanges are best seen as simply part of the CSRC bureaucracy.

B. Limited Role of Securities Exchanges in Regulating Listed Companies and Constraints on Self-Regulation

Unlike Western stock exchanges, which administer the listing of a company according to listing standards, the Chinese securities exchanges have limited power in administering the listing of companies. Instead, listing is again strictly controlled by the CSRC.⁹⁹ The procedural regulatory role of the securities exchanges in relation to listed companies starts with a listing agreement, which sets out the rights and obligations of both parties.¹⁰⁰

After the listing, the securities exchanges then regulate listed companies through the mandatory information disclosure in a timely manner.¹⁰¹ Globalization has increased the value of reliable information in capital markets and the enhanced disclosure of information therefore will have a positive impact on the efficient functioning of capital markets.¹⁰² This is reflected in the listing rules of Shenzhen and Shanghai Securities Exchanges. These rules provide that the issuer shall ensure that all documents sent to the securities exchange contain no false information, misleading statements, or material omissions, and that the issuer shall not disclose relevant information during the application period without

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ CHINA SEC. AND REGULATORY COMM'N, Zhongguo Zhenquan jian du guan li wei yuan hui gu anyu qu xiao di yi pi xing zhen sheng pi xiang mu de tong zhi [Circular on the First Bundle of Abolishment of Administrative Approval] (promulgated by the CSRC, Dec. 21, 2002) ISINOLAW (on file with author) (P.R.C.); *See also* CHINA SEC. AND REGULATORY COMM'N, Zhongguo Zhenquan jian du guan li wei yuan hui gu anyu qu xiao di er pi xing zhen sheng pi xiang mu de tong zhi [Circular on the Second Bundle of Abolishment of Administrative Approval] (promulgated by the CSRC, Apr. 1, 2003) ISINOLAW (on file with author) (P.R.C.).

⁹⁹ *See* 2005 Securities Law, *supra* note 47.

¹⁰⁰ *See generally* Shanghai Stock Exchange Listing Agreement, http://www.sse.com.cn/en_us/ps/le/lst_agmt.shtml (last visited March 30, 2006) [hereinafter Shanghai Listing Rules].

¹⁰¹ *See* 2005 Securities Law, *supra* note 47, arts. 61, 62 & 64.

¹⁰² *See* Paul M. Healy & Krishna G. Palepu, *Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature*, 31 J. ACCT. & ECON. 405 (2001).

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the exchange's prior approval.¹⁰³ A listed company is also required to disclose any information that may have a material effect on the share price of the listed company in a timely manner, and to ensure that disclosed information is true, accurate, complete and contains no false, misleading statements, or material omissions.¹⁰⁴ Most significantly, the Securities Law introduced continuous disclosure requirements.¹⁰⁵

The securities exchanges' responsibility for monitoring the information disclosure does, however, overlap with and supplement that of the CSRC.¹⁰⁶ In fact, information disclosure by listed companies is one of the CSRC's major regulatory domains.¹⁰⁷ For example, in recent years the CSRC has formulated numerous rules governing information disclosure by listed companies, largely as a response to widespread misconduct involving information disclosure.¹⁰⁸ A large number of companies were publicly de-listed, suspended, or otherwise punished for engaging in false or fraudulent disclosure practices.¹⁰⁹

Because of their operating system and the constraints on their regulatory powers, the supervisory role of the securities exchanges over their members through registration and management of membership is also restricted. Members are required to implement the rules set down by the CSRC and to have a council,¹¹⁰ which has limited powers and functions. For example, the council has no power to appoint the general manager for the exchanges; only the CSRC has the power to make such appointments.¹¹¹ The Law also gives a limited role to industry associations to practice self-regulation.¹¹²

The self-regulatory nature of exchanges has thus been largely and deliberately constrained in China by the policy and administrative demands of the government. Despite waves of demutualization of stock exchanges in recent times in countries such as the United Kingdom, the United States, Canada, and Australia,

¹⁰³ See generally Shanghai Listing Rules, *supra* note 100; see also Shenzhen Listing Rules, *supra* note 51.

¹⁰⁴ *Id.*

¹⁰⁵ See generally 2005 Securities Law, *supra* note 47.

¹⁰⁶ *Id.*

¹⁰⁷ China Sec. and Regulatory Comm'n, Brief Introduction to the Department of Listed Company Supervision, http://www.csrc.gov.cn/en/depjps/depsecond_en.jsp?path=ROOT>EN>Departments>Dept.%20of%20Listed%20Company%20Supervision>Introduction&level=5 (last visited March 30, 2006).

¹⁰⁸ There have been a series of cases of fraudulent or misleading information disclosure of listed companies since the 1990s. The biggest fraudulent disclosure case was the Yinguangxia case in 2001. The CSRC conducted a campaign in 2001 to curb widespread corporate fraud and misconduct. The CSRC then issued new reporting rules for listed companies in December 2003. See China Securities and Regulatory Commission, Reporting Rules No. 19 on Information Disclosure of Companies that Offer Securities to the Public—Amendment of Accounting Information and Disclosure, <http://gbcode.tdctrade.com/gb/my.tdctrade.com/airlaws/index.asp?id=22754> (last visited Sept. 7, 2006) (P.R.C.).

¹⁰⁹ See W. Hong, *Securities Regulation: Theory and Practice*, SHANGHAI FINANCE AND ECONOMIC PRESS (2000) 251-52.

¹¹⁰ 2005 Securities Law, *supra* note 47, art. 106.

¹¹¹ *Id.* art. 107.

¹¹² *Id.* art. 8. "Under the centralized and unified supervision and administration of the state regarding the issuance and transaction of securities, a securities industrial association shall be established according to law, which shall adopt the self-regulating administration." *Id.*

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Chinese securities exchanges retain their mutual business form.¹¹³ Yet, they are rigorously administered by the relevant government agencies such as CSRC with, in reality, little role played by the members' council.¹¹⁴

C. Issues Concerning Dispute Resolution

Most stock exchanges around the world have dispute resolution mechanisms in place.¹¹⁵ Arbitration and mediation are two of the practical methods of resolving disputes between members that serve as alternatives to time-consuming and expensive litigation. The NYSE, for example, has typically used arbitration and mediation to resolve disputes among members, reflecting the self-regulatory nature of most stock exchanges.¹¹⁶

It is perhaps ironic that China, a country with a rich history of using mediation in resolving disputes, has not officially adopted alternative dispute resolution mechanisms for securities exchanges. Alternative dispute resolution is mentioned only in passing in the Exchanges' Share Listing Agreement for listed companies.¹¹⁷ It merely provides that if any disputes between the exchange and the listed companies cannot be resolved between the parties, it will be submitted to an arbitration agency designated by the CSRC.¹¹⁸ There is no alternative dispute resolution mechanism for disputes between members of the securities exchanges or for disputes between members and their clients. The new law only provides that one of the functions of the Securities Industry Association is to conduct mediation over disputes between its members, and between its members and clients in relation to securities operation.¹¹⁹

D. Issues concerning investor protection

Previous company and securities laws did not provide investors with effective civil remedies, such as the right of class actions.¹²⁰ Because of the inadequacy of the laws in this area, investors in the Chinese securities market, particularly mi-

¹¹³ *Id.* art. 105.

The gains as accumulated by a stock exchange that adopts a membership system shall belong to its members. The rights and interests of a stock exchange shall be jointly shared by its members. No accumulated gains of a stock exchange may be distributed to any member within the holding term.

Id.

¹¹⁴ Zhou Linjie, *zhengquan jiaoyi suo huiyuan jianguan zhidu yanjiu baogao* [A Report on the Supervision System of Members of Stock Exchanges], <http://www.szse.cn/main/research/Catalog1088.aspx> (last visited Aug. 11, 2006).

¹¹⁵ Stefano E. Cirielli, *Arbitration, Financial Markets and Banking Disputes*, 14 AM. REV. INT'L ARB. 243, 278-79 (2003).

¹¹⁶ See New York Stock Exch., Dispute Resolution/Arbitration, <http://www.nyse.com/regulation/helpforinvestors/1145486469200.html> (last visited Aug. 11, 2006).

¹¹⁷ Shenzhen Listing Rules, *supra* note 51, at 43-44.

¹¹⁸ See Shenzhen Listing Rules, *supra* note 100.

¹¹⁹ 2005 Securities Law, *supra* note 47, art. 176.

¹²⁰ Wenhai Cai, *Private Securities Litigation in China: of Prominence and Problems*, 13 COLUM. J. ASIAN L. 135, 143-48 (1999).

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nority investors, were susceptible to market manipulation and fraud and were often left without redress.¹²¹ "Inside control and inside trading"¹²² of listed companies were partly the cause of the problem. Accordingly, the ownership structure and agency problems of the listed companies, in which the State was often the dominant shareholder, made it difficult to effectively curb widespread inside-trading activities.¹²³ The end result was the weak protection of investors' interests and a lack of confidence in the Chinese securities market.¹²⁴

Following the recent Supreme Court ruling that investors could sue a company or its directors if an investigation of CSRC established that there was fraudulent conduct, the newly amended securities law offered better protection for investors.¹²⁵ It set down more stringent requirements regarding information disclosure of listed companies.¹²⁶ Authenticity, accuracy, and completeness are three benchmarks for proper information disclosure.¹²⁷ The listed companies are prohibited from using false or misleading information or omitting material information in their disclosure documents.¹²⁸ The law also requires disclosed information to be circulated in the media designated by the State Council, and to be kept at the company's registered office and at the securities exchange for public inspection.¹²⁹

Moreover, the law provides that the state set up a Securities Investor Protection Fund, the administration of which will be subject to relevant implementation rules to be issued by the State Council.¹³⁰ The primary use of the protection fund is to compensate creditors of securities companies that failed or are insolvent, according to the Measures for the Administration of the Securities Investor Protection Fund jointly issued in 2005 by the CSRC, the Ministry of Finance, and the PBOC.¹³¹

¹²¹ See Cindy A. Schipani & Junhai Liu, *Corporate Governance in China: Then and Now*, 1 COLUM. BUS. L. REV. 35 (2002); see generally JUNHAI LIU, SHANGSHI GONGSI GUDONGQUAN BAOHU [PROTECTION OF RIGHTS OF SHAREHOLDERS OF LISTED COMPANIES] (1997).

¹²² See 2005 Securities Law, *supra* note 47, art. 74. In the Chinese context an insider refers to directors, officers, employees, or related parties of a company, not only a person who possess inside information through various means.

¹²³ See generally Chenxia Shi, *International Corporate Governance Developments: The Path for China*, 7 AUSTL. J. ASIAN L. 60 (2005) (discussing issues concerning absence of ownership and inside control in Chinese companies).

¹²⁴ CHINA DAILY, *Poor Governance Blamed for Securities Market*, http://www.chinadaily.com.cn/english/doc/2005-04/03/content_430562.htm (last visited Aug. 10, 2006).

¹²⁵ Guiping Lu, *Private Enforcement of Securities Fraud Law in China: A Critique of the Supreme People's Court 2003 Provisions Concerning Private Securities Litigation*, 12 PAC. RIM L. & POL'Y J. 781, 785 (2003).

¹²⁶ See 2005 Securities Law, *supra* note 47.

¹²⁷ *Id.* art. 63.

¹²⁸ *Id.*

¹²⁹ *Id.* art. 70.

¹³⁰ *Id.* art. 134.

¹³¹ See Hong Kong Trade Development Council, *Measures for Administration of the Securities Investment Protection Fund*, http://www.tdctrade.com/report/reg/reg_051005.htm (last visited on Aug. 16, 2006).

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The new securities law also increases the liabilities of directors, senior management, and supervisors of the listed companies in order to improve investor protection.¹³² The directors and senior management are required to include their opinions in the periodic reports of the company.¹³³ The law has also improved provisions on continuous disclosure, strengthened reporting and auditing regulation, and combated fraud, market manipulation, and inside trading.¹³⁴ The correlation between information disclosure and investor protection cannot be understated; investors rely on publicly disclosed information to make their investment decisions.

Investors are also being protected by the amended Company Law. It has provided shareholders with the right to bring actions against directors, senior management, and supervisors for breaching individual company law, regulations, or the company's articles of association.¹³⁵ Shareholders holding 10% or more are entitled to petition the People's Court to liquidate the company when the company's managerial failures threaten to harm shareholder interests.¹³⁶ Shareholders may request the board of supervisors or the board of directors in writing to take action against directors or senior management who have violated law, administrative regulations, or rules, and who have subsequently caused detriment to the company.¹³⁷ Shareholders may also require the company to repurchase their shares if they oppose the decisions on the acquisition or the merger of the company.¹³⁸

These regulations have done a great deal to further China's goal of increased transparency and efficiency of its securities markets. This has allowed foreign investors to enter the Chinese market with an added sense of security and greater investment opportunities.

VIII. Foreign Investors in China's Securities Market

Traditionally, foreign investment companies and Chinese domestic companies have been subject to different regimes and rules. The new Company Law provides that, where the laws governing foreign investment differ from the provisions of the new law, the former shall prevail.¹³⁹ Consequently, the law applies

¹³² See Company Law, *supra* note 48 (noting it also strengthened directors' duties).

¹³³ See 2005 Securities Law, *supra* note 47, art. 68. Article 68 states:

The directors and senior management of a listed company shall subscribe their opinions for recognition in the periodic report of their company in written form. The board of supervisors of a listed company shall inspect periodic reports prepared by the board of directors and produce written examination opinions. The directors, supervisors and senior management of a listed company shall guarantee the authenticity, accuracy and integrity of the information disclosed by the company.

¹³⁴ See generally 2005 Securities Law, *supra* note 47.

¹³⁵ Company Law, *supra* note 48, arts.150-53.

¹³⁶ *Id.* art. 183.

¹³⁷ *Id.* art. 152.

¹³⁸ *Id.* art. 143.

¹³⁹ *Id.* art. 218.

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to foreign investors only when former laws governing foreign investment are silent.

The amended Securities Law cautiously embraced more international securities law principles and practices in order to cater to increasing regulatory demand from foreign securities firms and investors. Foreign companies may trade A shares and other listed securities through the QFII scheme,¹⁴⁰ but domestic companies that issue shares in foreign currencies within China (B shares) are subject to special regulations of the State Council.¹⁴¹ When a domestic company directly or indirectly issues any securities abroad or lists its securities abroad for trading, it shall be subject to the approval of the CSRC according to the relevant provisions of the State Council.¹⁴²

Under the law, it remains unclear whether foreign companies are allowed to directly offer securities in China either publicly or privately. Foreign companies may not offer securities in China's stock market unless permitted expressly by relevant laws, regulations, or specific approvals given by relevant authorities. For example, the international development institutions such as International Finance Corporation or Asia Development Bank were allowed to issue Renminbi bonds (Panda Bonds) according to the Interim Measures for the Administration of the Issuance of Renminbi-denominated Bonds.¹⁴³ Nevertheless, with China's continued economic integration with the world and its controlled but progressing pace of liberalization of its financial market, China will gradually have to offer a regulation-friendly environment to foreign investors in order to compete successfully in the international arena.

IX. Conclusion

A fair and competitive market emerges and develops from a well-structured and functional regulatory framework. The international competition faced by Chinese securities market players due to the increased pace of globalization and China's entry to the WTO has served as the catalyst for more effective regulation and measured liberalization of China's market. The CSRC has played a key role in regulating the securities market and exchanges. The regulatory framework for the securities market in China is, however, still in its early development. The Chinese legislature, the National People's Congress, amended Securities Law to bring it up to date with rapidly changing economic conditions and regulatory

¹⁴⁰ China Sec. and Regulatory Comm'n, The Provisional Regulation on Administration of Domestic Securities Investment of Qualified Foreign Institutional Investors (joint Decree No. 12 of the CSRC and the PBC, 2002), http://www.sse.com.cn/sseportal/en_us/ps/support/qfii.pdf (last visited on 18 August 2006) (defining "QFII" as "overseas asset management institutions, insurance companies, securities companies and other asset management institutions" approved by the CSRC and granted foreign exchange quota for the State Administration of Foreign Exchange).

¹⁴¹ 2005 Securities Law, *supra* note 47, art. 239.

¹⁴² *Id.* art. 238.

¹⁴³ See People's Bank of China, Highlights of China's Monetary Policy in 2005, (jointly issued by People's Bank of China, The Ministry of Finance, the Nat'l Dev. and Reform Comm'n and the China Sec. Regulatory Comm'n on Feb. 18, 2005), <http://www.pbc.gov.cn/english/detail.asp?col=6400&id=646> (last visited Mar. 30, 2006).

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needs. Yet it remains to be seen whether improved legislation will bring about changes in practice. More changes are needed to further liberalize the regulation of the Chinese securities market for foreign investors.

Direct administrative control of the securities market has produced positive effects. It quickly and forcefully promoted the development of the Shanghai and Shenzhen Securities Exchanges, but the regulatory role of CSRC remains problematic because it effectively limits the scope of self-regulation. This is in contrast to "best practice" jurisdictions where exchanges are self-regulatory organizations that play an important role in fostering fair, well-informed, and competitive markets. Chinese securities exchanges were established by the imperatives of reform and not by the market forces that naturally nurture the formation of self-regulatory organizations. Therefore, an education program about self-regulation is needed to inform the market and its participants of regulatory alternatives that may have better outcomes with lower regulatory costs.

The scope of self-regulation by securities exchanges must increase, thereby allowing a gradual reduction of the direct regulatory role of the CSRC, so that a healthy competitive environment can be fostered. But, a wholesale embrace of Western self-regulation would not suit the country's institutional setting well. Moreover, implementation of laws and rules concerning securities regulation should be strengthened. The securities regulatory authorities should be empowered to investigate and bring court proceedings against companies and directors for breaches of the Securities Law. Enhancing accountability of market players needs robust legal regulation. Effective enforcement of laws and regulations would discipline the market and market players, and create a more competitive environment for trade, supporting China's economic development and its integration into the global economy.
