Institute of
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IIF Equity Advisory Group

Corporate Governance in China

An Investor Perspective

Task Force Report

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PREFACE

In view of the importance of portfolio equity flows to emerging markets, the Institute of International Finance (IIF) established in January 2001 the IIF Equity Advisory Group (EAG) consisting of senior executives from leading asset management firms throughout the world. The EAG, chaired by Edward Baker, Chief Investment Officer of Global Emerging Markets, AllianceBernstein Ltd., is seeking implementation of its Code of Corporate Governance (the "IIF Code") in key emerging market countries that are of particular interest to the Institute's membership base. The IIF Code, which was first released in February 2002 and revised in May 2003,[1] endeavors to improve the investment climate in emerging markets by establishing practical guidelines for the treatment of minority shareholders, the structure and responsibilities of the board of directors, and the transparency of ownership and control of companies.

The strategy for promoting the implementation of the IIF Code, as the standard by which the company/shareholder relationship is measured, is country-focused. Country Task Forces have been set up for Brazil, China, India, Lebanon, Mexico, Poland, Russia, South Africa, South Korea, and Turkey.

In February 2006, the China Task Force held meetings in Beijing and Shanghai to assess changes in China's corporate governance framework since its last visit in late 2003. The Task Force held meetings with senior officials from the Chinese government, the China Securities and Regulatory Commission, the Shanghai Stock Exchange, lawyers, academic experts, independent directors, journalists, and accountants and management consultants involved in corporate governance in China. Victor L.L. Chu, Chairman of First Eastern Investment Group, led the Task Force. Other Task Force members include Kenneth King, Rexiter Capital Management Ltd.; Manish Singhai, AllianceBernstein Ltd.; Karin Ri, Hermes Investment Management Ltd.; and Keith Savard and Rakhi Kumar of the IIF staff.

The aim of this report is to offer an assessment as to where China stands relative to the investment environment that members of the IIF Equity Advisory Group would like to see develop in key emerging market countries. This report is not meant to provide an exhaustive due diligence of corporate governance in China and, as with other Task Force Reports, neither the Task Force nor the IIF can in any way attest to or guarantee the accuracy or completeness of the information in the report.

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[1] Investors' poor experience in a generally weak corporate governance environment in many emerging markets led to relatively strict and comprehensive original IIF guidelines. Nevertheless, more detailed standards were considered desirable in a few areas in light of far-reaching new legislation such as the Sarbanes-Oxley Act passed by the U.S. Congress in the summer of 2002. The revised standards offer guidance to emerging market officials as they decide what rules and regulations must be put in place to satisfy investors.

SUMMARY APPRAISAL

Since the EAG's first China Task Force visit in late 2003, improvements have been observed in the overall corporate governance structure of the country. In its follow-up visit in February this year, the Task Force recognized that positive changes in the corporate governance framework have been made through revisions to the Company Law and Securities Law. These changes, which came into effect on January 1, 2006, strengthen minority shareholder rights by:

- Allowing companies to use cumulative voting, if desired, thereby empowering minority shareholders to appoint directors and/or supervisors
- Imposing a stricter duty of care[2] on directors, supervisors, and senior management
- Granting shareholders the right to bring a derivative suit or direct suit against directors, supervisors, and senior management
- Introducing the concept of 'piercing the corporate veil,' enabling courts to look beyond the principle of limited liability
- Increasing minority shareholder protection by granting shareholders the right to check and copy the company's account books and meeting minutes, allowing share buy-backs, and granting shareholders the right to petition for liquidation of a company

Authorities in China have also made progress in improving the quality of China's financial markets by undertaking reforms in both the banking sector and equity markets. Banking reforms designed primarily to improve operational efficiency and reduce financial risk, in part by reducing the large volume of non-performing loans (NPLs) in the banking system (at one time estimated at about 40 percent of total outstanding loans), have been underway for the past two years. In the equity capital market, authorities have devised an effective way to deal with the share-overhang issue facing all state controlled companies (SCCs) with non-tradable state-owned shares in the country. **In April 2005, the China Securities Regulatory Commission (CSRC) introduced a pilot share reform program requiring all non-tradable shares in SCCs to be converted into tradable shares. IPO fundraising on the Shanghai and Shenzhen stock exchanges by listed companies has been suspended since mid 2005, but it is likely to be resumed when a substantial majority of the SCCs have completed the share conversion.** SCCs constitute about 70 percent of the 1,400 listed companies in China. As of January 2006, the share conversion process had been completed in companies that constitute about 50 percent of total market capitalization of the domestic stock exchanges.

Despite the progress described above, China continues to lag behind many other emerging market countries in the area of corporate governance. This report confirms that, while China's overall corporate governance framework now complies with roughly two-thirds of guidelines prescribed in the IIF's Code, up from about one-half two years ago, corporate governance as practiced in most Chinese firms has considerable room for improvement.

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[2] Requirement that a person exercise a reasonable standard of care to prevent injury to others.

Financial disclosure remains weak. Ongoing reforms to SCCs' share structure and the lack of reliable financial information makes it difficult for China's equity market to function efficiently. The Shanghai and Shenzhen stock exchange indices were among the ten worst-performing equity markets in 2005. China's corporate governance culture also remains weak. Several independent directors that the Task Force met during its visit indicated that, despite improvements in the governance framework of boards (such as requiring that at least one-third of board directors be independent), **independent directors still have limited ability to influence the overall strategy of the company.**

Recent revisions to the Company Law have clarified and made more permanent the role of the supervisory board in Chinese companies, but a number of shortcomings remain. China has a quasi two-tier structure of board governance, designed very loosely on the German governance system, with a board of directors and a supervisory board. However, **in practice, Chinese supervisory boards merely rubber stamp decisions taken by the board of directors, which is the main decision making authority. This duplication and overlap of functions creates redundancy in the corporate governance structure.** Further, it dilutes the authority of the board of directors and increases administrative costs for companies.

The government has been encouraging Chinese companies to improve their corporate governance culture. One mechanism to improve corporate governance has been to encourage Chinese companies to list on the Hong Kong Stock Exchange (HKEx), which has a more effective post-IPO corporate governance monitoring system than the Shanghai or Shenzhen stock exchanges and higher standards of corporate governance for listed companies. Several Chinese companies that have recently listed shares on the HKEx improved their corporate governance and increased financial transparency prior to their IPO listings. However, this strategy could result in a natural selection problem, where companies listed on the local Chinese exchanges may be considered second-tier companies with weaker corporate governance compared to the better-governed companies listed on the HKEx.

Another mechanism to improve corporate governance in Chinese companies is to build strategic partnerships with foreign multinational companies that have a good track record on governance. This mechanism is being tested through the process of banking sector reforms, whereby foreign banks are allowed to take a minority strategic stake in state-owned banks. Furthermore, at the end of 2005, several governmental departments and the CSRC jointly issued a circular titled "Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors" (the "Strategic Investment Measures" report) allowing foreign investors to acquire A shares of PRC listed companies that have completed the share conversion process (discussed below) as a strategic investor subject to a three year transfer prohibition period. Chinese banks with strategic foreign partners have added representatives of foreign banks to their boards of directors. Foreign directors have helped improve the quality of board oversight by requesting additional financial information and increasing board discussion on operational and strategic issues.

The government's recent steps to improve corporate governance, important as they are, do not provide a long-term solution for the major corporate governance problems in China. To bring about real effective change, it is necessary that the government reduce its

role and influence in Chinese companies. The government's controversial decision to reshuffle the CEOs of China's four leading mobile phone companies is an example of the degree of state interference that continues to hinder substantive governance improvements in China. Given the large number of SCCs listed on the domestic exchanges, improvements in China's corporate governance culture is possible only if corporate governance in SCCs is improved.

China also needs to do more to revitalize its capital markets by building on the recent banking and equity market reforms. These initiatives are a step in the right direction and demonstrate the government's desire to improve financial intermediation and opportunities for investors. In an attempt to make Shanghai a financial hub in Asia, plans are underway to open China's financial futures and derivatives exchange in Shanghai. The government also intends to set up several over-the-counter (OTC) stock exchanges in cities throughout the country. Confidence building in new OTC markets will depend importantly on fostering sound corporate governance practices.

To significantly improve the corporate governance environment in the country, China's regulators need to implement the following changes:

- Reinvigorate China's capital markets to put the new corporate governance framework to the test. In particular, resume IPO listings on the Shanghai and Shenzhen stock exchanges, which are reeling under the moratorium on local IPOs
- Reduce state interference in Chinese companies by protecting minority shareholder interests in the business decision-making process
- Further promote director training programs for directors of listed companies
- Encourage a broader share ownership structure by increasing participation of institutional investors
- Introduce more effective post-IPO corporate governance monitoring systems
- Strengthen judicial enforcement for the protection of shareholders' interests
- Promote investor education

KEY CORPORATE GOVERNANCE ISSUES

Efforts Made to Improve Overall Corporate Governance Framework

Recent revisions to the Company Law and Securities Law have helped improve the corporate governance framework in China. **Changes have focused on strengthening minority shareholder rights, increasing financial reliability, and clarifying the role of the supervisory board and chairman.** Specific changes include:

Shareholders

- Granting shareholders the right to make motions, learn the truth, convene and preside over shareholders' meetings and bring a derivative suit or direct suit against directors, supervisors and senior management
- Allowing a cumulative voting system in electing directors and supervisors – the general shareholders' meeting of a joint stock company may adopt a cumulative voting system in electing directors and supervisors in accordance with a company's articles of association or shareholders' meeting resolution
- Enlarging the scope of information disclosure to shareholders – companies are now required to disclose the following information to shareholders: articles of association, minutes of shareholders' meetings, resolutions adopted by the board of directors and the supervisory board, financial reports, and the accounting books

Board and Company

- Increasing the functions and powers of the supervisory board
- Limiting the powers of board chairmen by abolishing chairman's rights to exercise some of the powers of the board of directors during the period when the board is not in session. Abolishing the right of the chairman to designate a substitute chairman in the event he/she cannot perform duties
- Clarifying functions of convening and presiding over board meetings and voting rights of board members

Quality of financial disclosure

- Requiring a limited liability company (LLC) to have its financial and accounting reports audited by an accounting firm (requirement previously limited only to joint stock companies)
- Stipulating terms of engagement and dismissal of the external auditor
- Establishing procedures for entering into related-party transactions – a resolution approved in the shareholders' meeting is required before a company can provide security to a shareholder or to the actual controlling person/entity. Under the new

procedures, the relevant shareholders or the shareholders controlled by the actual controlling person cannot participate in voting with respect to related matters. Such resolutions must be passed by a majority of the votes held by other shareholders present in the meeting

Financial Transparency and Accounting Standards

Financial disclosure in China remains weak, which continues to hamper the growth of efficient equity markets. **A common complaint among investors in China is that financial information on company performance is either unavailable or, if provided, lacks reliability.** The government is beginning to tackle this problem, for example, by establishing procedures for voting and disclosure of related-party transactions as described above.

On February 15, 2006, the Ministry of Finance (MOF) formally issued 38 specific Basic Accounting Standards for Business Enterprises (ASBE) that will become effective on January 1, 2007 and apply to all listed Chinese companies. The new ASBE standards will bring Chinese accounting practices largely in line with International Financial Reporting Standards (IFRS), with some exceptions.

Continued State Influence on Business Operations of State-Owned Enterprises

Local governments and municipalities continue to exert influence on the overall management of more than two-thirds of listed companies. This creates an environment where the loyalties of directors and senior managers in SCCs may lie almost entirely with the majority shareholder (the state) to the detriment of minority shareholders. In general, corporate governance structures in SCCs are weaker than those found in newer non-government owned enterprises. **In addition to management appointments, the state also strongly influences business strategy and operational decisions.** The reshuffle of CEOs at the top four Chinese mobile phone operators in late 2004, without any explanation by the government, is an example of the state's close involvement in managing SCCs.

Due to the non-merit based promotion system, SCCs fail to attract quality managers at the senior-most level. Students in China's new business schools would prefer joining multinational corporations or becoming entrepreneurs over joining an SCC. This does not bode well for the future if mainstay SCCs are to survive and evolve.

Today, Chinese companies are operating in a socialist market economy, with an increasing emphasis on financial performance. **If SCCs are to survive in a competitive market environment, it is crucial for senior managers to develop independent decision-making skills that will allow them to make decisions that are in the interest of shareholders. A recent revision to the Securities Law paves the way for the issuance of stock options for directors, which is an important tool for aligning manager and shareholder interests.**

The Administrative Measures on Stock Incentives in Listed Companies, published recently, provides detailed implementation rules for listed companies to adopt stock options and other stock incentive plans. It requires that a stock option plan be drafted by the remuneration/appraisal committee under the board of directors. When it deems necessary, the remuneration committee may retain an independent financial consultant to provide opinions on the draft plan. Independent directors' opinions and a legal opinion are also required for the draft plan. Upon the approval of the board of directors, the plan is required to be filed with the CSRC, which has 20 working days to raise any objection to the terms in the plan. The listed company may submit the plan for deliberation and approval by the shareholders' general meeting only if there is no objection by the CSRC. These provisions may help to prevent listed companies from abusing stock option plans.

Nevertheless, a cultural shift is needed within Chinese companies if the 'new' corporate governance structure is to be successfully adopted. Further, the government also needs to put more emphasis on corporate governance 'capacity building' by introducing training programs for managers, senior executives, and directors.

Moribund Capital Market

With reforms underway in the banking sector and in equity markets, capital markets in China have been mostly dormant since 2005. The government has temporarily suspended the issuance of new capital on the local stock exchanges. Listed companies cannot issue new A or B shares[3] until they have completed the share conversion process (i.e. converted all non-tradable shares to tradable shares). Companies that wish to raise capital can do so only by issuing H, N, or S shares.[4] The Hong Kong Stock Exchange (HKEx) has benefited significantly from the ban on new local listings. In November 2005, mainland Chinese companies accounted for 37 percent of Hong Kong's market capitalization. Today five of the top fifteen largest companies listed on the HKEx (by market capitalization) are mainland companies, compared with only one mainland company in the top fifteen list in 1993.

Even those SCCs that have completed the share conversion process have a one-year moratorium on the disposal of the newly converted tradable shares. In the second year after conversion, the investor is not allowed to sell more than 5 percent of the newly converted shares. In the second and third year together, the investor is not allowed to sell more than 10 percent of the shares. The primary reason for the ban on new issues is to prevent a collapse of local equity markets due to a sudden increase in the supply of A shares during the share conversion process. **The government hopes that encouraging SCCs to list in Hong Kong will improve the standard of corporate governance in Chinese companies. However, if corporate governance in Chinese companies is to improve in the long term, the government should strengthen enforcement, continue reforming governance structures,**

[3] *A shares* are listed on one of the two mainland China stock exchanges (Shanghai or Shenzhen). Trading is denominated in renminbi and is restricted to Chinese investors and Qualified Foreign Institutional Investors (QFIIs). *B shares* are also listed either on the Shanghai or Shenzhen exchanges but are denominated in US or HK dollars. Trading of B-shares is open to foreign investors.

[4] *H shares, N shares,* and *S shares* are shares listed in Hong Kong, New York, or Singapore, respectively.

and allow capital markets to operate again in China so that competitive forces can encourage governance changes in Chinese companies.

China's equity culture began only in the early 1990s with the reformation of the country's first capital market. Since then, China's equity culture has remained weak and has suffered due to the lockdown in the capital market. With little or no access to the equity market, Chinese companies have little incentive to provide the protections for minority shareholders that lie at the heart of many of the IIF corporate governance guidelines. Given this situation, strategic investors generally have not seen the equity market as a good way to invest their money.

Another side effect of the moribund capital market is the lack of investment opportunities for China's broker-dealer community. Falling share prices, the dearth of new issues, and bad management has the country's 130-odd securities companies struggling to make enough money to match the returns they guarantee their customers. Many of these companies are technically insolvent. This environment combined with the CSRC and stock exchanges' limited ability to identify and prevent insider trading has done little to discourage the practice. The China Aviation Oil scandal and the recent sentencing of three of its senior executives by a Singaporean court for insider trading activities illustrate the problem that exists among Chinese firms. Civil liabilities have now been codified in the revised Securities Law, which should help to deter insider trading. Nevertheless, better surveillance by the stock exchanges is required to identify and prosecute offenders.

Redundancy in China's Board Governance Structure

China's board governance structure is designed loosely on Germany's two-tier board structure. However, important differences between the German model and the Chinese model have resulted in redundancy in the Chinese corporate governance system. The German two-tier board structure creates a management board that is responsible for managing the company and a supervisory board, which supervises decisions of the management board. **China's current board structure, while giving the illusion of a two-tier board structure, in practice is more like a muddled one-tier (Anglo-Saxon) board.**

Recent revisions to China's Company Law have clarified the structure and the roles of the board of directors and the supervisory board, which are as follows:

- The board of directors is styled after the 'board of directors' in the Anglo-Saxon model of corporate governance, where the board oversees and aids management decision making. Similar to practices followed in the UK and the US, guidelines issued by the CSRC require that at least one-third of directors be independent.
- The supervisory board in China is much smaller than the supervisory board in Germany, and shares only a few similar responsibilities with its German counterpart.
- In China, the board of directors is the main decision-making authority, with the supervisory board designated with legal powers to overturn decisions taken by the board of directors. In practice, the supervisory board is only symbolic and any

attempt to strengthen its role is likely only to create further ambiguity in China's board structure.

- The blending of the Anglo-Saxon model and the German model of corporate governance dilutes the effectiveness of both the board of directors and the supervisory board and duplicates administrative costs by increasing the overall number of directors in a company.

OUTLOOK AND KEY RECOMMENDATIONS

During the past two years, steps have been made to enhance China's corporate governance framework. **The Task Force welcomes the government's efforts to deal with the share-overhang issue in SCCs and to improve financial reporting in China by bringing it more in line with International Financial Reporting Standards.** However, more needs to be done by way of implementation and enforcement of revised rules and regulations. Specifically, the Task Force would propose the following actions to further improve corporate governance in China:

- Reduce state interference in operations of SCCs; in particular, reduce the state's influence in appointing senior management and in setting business strategy
- Introduce corporate governance best practices designed specifically to improve corporate governance in SCCs
- Move from "comply or explain" to a strictly enforced Code of Corporate Governance
- Align management interests with the interests of minority shareholders; in particular, better align executive remuneration with overall company performance
- Rationalize the board governance structure by eliminating redundancies caused by the quasi two-tier structure
- Establish specialized courts to deal with enforcement of securities laws; this will expedite the delivery of justice for securities and finance-related offenses and reduce the cost of litigation
- Allow new listing of A shares on the Shanghai and Shenzhen stock exchanges

The China Task Force believes it is important to re-open local equity markets to Chinese companies and allow market forces to freely function in the country. **As suggested by Victor L.L. Chu, Chairman of First Eastern Investment Group and Chairman of the China Task Force, one mechanism to reinvigorate China's moribund equity markets is to allow the Shanghai and Shenzhen stock exchanges to have secondary listings of Mainland companies' shares on the Hong Kong Stock Exchange.**

Finally, the Task Force believes that weak corporate governance in Chinese firms can limit their ability to become multinational corporations. The past decade has seen

Chinese companies capture a significant share of global manufacturing, establishing China as the single largest exporting country in the world in 2005. Much of this success can be attributed to strategic direction provided by the Chinese government. In the next decade, Chinese companies will likely acquire many foreign companies to become multinational corporations. This trend began in 2005 with the acquisition of IBM's PC-making business by China's largest personal computer maker, Lenovo Group. A recent revision to the Company Law removes previous restrictions on outward investment by Chinese companies, allowing for greater international business acquisitions. However, the poor corporate governance structure of Chinese companies will prove to be a stumbling block in their ability to compete with other companies in the bidding process and in management. **The probability of getting board and shareholder approval for a merger or an acquisition is lower when the acquiring company has poor corporate governance. Consequently, Chinese companies are more likely to find that their existing governance structure limits their ability to grow internationally.** Therefore, the China Task Force strongly recommends that the government continue to pursue corporate governance reforms by adopting the recommendations provided above.

APPENDIX

CHINESE CORPORATE GOVERNANCE FRAMEWORK

Recent revisions to China's Company Law have helped strengthen the corporate governance framework of the country. Corporate governance-related legislation and rules now comply with about two-thirds of guidelines in the IIF Code, compared to compliance with about one-half of guidelines in 2004. Improvements can be attributed to the strengthening of minority shareholder rights and clearly defining the board structure, in particular, specifying the role of the supervisory board and chairman. Legislative rules pertaining to the Accounting and Auditing area continue to remain weak.

Minority Shareholder Protection

The Chinese corporate governance framework addresses roughly three-fourths of the minority shareholder protection guidelines contained in the IIF Code, up from about one-half two years ago. Scope for further improvement exists in strengthening rules regarding changes to the capital structure.

<u>Voting Rights</u>

Proxy voting is permitted in both the Code of Corporate Governance in Listed Companies issued by the CSRC (the "CSRC Code") and Company Law. For instance, the CSRC Code mentions, "shareholders can either be present at the shareholder meetings in person or they may appoint a proxy to vote on their behalf, and both means of voting possess the same legal effect." The CSRC Code states that listed companies should make every effort, including utilizing modern information technology, to increase the number of shareholders attending shareholders' meetings.

Company Law endorses the **one-share one-vote principle** by clearly stipulating "when a shareholder attends the shareholders meeting, each share he holds is entitled to one vote."

Cumulative voting is also encouraged in the CSRC Code as a means of fully reflecting the opinions of minority shareholders. The CSRC Code articulates that "a cumulative voting system should be earnestly advanced in shareholders' meetings for the election of directors" and that "listed companies that are more than 30 percent owned by controlling shareholders should adopt a cumulative voting system." **Provisions for cumulative voting, which were previously in the CSRC Code, have now been codified in the Company Law through recent revisions, giving it the legal backing required for better enforcement.**

The IIF Code strongly encourages companies to adopt all of these three elements (proxy voting, one-share on-vote principle, and cumulative voting) to ensure voting rights of minority shareholders.

Company Capital Structure

As for **takeover and merger procedures,** Company Law says, "if a company is to undergo merger or division, its shareholders should adopt a resolution," and this resolution "requires affirmative votes by at least two-thirds of the votes held by shareholders attending the meeting." It also requires that the merger/division proposal be subject to the approval of the relevant authorities. In recognition of an increasing trend in M&A, the Chinese government seems to be willing to create an environment that is more hospitable to corporate takeovers and mergers. The CSRC issued the Administration of Takeover of Listed Companies Procedures (the "Takeover Procedures") in December 2002, which regulates M&A activities in listed companies in China. Non-state companies, including private and foreign companies, are now allowed to acquire Chinese listed companies. However, the market for corporate takeover is still not well-developed. In particular, hostile takeovers are still considered to be nearly impossible in China.

The IIF Code calls for a public offer to be made for acquisition of all shares when ownership exceeds the 35 percent trigger level. It also calls for disclosure of share buybacks to shareholders. The Company Law does not address these issues, but the Securities Law sets the trigger level at 30 percent.

Shareholder Meetings/Other Rights

According to Company Law, **a general shareholders' meeting** should be held annually and **interim shareholders' meetings** should be held within two months of the occurrence of several pre-specified circumstances. Such circumstances include requests by shareholders holding at least 10 percent of outstanding stock.

A **meeting notice** and agenda should be provided to shareholders 30 days in advance. The guidelines of the IIF Code call for notices and agendas to be sent within a reasonable amount of time in advance of meetings. The best practice suggested by the IIF Code is that meeting notices and agendas should be sent at least one month prior.

Under the Company Law, adoption of **a resolution** at a shareholders' meeting requires the majority of votes held by shareholders attending the meeting. As noted above, a resolution regarding merger/division/dissolution of the company requires affirmation by at least two-thirds vote. If the procedure for convening or the method of voting at a shareholders' meeting, shareholders' general meeting, or meeting of the board of directors violates laws, administrative regulations, or the company's articles of association, or if the substance of a resolution breaches the company's articles of association, the Company Law allows shareholders to protect their interests through civil litigation by stipulating that "a shareholder may file a petition with the People's Court to revoke the resolution within 60 days of it being adopted."

Structure and Responsibilities of the Board of Directors

The Chinese corporate governance framework encompasses over three-fourths of the guidelines pertaining to the board of directors in the IIF Code. Major aspects underpinning the functioning of the board of directors are well addressed.

Board Structure

The CSRC Code presents a **general principle** that board directors should faithfully, honestly and diligently perform their duties in the best interests of the company and its shareholders. In cases where resolutions by the board of directors violate relevant laws or regulations and result in losses to a company, directors responsible for making such resolutions are liable for damages.

The CSRC has also issued specific guidelines about qualifications of **independent directors** of listed companies, namely the "Guideline on Establishment of Independent Director System in Listed Companies" (the "CSRC Guideline"). It first defines independent directors as those directors "who hold no posts in the company and who maintain no relationship with the company and its major shareholders that might prevent them from making objective judgments independently." The guideline goes on to list several specific requirements for independent directors. Most notably, a person who holds more than 1 percent of the outstanding shares of a company directly or indirectly, or a person who is among the top 10 largest shareholders of a company, cannot hold the position of independent director. Also, a person who was an employee of the company in the past year cannot be an independent director. Independent directors have to make a public statement as to their independence. The CSRC Guideline also states that independent directors can concurrently hold the post of independent directors at a maximum of five listed companies. Given the limited availability of qualified independent directors,[5] this provision can be justified for the time being, but as corporate governance reform in China progresses, it might become necessary to lower the maximum number of concurrent independent directorship held by the same person.[6] The IIF Code cites several requirements that should be met to qualify as an independent director. Importantly, an independent director cannot have been an employee of the firm in the past three years nor have a current business relationship with the firm.

Concerning the **composition of the board**, the CSRC Code simply states that the number of directors and the structure of the board should be in compliance with laws and regulations. The Company Law specifically requires that the board of directors be composed of not fewer than 5 but not more than 19 members. With regard to the share of independent directors, the CSRC Guideline stipulates that as of end-June 2003, at least one-third of board members should be independent. This complies with the IIF Code recommendation that at least one-third of the

[5] According to the CSRC, roughly 40 percent of independent directors come from academia, 25 percent from accounting/law firms, 15 percent from other unrelated companies, and 10 percent from the public sector.
[6] Both the CSRC and the Shanghai Stock Exchange (SSE) are working hard to expand the pool of qualified independent directors. For example, the CSRC and the SSE provide a training program in collaboration with some leading Chinese universities. The CSRC also has the authority to examine the qualifications of candidates prior to shareholder meetings.

board should be non-executive, a majority of which should be independent. Moreover, the IIF Code calls for a majority of board members to be independent as a best practice.

Regarding the **frequency of board meetings**, Company Law requires them to be held at least twice a year. This is less frequent than suggested in the IIF Code (every quarter).

According to the CSRC Code, the **nomination committee should nominate directors**. An independent director should chair the nomination committee and the majority of its members should be independent directors. The nomination committee is responsible for formulating standards and procedures for the election of directors, extensively seeking qualified candidates, reviewing candidates, and issuing recommendations. The CSRC Guideline adds that shareholders holding more than 1 percent of outstanding shares–whether independently or jointly–may nominate independent directors for election. Prior to convening the shareholder meeting to elect independent directors, the Guideline also requires that the company submit the relevant background materials about the nominees to the CSRC and the stock exchange. Within 15 working days, the CSRC should examine the qualifications of the nominated candidates. If a nominee is rejected by the CSRC, he or she can still be a candidate for director, but not an independent one. Under the IIF Code, a committee chaired by an independent non-executive director should nominate new board members.

As for **term limits** for directors, Company Law states that each term should not exceed three years and a director may be re-elected at the expiration of his or her previous term. According to the CSRC Guideline, the term of an independent director should be the same as that of other directors with the exception that an independent director's consecutive terms should not exceed six years in aggregate. The best practice of the IIF Code recommends that independent directors should be re-elected every three years for no more than three terms.

Board Committees

Under the CSRC Code, listed companies may establish various specialized **board committees** on corporate strategy, audit, nomination, and remuneration/appraisal. The CSRC Code further elaborates that an independent director should chair the audit, nomination, and remuneration/appraisal committees and that independent directors must constitute the majority of these committees. The composition and work of board committees should be disclosed. The IIF Code recommends the establishment of audit, nomination, and compensation committees to enhance the board's efficiency and the effectiveness of its involvement in the company. The IIF Code also suggests that an independent director chair each of these committees.

Disclosure

The CSRC Code unambiguously states that **information disclosure** is an ongoing responsibility of listed companies. In addition to disclosing mandatory information, companies should also voluntarily and on a timely basis disclose all other information that may have a material effect on the decisions of shareholders and stakeholders. This includes information on performance assessment and compensation of directors, independent directors' opinions on related-party transactions, and controlling shareholders' interests. Disclosure among listed

companies in China has improved, especially for more recent listings due to the CSRC's requirement that companies prepare financial statements for three years ahead of an IPO.

With respect to the **annual report**, the CSRC rule, "Implementation guidelines on information disclosure for companies seeking public offering of stock," requires companies to release the audited annual report within four months of the end of each fiscal year and the audited interim report within two months of the end of the sixth month in each fiscal year. Since 2002, companies have also been required to release un-audited quarterly reports as well. These reports should be available in their entirety on the Internet.

To support implementation of corporate governance practices, all listed companies in China are called on by the CSRC Code to **disclose the gap between their practices and the recommendations in the Code and the reasons for the existing gap** (the so-called "comply or explain" rule).

Other Responsibilities

Although the CSRC Code falls short of providing a generic statement pertaining to **conflicts of interest** on the part of directors or senior management, it briefly states that when the board of directors or the remuneration/appraisal committee reviews the performance of, or discusses the compensation of a certain director, such director should withdraw from the discussion.

Regarding **investor relation** programs, the CSRC Code recommends that the secretary of the board of directors be the officer responsible for providing information about the company to investors.

The CSRC Code also calls attention to the importance of **social responsibility of the company**. It clearly states that while maximizing shareholders' benefits, the company should be concerned with environmental protection and the public interest of the community in which it resides.

Accounting/Auditing

Requirements in Chinese law continue to remain weak with regard to accounting and auditing of financial information. Current laws comply with a little over one-third of guidelines in the IIF Code. However, some progress has been made over the last two years. Revisions to the Company Law now require that, in addition to joint stock companies, LLCs must also have their financials and accounting reports audited. The law also clarifies conditions for engagement and dismissal of the external auditor. As described above, efforts are also underway to bring China's accounting practices in line with internationally recognized standards.

Standards

In the past, Chinese companies applied **accounting rules** on an industry-by-industry basis. To rectify this situation, the Ministry of Finance issued "Provisional Accounting Regulations for Joint-Stock Limited Enterprises" in 1992, which became the first statutory accounting rules for listed companies in China. These rules were subsequently revised to result in the promulgation of Chinese Accounting Standards (CAS) in 1997, which subsume 16 separate accounting rules and are broadly in line with International Financial Reporting Standards (IFRS).

On February 15, 2006, the MOF formally issued 38 specific Basic Accounting Standards for Business Enterprises (ASBE) that will become effective on January 1, 2007 and apply to all listed Chinese companies. The new ASBE standards will bring Chinese accounting practices largely in line with International Financial Reporting Standards (IFRS), with some exceptions.

Company Law calls for companies to establish internal accounting systems in accordance with these standards. Company Law also requires listed companies to prepare and publish their financial and accounting reports at the end of each fiscal year. These reports should include a company's balance sheet, income statement, cash flow statement, and statement on profit distribution. Furthermore, the CSRC has issued rules requiring companies issuing B shares to explain any departure from IFRS in the appendix of their annual reports. The accounting reports of listed companies should be available for shareholder inspection at companies' premises.

Further improvements can be made by requiring Chinese firms to comply with the IIF Code's guidelines on disclosure of off-balance sheet transactions and requiring the board of directors to assess/monitor risk.

Audit Committee

The CSRC Code addresses the responsibilities of **audit committees**. The main duties of an audit committee are to recommend the engagement or replacement of external auditors, to review the internal audit system, to oversee the interaction between the internal and external auditors, to inspect the company's financial information and its disclosure, and to monitor the company's **internal control system**. Companies are required by accounting law to set up a sound internal control system. The Code expects the audit committee to be chaired by an independent director and composed of a majority of independent directors. It also requires that at least one independent director on the audit committee should be an **accounting professional**.

Transparency of Ownership and Control

China's corporate governance framework touches on all of the IIF guidelines in the areas of firm ownership and control. For example, the CSRC Code addresses in detail the issues associated with **majority (controlling) shareholders** and the recent revision to the Company Law defines a "controlling shareholder" as "a shareholder whose capital contribution to a limited liability company accounts for at least 50% of the company's total capital or whose

shareholding accounts for at least 50% of the total share capital of a joint stock company; or a shareholder whose capital contribution or shareholding, although not accounting for 50%, is nonetheless, through the voting rights attaching to his or her capital contribution or his or her shareholding, able to materially affect the resolutions of the shareholders' meeting or shareholders' general meeting."

Regulations governing related-party transactions have been strengthened. Amendments to the Company Law now establish procedures for entering into related-party transactions, and require shareholder approval before a company can provide security to a shareholder or to the actual controlling person/entity. However, rules concerning majority/controlling shareholders should be more clearly elaborated as the market for corporate control/takeover develops in China.

The CSRC Code is fairly detailed in its description of rules pertaining to **related-party transactions.** First, such matters as the nature, type, and other pertinent information of related-party transactions among a listed company and its connected parties should be disclosed in accordance with relevant regulations ("Disclosure of Related-Party Relationship and Transactions" published by the MOF in 1997 and rules as amended by the CSRC from time to time regarding the contents and standard format for information disclosure). Second, listed companies should take efficient measures to prevent related parties from damaging company interests. Third, related-party transactions should observe commercial principles. Fourth, a listed company should not provide financial guarantees for its shareholders or their affiliates[7]. The CSRC Guideline accords a special role to independent directors to oversee related-party transactions in a proper manner. Specifically, related-party transactions whose total value exceeds RMB 3 million or 5 percent of the company's net assets should be approved by the board's independent directors before being submitted for board discussion.

As for **buyout offers to shareholders**, the CSRC Code makes a general statement that if controlling shareholders increase/decrease their shareholdings or if the actual control of the company transfers, the company and its controlling shareholders should disclose relevant information to all shareholders on a timely basis. The numerical threshold that triggers mandatory offers to all shareholders is stipulated in the Securities Law. The State Council released administrative regulations in 1993 ("Administration of the Issuing and Trading of Shares: Tentative Regulations") which require legal persons directly or indirectly owning 30 percent or more of outstanding shares of a listed company to make an offer to purchase all outstanding shares from other investors within 45 days of reaching this threshold. The IIF Code defines 35 percent ownership of the company as the trigger point for mandatory offers.

Regarding the regulations and procedures for takeovers in general, the CSRC promulgated the Takeover Procedures in 2002. These procedures also provide for the regulations of mandatory offers.

Regarding **significant shareholders**, the CSRC Code calls for the timely disclosure of the interest of shareholders who own "a comparatively large percentage" of the company's

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[7] The Notice on Regulating Provision of Security to External Parties by Listed Companies jointly issued by the CSRC and the China Banking Regulatory Commission ("CBRC") recently has lifted such restriction.

outstanding shares. Unlike the IIF Code, however, no numerical threshold regarding "being comparatively large" is given in the CSRC Code. In 2002, the CSRC promulgated the "Administrative Measures of the Disclosure of Information on Changes of Shareholdings of Listed Companies" which purports to objectively set out the requirements for disclosure of interests of certain shareholders.

Regulatory Environment and Enforcement

Although progress has been made to upgrade the capacity of regulatory and judicial authorities, enforcement is not immune from weaknesses that need to be tackled more vigorously to ensure China's successful transition to a market-oriented economy.

Oversight and regulatory responsibilities rest primarily with the CSRC. The CSRC, as a centralized supervisory agency of securities markets, is responsible for promulgating regulations/ rules concerning regulation of the securities market and monitoring companies' compliance with relevant regulations. The MOF is responsible for promulgating the relevant financial and accounting regulations/ rules. As corporate governance reform in China is closely linked to the reorganization of the SCCs, the State-owned Assets Supervision and Administration Commission (SASAC) established in 2003 also has a key role to play. In this connection, it should be noted that a robust and unified insolvency regime has yet to be established in China and the authorities appear to be working hard toward this goal so that creditors are protected appropriately and consistently in the SCC-related bankruptcy process.

The CSRC was created in October 1992 as the executive branch of the State Council Securities Commission (SCSC) to conduct supervision and regulation of the securities markets. The scope of its authority was subsequently expanded. In 1998, in accordance with the State Council Reform Plan, the SCSC and the CSRC were consolidated to form a unified supervisory agency under the direct control of the State Council. Currently, major functions and responsibilities of the CSRC include: supervising securities and futures markets; overseeing the issuance, trading, custodial services, and settlement of securities; monitoring the behavior of listed companies; governing the stock exchanges; regulating securities and futures companies, investment fund managers, and investment consulting firms; and penalizing activities that violate relevant laws and regulations.

Unlike in some other countries, China does not appear to suffer from potential regulatory inconsistencies. The MOF, CSRC, CBRC, and China Insurance Regulatory Commission (CIRC) are closely consulted and coordinate regulation to avoid conflicting guidelines for banks and insurance companies following their IPOs.

China has two stock exchanges in Shanghai and Shenzhen. The Shanghai Stock Exchange is playing a more prominent role in terms of the number of listed companies/shares and total market capitalization. The stock exchange is a nonprofit membership organization directly governed by the CSRC. The stock exchange is performing a variety of functions such as providing facilities and a marketplace for securities trading, approving and arranging listing/delisting, monitoring securities transactions, overseeing listed companies, and

disseminating market information. The stock exchange's listing requirements set out several criteria on the company's total share capital, profit history, and the number of shareholders. Although the stock exchange is given some degree of discretion, the enforcement and punitive authorities fall primarily within the purview of the CSRC. For instance, the stock exchange is engaged in market surveillance activities to detect manipulative transactions, but it is the CSRC that has the administrative power to penalize a company involved in such malpractices. The recent revision to the Securities Law has granted more powers to the stock exchange which allow it to directly approve the listing of shares and corporate bonds and make decisions on suspension and termination of listing.

Comparison of IIF Code and CSRC Code, CSRC Guideline and Company Law

	IIF	CSRC Code ("Code"), CSRC Guideline ("Guideline"), Company Law ("CL")
Minority Shareholder Protection		
Voting rights		
Proxy voting	Firms are encouraged to allow proxy voting.	Proxy voting is allowed. (Code, CL)
One share one vote principle	"One share on vote" should be a threshold requirement for new issues.	At shareholders' meetings, each share that a shareholder holds is entitled to one vote (CL). A company has no voting rights on its own shares it holds. (CL)
Cumulative voting	Cumulative voting should be permitted.	Cumulative voting is encouraged in shareholders' meetings for the election of directors. Listed companies that are more than 30% owned by controlling shareholders are required to adopt a cumulative voting system to reflect the opinions of minority shareholders. (Code) When electing directors or supervisors, the shareholders' general meeting may implement a cumulative voting system pursuant to the company's articles of association or a resolution of the shareholders' general meeting. (CL)
Capital structure		
Takeover/buyout/merger - Procedures on major corporate changes	Shareholder approval of mergers and major asset transactions should be required. If an offer is made above a reasonable minimum threshold of outstanding stock, a significant portion of that purchase must be through a public offer. Ownership exceeding 35% triggers a public offer in which all shareholders are treated equally. Under a merger or takeover, minority shareholders should have a legal right to sell shares at appraised value.	A merger, split-up, or dissolution requires approval from shareholders representing 2/3 or more of total voting rights. (CL) (Note: According to the Securities Law, ownership exceeding 30% triggers a general offer to all shareholders. The detailed rules and procedures on takeovers are provided in the takeover Procedures.)
Capital Increases (pre-emptive rights)	Shareholder approval is required. Any capital increase over a period of one year and above a minimum threshold must first be offered to all existing shareholders.	When a company is to increase its capital, its shareholders have the preemptive right to contribute to the increased amount on the basis of the same percentages of the old capital

		contributions they have made, unless all shareholders agree that they will not contribute to the increased amount of capital on the basis of the percentages of the old capital contributions they have made. (CL)
Share buybacks	Details of share buybacks should be fully disclosed to shareholders.	Share buybacks are only allowed in the following circumstances: (i) to decrease the registered capital of the company, (ii) to merge with another company holding shares of the company, (iii) to award the employees of the company with shares or (iv) at the request of a shareholder who has raised objections to the company's resolution on merger or split-up made at a session of the meeting of shareholders. (CL)
Shareholder meeting		
Meeting notice and agenda	Meeting notice and agenda should be sent to shareholders within a reasonable amount of time prior to meetings.	Meeting notice should be given to each shareholder 20 days in advance. Meeting notice for a temporary shareholders' meeting should be given to each shareholder 15 days in advance. (CL)
Special meetings	Minority shareholders should be able to call special meetings with some minimum threshold of the outstanding shares.	Shareholders holding at least 10% of a company's stocks can make a request for an interim shareholders' meeting also know as a 'temporary meeting.' (CL)
Treatment of foreign shareholders	Foreign shareholders should be treated equally with domestic shareholders.	Shares are categorized based on ownership. Foreign owners (except for a QFII or a strategic investor under the Strategic Investment Measures) cannot buy class A shares.
Conflicts between shareholders	Should have mechanisms whereby a majority of minority shareholders can trigger an arbitration procedure to resolve conflicts between minority and controlling shareholders.	If the procedure for convening or the method of voting at a shareholders' meeting, shareholders' general meeting or meeting of the board of directors violates laws, administrative regulations, or the company's articles of association, or if the substance of a resolution breaches the company's articles of association, a shareholder may, within 60 days, request that the People's Court revoke such board or shareholder resolution that violates their rights. (CL)
Quorum	Should not be set too high or too low. Suggested level would be about 30% and should include some independent non-majority-owning shareholders.	No provisions.
Petition rules/objection to majority shareholder actions	Minority shareholders should have the right to formally present a view to the board if they own some predefined minimum threshold of	Shareholders should have the right to protect their interests through civil litigation or other legal means in the event that a shareholders' meeting

	outstanding shares.	resolution or a board resolution constitutes a breach or infringement on shareholders' interests. (Code, CL) Shareholders separately or aggregately holding 10% or more of the shares of the company may call for a temporary shareholders' meeting. (CL) Shareholders separately or aggregately holding 3% or more of the shares of the company may put forward a written temporary proposal to the board of directors 10 days before a shareholders' meeting is held. The board of directors may notify other shareholders within 2 days and submit the temporary proposal to the shareholders' meeting for deliberation. (CL)

Structure and Responsibilities of the Board of Directors		
Board structure		
Definition of independence	Cannot have a business or personal relationship with the management or company, and cannot be a controlling shareholder such that independence, or appearance of independence, is jeopardized.	Cannot have any posts in the company or its affiliated enterprises, cannot maintain (both business and social) relationship with the company and its major shareholders that might undermine objective judgment, cannot be a shareholder who holds more than 1% of the outstanding shares of the company or is among the top 10 largest shareholders of the company, and cannot hold a position in a unit that holds more than 5% of outstanding shares or ranks as one of the 5 largest shareholders of the company. There is a one-year look back period on these requirements. (Guideline)
Share of independent directors	At least one-third of the board should be non-executive, a majority of whom should be independent.	By end-June 2003, at least 1/3 of the board members were required to be independent directors. (Code)
Frequency and record of meetings	For large companies, board meetings every quarter, audit committee meetings every 6 months. Minutes of meetings should become part of public record.	The board should hold meetings at least twice a year. A shareholder representing one-tenth or more of the voting rights or one-third or more of directors or supervisory board members may call for a temporary meeting of the board of directors. (CL) Minutes/records of meetings should be properly maintained. (Code)
Quorum	Should consist of executive, non-executive, and independent non-executive members.	Board meeting may not be held unless attended by at least half of the directors. (CL)

Nomination and election of directors	Should be done by nomination committee chaired by an independent director. Minority shareholders should have mechanism for putting forward directors at Annual General Meeting (AGM) and Extraordinary General Meeting (EGM).	Should be done by nomination committee chaired by an independent director. (Code) Shareholders who independently or jointly hold more than 1% of the shares issued by the company may nominate independent directors at the shareholders' meeting. (Guideline)
Term limits for independent directors	For large companies, re-election should be every 3 years with specified term limits.	Each term should not exceed 3 years (CL). Re-election is allowed but the consecutive term should not exceed 6 years. (Guideline)
Board committees	The board should set up 3 essential committees: nomination, compensation and audit.	The board may establish specialized committees on: corporate strategy, nomination, remuneration/appraisal, and audit. Committees should be chaired by an independent director and independent directors should constitute the majority of each committee. (Guideline)
Formal evaluation of board members	For large companies, nomination committee must review directors ahead of formal re-election at AGM.	Evaluation of directors should be conducted by the board or its remuneration/appraisal committee. Evaluation of independent directors should be conducted through a combination of self-review and peer review. (Code)
Disclosure		
Immediate disclosure of information that affects share prices, including major asset sales or pledges	Any material information that could affect share prices should be disclosed through stock exchange. Material information includes acquisition/disposal of assets, board changes, related-party deals, ownership changes, directors' shareholdings, etc.	In addition to disclosing mandatory information, a company shall also disclose voluntarily and in a timely manner all other information that may have a material effect on the decisions of shareholders and stakeholders, and shall ensure equal access to information for all shareholders. (Code)
Procedures for information release	Through local exchanges, and as best practice, through company website.	Disclosed information by a listed company shall be easily comprehensible. Companies shall ensure economical, convenient, and speedy access to information through various means, such as the Internet. (Code)
Remuneration of directors	Should be disclosed in annual report. All major compensation schemes, including stock options, should be fully disclosed and subject to shareholder approval.	The board should report, at shareholders' meetings, the performance evaluation and compensation of directors and disclose such information. (Code) A company shall regularly disclose to its shareholders information about remunerations obtained by the directors, supervisors, and senior managers from the company. (CL)

Other responsibilities		
Conflict of interest	Any potential or actual conflicts of interest on the part of directors should be disclosed. Board members should abstain from voting if they have a conflict of interest pertaining to that matter.	Where any of the directors has any relationship with the enterprise involved in the matter to be discussed at the meeting of the board of directors of a listed company, he shall not vote on this resolution, nor may he vote on behalf of any other person. (CL) The meeting of the board of directors of a listed company shall not be held unless more than half of the unrelated directors are present at the meeting. A resolution of the board of directors shall be adopted by more than half of the unrelated directors. If the number of unrelated directors present is less than 3 persons, the matter shall be submitted to the shareholders' meeting of the listed company for deliberation. (CL)
Integrity of internal control and risk management system	Should be a function of the audit committee.	The audit committee is required to monitor the company's internal control system. (Code)
Investor relations	Should have an investor relations program.	The secretary of the board of directors is responsible for providing/explaining publicly-disclosed information to investors. (Code)
Social responsibility and ethics	Make a statement on policy concerning environmental issues and social responsibility.	Companies should be concerned with the environmental protection and public interest of the community and pay attention to their social responsibilities. (Code)

Accounting/Auditing		
Standards		
National/international GAAP	Identify accounting standard used. Comply with local practices and use consolidated accounting (annually) for all subsidiaries in which sizable ownership exists.	Companies should establish an accounting system in accordance with the relevant national statutes, regulations, and the stipulations of the finance authority under the State Council. (CL)
Frequency	Semi-annually audited report at end-FY.	A company shall, after the end of each fiscal year, formulate a financial report and shall have it checked by an accounting firm. (CL)
Audit quality	Independent public accountant. As a best practice, auditors should adhere to the global standards devised by the International Forum on Accountancy Development (IFAD).	N.A.
Off-balance sheet transactions	Listing requirements should specify disclosure of off-balance-sheet transactions in the annual report with	N.A.

	materiality level for disclosure.	
Risk factors/ monitoring procedures	Should be statement from audit committee in reports and accounts addressing business risks. Need a mechanism for review by auditors.	N.A.
Audit committee		
Audit committee	For large firms, must be chaired by qualified independent director with a financial background	Must be chaired by an independent director. The majority of the committee members should be independent directors. (Code) At least one independent director on the committee must be an accounting professional. (Code)
Relationship/communication with internal and external auditors	Committee should approve services provided by external auditor. Breakdown of proportion of fees paid for each service should be made available in annual report. As a best practice, communication with auditors should be without executives present. Contemporaneous provision of audit and non-audit services from the same entity should be prohibited.	The audit committee is required to oversee the interaction between the company's internal and external auditing institutions. (Code)

Transparency of Ownership and Control		
Majority ownership	Significant ownership (20-50% including cross-holdings) is deemed to be control.	The Code does not specify the percentage of share ownership that constitutes control. It calls for a company to disclose, in a timely manner, detailed information about each shareholder who owns a comparatively large percentage of shares of the company, the shareholder who actually controls the company when acting in concert, and the company's actual controllers in accordance with relevant regulations. (Code) "Controlling shareholder" is defined by the Company Law as "a shareholder whose capital contribution to a limited liability company accounts for at least 50% of the company's total capital or whose shareholding accounts for at least 50% of the total share capital of a joint stock company; or a shareholder whose capital contribution or shareholding, although not accounting for 50% is nonetheless, through voting rights attaching to his or her capital contribution or his or her shareholding, able to materially affect the resolutions of the shareholders' meeting or shareholders' general meeting." (CL)

Buyout offer to minority shareholders	Ownership exceeding 35% triggers a buyout offer in which all shareholders are treated equally.	If controlling shareholders increase/ decrease their shareholdings or if the actual control of the company transfers, the company and its controlling shareholders should disclose relevant information to all shareholders in a timely manner (Code). (Note: According to the Securities Law, ownership exceeding 30% triggers a general offer to all shareholders.)
Related-party ownership	Companies should disclose directors' and senior executives' shareholdings, and all insider dealings by directors and senior executives should be disclosed.	Agreements on related-party transactions among listed companies and their connected parties should be disclosed in accordance with relevant regulations. (Code) Major related-party transactions whose total value exceeds RMB 3 million or 5% of the company's net assets should be approved by independent directors before being submitted to the board meeting. (Guideline)
Minimally significant shareholders	Shareholders with minimally significant ownership (greater than 3-10%) of outstanding shares must disclose their holdings	Companies should disclose information about shareholders who own "a comparatively large percentage" of outstanding shares in a timely manner. (Code) A listed company should learn about and disclose in a timely manner changes in the shareholding of the company and other important matters that may cause changes in the shareholding of the company. (Code)

Regulatory Environment		
Enforcement powers	The supervisory authority and the exchange must have adequate enforcement powers. Exchanges should have the power to grant, review, suspend, or terminate the listing of securities. Enforcement authorities should have adequate training and an understanding of the judicial process.	The China Securities Regulatory Commission (CSRC) is responsible for the implementation of the Code and Guideline.
Independence of supervisory body and of exchange	The supervisory body and the exchange should be independent from government and industry	The CSRC is an institution of the State Council of the People's Republic of China. The State Council is the chief civilian administrative body of the People's Republic of China. It is chaired by the Premier and contains the heads of each governmental department and agency.

Members of the IIF Equity Advisory Group

Mr. Edward Baker (Chair)
Chief Investment Officer of Global Emerging Markets
AllianceBernstein, Ltd.

Mr. Khalid Sheikh
Senior Vice President
Emerging Markets Analysis and Multilateral Organizations
ABN AMRO Bank NV

Mr. Bernard Sucher
Managing Director
Alfa Capital

Ms. Sanem Bilgin
South African & Emerging Market Equity Analyst
AllianceBernstein, Ltd.

Mr. Manish Singhai
Principal Portfolio Manager
AllianceBernstein, Ltd.

Mr. Gregory Eckersley
Chief Investment Officer
AllianceBernstein, Ltd.

Mr. Philippe Lespinard
Chief Investment Officer
BNP Paribas

Mr. Andrzej Dorosz
President of the Board
Bank Gospodarstwa Krajowego

Ms. Cheryl Hesse
Vice President and Senior Counsel
Capital Group International, Inc.

Mr. Dipak Rastogi
Vice Chairman, Emerging Markets
Citigroup Investments, Inc.

Mr. Gordon Clancy
Managing Director, Asia Pacific Head
Citigroup Venture Capital

Mr. Gavin Grant
Director, Corporate Governance Research
Deutsche Bank

Mr. Victor L.L. Chu
Chairman
First Eastern Investment Group

Mr. Mark Young
Senior Director, Emerging Markets
Fitch Ratings

Mr. Grzegorz Konieczny
Senior Vice President/Portfolio Manager
Central and Eastern Europe
Franklin Templeton Investment

Mr. Jeremy Paulson-Ellis
Chairman
Genesis Investment Management, Ltd.

Mr. Colin Melvin
Director of Corporate Governance
Hermes Investment Management, Ltd.

Mr. William F. Browder
Chief Executive Officer
Hermitage Capital Management

Mr. Grant P. Felgenhauer
Counsel and Investment Officer
Hermitage Capital Management

Mr. Ibrahim S. Dabdoub
Chief Executive Officer
National Bank of Kuwait, S.A.K.

Mr. Adrian Cowell
Senior Asian Investment Manager and Director
Rexiter Capital Management, Ltd.

Mr. Christopher James
Senior Asian Investment Manager and Director
Rexiter Capital Management, Ltd.

Mr. Kenneth King
Chairman
Rexiter Capital Management, Ltd.

Mr. Paul Emerton
Head of Corporate Governance
Schroders Investment Management, Ltd.

Mr. Dan Kwiatkowski
Equity Analyst
Schroders Investment Management North America

Mr. Richard Firth
Chief Investment Officer
Schroders Korea, Ltd.

Dr. Mina Toksoz
Head of Country Risk
Standard Bank London

Mr. Steve Chae
Vice President
Templeton Asset Management, Ltd.

Mr. Sean Chong
Vice President, Legal & Compliance
Templeton Asset Management, Ltd.

Dr. J. Mark Mobius
President
Portfolio Management - Equity
Templeton Asset Management, Ltd.

Mr. Peter Clapman
Senior Vice President & Chief Counsel
Corporate Governance
TIAA CREF

Ms. Elena Krasnitskaya
Analyst, Corporate Governance
Troika Dialog

Ms. Mary Curtis
Executive Director Strategy
UBS Securities South Africa (Pty) Ltd.

Mr. Damian Fraser
Head of Latin American Strategy & Research
UBS AG

Mr. Mehran Nakhjavani
Executive Director and Co-Head of Emerging Markets, Global Active Equity
UBS Global Asset Management

EAG Task Force Chairs

India, South Africa and Turkey Task Forces
Mr. Edward Baker
Chief Investment Officer of
Global Emerging Markets
AllianceBernstein, Ltd.

China Task Force
Mr. Victor L.L. Chu
Chairman
First Eastern Investment Group

Latin America Task Force
Mr. Jeremy Paulson-Ellis
Chairman
Genesis Investment Management, Ltd.

Russia Task Force
Mr. William Browder
Chief Executive Officer
Hermitage Capital Management

Middle East Task Force
Mr. Ibrahim Dabdoub
Chief Executive Officer
National Bank of Kuwait, S.A.K.

South Korea Task Force
Mr. Kenneth King
Chairman
Rexiter Capital Management, Ltd.

EAG China Task Force Members

Mr. Victor L.L. Chu
Chairman
First Eastern Investment Group

Mr. Manish Singhai
Chief Investment Officer,
Asia ex-Japan Markets
AllianceBernstein, Ltd.

Mr. Keith Savard
Director of Global Economic Analysis
Institute of International Finance

Mr. Kenneth King
Chairman
Rexiter Capital Management, Ltd.

Ms. Karin Ri
Manager, Corporate Governance
Hermes Investment Management, Ltd.

Ms. Rakhi Kumar
Corporate Governance Analyst
Institute of International Finance

Participants in EAG China Task Force Meetings

Chinese Officials and Private Sector Representatives

Mr. Jamie Allen
Secretary General
Asian Corporate Governance Association

Prof. Frederick (Fengming) Song
Independent Director
Board of China Construction Bank

Mr. Ye Weiqiang
Academic Editor
Caijing Magazine

Dr. Lifen Wang
Executive Producer
CCTV

Dr. Jesse Wang
Vice Chairman
Central SAFE Investments Ltd.

Mr. Zhang Lingjia
General Counsel
Central SAFE Investments Ltd.

Mr. Tu Guangshao
Executive Vice-Chairman
China Securities Regulatory Commission

Mr. Jiao Jin hong
Deputy Director-general
China Securities Regulatory Commission

Dr. Donald (Daochi) Tong
Deputy Director-general
China Securities Regulatory Commission

Mr. Xie Shikun
Deputy Director-general
China Securities Regulatory Commission

Mr. Ge Jun
Director, External Relations
China Europe International Business School

Mr. Roger Zhang
Executive Secretary to President
China Europe International Business School

Dr. Gary Liu
Assistant Director, Case Development Center
China Europe International Business School

Ms. Jennifer Liu
Research Assistant, China Centre for Financial Research
China Europe International Business School

Ambassador Wu Jianmin
President
China Foreign Affairs University

Mr. Feng Wei
Deputy Secretary-General
China Foreign Affairs University

Mr. Boming Wang
President
Stock Exchange Executive Council (SEEC)

Mr. Ted T. Lee
Managing Partner, Global Client Services Audit
Deloitte Touche Tohmatsu CPA Ltd.

Mr. Richard McGregor
Beijing Bureau Chief
Financial Times

Mr. Wang Jinzhen
Secretary General
ICC China

Mr. Peter Taylor
Corporate Governance Officer
International Finance Corporation

Dr. Guo Feng
Attorney
Law School of the Central University of Finance & Economics

Mr. Jonathan Woetzel
Director
Chairman, Corporate Finance PRC
McKinsey & Company

Prof. Cheng Siwei
Vice Chairman of the Standing Committee
National People's Congress

Mr. James Kynge
Chief Representative
Pearson

Prof. Jiahe Zhao
Investment Banking & Management Consultant
School of Eco. Mgmt. Tsinghua University

Dr. James Liu
Executive Vice President
Shanghai Stock Exchange

Dr. Kejian Chao
Executive Manager, Global Business Development
Shanghai Stock Exchange

Mr. Cao Jian
Assistant Director, Listing Department
Shanghai Stock Exchange

Dr. Fang Xing-Hai
Deputy Director
Shanghai Municipal Government Financial Services Office

Ms. Kang Yan
Vice President
Shanghai Media & Entertainment Group

Institute of
International
Finance, Inc.

The Global Association
of Financial Institutions

Institute of International Finance, Inc.
1333 H St NW, Suite 800E
Washington, DC 20005
Phone: 202–857–3600
Fax: 202–775–1430
Web: www.iif.com