The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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China Adopts Revised Securities Law

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January 13, 2020 TO: ICI Global Members
Global Operations Advisory Committee
ICI Global Pacific Chapter
ICI Global Regulated Funds Committee SUBJECTS: Compliance
Disclosure
Distribution
International/Global
Investment Advisers
Litigation & Enforcement
Trading and Markets RE: China Adopts Revised Securities Law

China's National People's Congress Standing Committee passed the People's Republic of China Securities Law (Revised) 2019[1] on December 28, 2019 ("Revised Securities Law"). The Securities Law was first promulgated in December 1998. It was substantially revised in 2005. This is the second substantial revision.

Major substantive changes in the Revised Securities Law include: (i) broadening of the definition of securities, (ii) reform of China's public offering of securities regime (including IPOs) from merit-based to disclosure-based, (iii) disclosure of securities ownership interests in voting shares of publicly listed companies at an initial threshold of 5% and, thereafter, at increments up and down of 1%, and (iv) enhancement of investor protection. This memo will give a brief explanation of each of these items. We would like to draw members' attention particularly to the third item above as it is directly relevant to their investment operations in China.

The revised Securities Law will come into effect on March 1, 2020.

1. Broadening of Definition of Securities

In addition to stocks, corporate bonds, and other securities designated by the State Council, the Revised Securities Law has expanded the definition of securities to include depositary receipts. The trading of government bonds and units in securities investment funds is also subject to the Revised Securities Law. However, the issue and trading of asset-backed securities and asset management products are not governed under this law. The State Council will make separate rules, based on the principles set down in the Revised Securities Law. This suggests that asset management products (for example, mutual funds issued by asset managers, and other asset/wealth management products issued by banks and insurance companies) would likely continue to be regulated by different regulators, although the rules to which they are subject may converge to remove regulatory arbitrage.

2. Reform of Public Offerings Regime

All public[2] offerings of securities (both IPOs and subsequent offerings) will move from a merit-based approval regime to a disclosure-based registration regime. The old law required an IPO applicant to satisfy the approval authority that the company had the ability to continue to be profitable. This qualitative requirement is now replaced by the quantitative requirement that the company has the ability to continue its operations.

For protection of investors, the Revised Securities Law provides that the securities market regulator has the power to order issuers and controlling shareholders who are responsible for fraudulent disclosures or concealment of significant facts in the prospectus/offering document to fully compensate investors by repurchasing the securities that the investors had bought (section 24). Where sponsors and underwriters are responsible for fraudulent or misleading disclosures or significant omissions (section 29), they are also responsible for making compensation to investors.

3. Disclosure of Securities Ownership Interests

Where an investor's ownership interest, whether held individually or jointly with others pursuant to agreements or other arrangements, in the voting shares of a listed company reaches 5%, the investor must report in writing to the China Securities Regulatory Commission (CSRC) and the stock exchange, and also inform the listed company, all within three days from the date on which the change occurred. During the notice period, the investor is prohibited from trading the shares of the relevant company. The investor is then under the obligation to report to the listed company and make a public announcement upon every 1% increase or decrease in ownership interest, on the day following the occurrence of that increase or decrease. The investor is not prohibited from trading the shares of the listed company during the one-day notice period.

4. Enhancement of Investor Protection

The Revised Securities Law introduces the concept of suitability (section 88). When selling securities or providing services, securities companies must understand their clients' financial circumstances, investment experience, *etc.*;fully explain the risks of the relevant investments; and recommend securities and services that are suitable having regard to the client's circumstances. Breach of this duty could expose the securities company to the obligation of compensation.

The revised legislation also allows "representative actions" (section 95). Provided that the subject matter of their legal action for civil damages is the same, investors may choose a representative to bring a civil action on their behalf. In any such action, where it appears to the court that there may be other investors with the same complaint, the court may issue a public notice to all potential claimants inviting them to register their case with the court. Any judgment issued by the court in favor of the plaintiffs will be equally effective with respect to these registrants. The Revised Securities Law further provides that the Investor Protection Institute (IPI) may, upon being requested by at least 50 investors to act as their litigation representative, bring a civil action on their behalf. In addition, the IPI also has the power to register with the court as additional plaintiffs (claimants) other investors whose interests are verified by the securities registration and clearing institute.

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endnotes

[1] The Revised Securities Law (available in Chinese) is available at: http://neris.csrc.gov.cn/falvfagui/rdqsHeader/mainbody?navbarId=1&secFutrsLawId=0fc431a2a10b47909beef058f6ac3335

[2] An issue of securities to over 200 designated recipients constitutes a public offer.