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Legal Updates

CBRC Financial Leasing: Is the Door still Open to Foreign Investors? (Authors: James WANG, Shu WANG, Fang JI, Sean JIANG)

This legal commentary (this "**Legal Commentary**") aims to provide foreign investors interested in establishing and operating financial leasing companies ("**CBRC FLCs**" or "金融租赁公司") regulated by the China Banking Regulatory Commission (the "**CBRC**") in the People's Republic of China (the "**PRC**", for the purpose of this Memo, the "PRC" excludes Hong Kong, Macau and Taiwan) with a general introduction of the applicable legal regime and current approval practices of the CBRC.

1. Overview of the Legal Regime Applicable to CBRC FLCs

The establishment and operation of CBRC FLCs are mainly governed by the following PRC regulations:

- the *Measures for the Administration of Financial Leasing Companies* ("**Measure 1**") promulgated by the CBRC on January 23, 2007; and
- the *Implementation Rules for Administrative Approvals for Non-Banking Financial Institutions* ("**Rule 13**") promulgated by the CBRC on August 3, 2007.

Pursuant to Measure 1, CBRC FLCs are non-bank financial institutions approved by the CBRC that engage primarily in the business of Financial Lease (as defined below). "**Financial Lease**" ("融资租赁") refer to transactions whereby the lessor, based on the lessee's selection or confirmation of the supplier(s) and the leased goods, purchases the leased goods from the supplier(s) and leases the same to the lessee. The lessee will occupy and use the leased goods in accordance with the leasing contract and pays rent to the lessor. According to Measure 1, properties suitable for Financial Lease shall be fixed assets.

Your attention is drawn to the difference between the CBRC FLCs established under Measure 1 and the foreign-invested financial leasing companies ("**MOFCOM FLCs**" or "外商投资融资租赁公司") established under the *Management Measures on Foreign Investments in the Leasing Industry* ("**Notice 5**") promulgated by the Ministry of Commerce ("**MOFCOM**") on February 3, 2005. CBRC FLCs are financial institutions that will be issued a financial license (the "**Financial License**", "金融许可证") after its commencement of business, whereas MOFCOM FLCs are not financial institutions and could not obtain a Financial License. Indeed, CBRC FLCs and MOFCOM FLCs are subject to different sets of regulatory regimes and are administered by different government bodies, i.e., CBRC and MOFCOM, respectively. As compared to MOFCOM FLCs, CBRC FLCs are more heavily regulated and supervised. On the other hand, CBRC FLCs also enjoy certain advantages, such as a wider permitted business scope (please refer to Section 4 below). As of the end of 2012, a total

of 20 CBRC FLCs have been approved by the CBRC.

2. Foreign Investment in CBRC FLCs

Foreign investments in CBRC FLCs used to be a restricted sector under the 2007 version of the *Foreign Investment Industries Guidance Catalogue* (the "**Catalogue**"). The new Catalogue, which was issued by the National Development and Reform Commission ("**NDRC**") and the MOFCOM on December 24, 2011 and effective as of January 30, 2012, reclassifies foreign investment in CBRC FLCs from the "restricted" category into the "permitted" one. Thus, foreign investments in CBRC FLCs are now classified as a permitted sector under the new Catalogue. It is still unclear whether this important change will have a positive impact on CBRC's attitude towards foreign investments in CBRC FLCs. Nevertheless, foreign investment in CBRC FLCs is still subject to strict restriction in practice.

The *Measures for the Administration of Equity Investment by Overseas Financial Institutions in Chinese-invested Financial Institutions* ("**Circular 6**") promulgated by the CBRC on December 5, 2003 provides the following restrictions on foreign investments in Chinese financial institutions, (i) a single foreign investor may not hold more than 20% of the equity interest in a Chinese-invested financial institution; and (ii) where the aggregate equity interests held by foreign investors is 25% or more, a non-listed financial institution will be regulated as a foreign-invested financial institution.

Although Measure 1 actually allows foreign investors to act as a principle investor in a CBRC FLC by specifying the relevant qualification requirements (see Section 3.1(a) below), in practice, the CBRC is extremely conservative with respect to foreign investment in CBRC FLCs. Presently, there are very few, if any, CBRC FLCs with foreign investments. In addition, the CBRC, based on Circular 6, has never approved any CBRC FLCs with an aggregate foreign investment of 25% or more. The first CBRC FLC with foreign investment, CCB Financial Leasing Corporation Limited ("**CCB Leasing**", Han Kun attorneys represented Bank of America in its equity investment into CCB Leasing), has just announced the transfer of the 24.9% equity interest previously held by Bank of America to its Chinese shareholder, China Construction Bank, making CCB Leasing a fully owned subsidiary of China Construction Bank.

Furthermore, please note that commencing from the second half of 2012, the CBRC has effectively suspended its approval for the establishment of any new CBRC FLCs, whether foreign invested or not. As such, it is very difficult in practice at this time to establish a CBRC FLC with foreign investment. We will watch closely CBRC's practice in approving foreign-invested CBRC FLCs and keep you updated .

3. Conditions for Establishing CBRC FLCs

3.1 Qualification Requirements for Investors

Pursuant to Measure 1, the investors of a CBRC FLC should consist of one principal

investor and several general investors. The principal investor should contribute more than 50% of the registered capital of a CBRC FLC, while all other investors of a CBRC FLC are classified as general investors.

(a) Qualification Requirements for the Principal Investors

Pursuant to Article 9 of Measure 1, the principal investor of a CBRC FLC can be a commercial bank, whether registered domestically or overseas; a leasing company, whether registered domestically or overseas; a domestically registered large-scale enterprise that mainly engages in the manufacturing of products suitable for financial leasing and other financial institutions approved by the CBRC. The qualification requirements for the different categories of principal investors are set out below:

(i) Domestically and Overseas Registered Commercial Banks:

- Capital adequacy ratio: The capital adequacy ratio of the bank should conform to the local regulatory requirements at the place where the bank is registered and should in no event be less than 8%;
- Total assets: The total assets of the bank at the end of the immediately preceding year should be no less than RMB 80 billion or an equivalent amount in a freely convertible foreign currency;
- Continued profitability: The bank should have been profitable for the last two consecutive years;
- Legal compliance: The bank should comply with the local laws and regulations at its place of registration and should not have been involved in any major cases or committed any serious violations of the laws or regulations during the immediately preceding two years;
- Sound corporate governance: The bank should have a well-established corporate governance structure, internal control system and sound risk management system;
- Requirements for foreign commercial banks: The jurisdiction where such bank is incorporated should have sophisticated financial supervisory and regulatory legal regime, and should be in good economic conditions; and
- Other conditions of prudence: The bank should meet other conditions of prudence specified by the CBRC.

(ii) Domestically and Overseas Registered Leasing Companies:

- Total assets: The total assets of the leasing company at the end of the immediately preceding year should be no less than RMB 10 billion or an equivalent amount in a freely convertible foreign currency;
- Continued profitability: The leasing company should be profitable for the last

two consecutive years;

- Legal compliance: The leasing company should comply with the local laws and regulations at its place of registration and should not have been involved in any major cases or committed any serious violations of the laws or regulations during the immediately preceding two years;
- Requirements for foreign leasing companies: The jurisdiction where such leasing company is incorporated should be in good economic conditions; and
- Other conditions of prudence: The leasing company should meet other conditions of prudence specified by the CBRC.

(iii) Chinese Large-scale Manufacturing Enterprises:

- Sales revenue: The sales revenue of the enterprise for the immediately preceding year should be no less than RMB 5 billion or an equivalent amount in a freely convertible foreign currency;
- Continued profitability: The enterprise should be profitable for the last two consecutive years;
- Net asset: The ratio of net assets of the enterprise at the end of the immediately preceding year should be no less than 30% (on a consolidated basis);
- Sales revenue of principal business: The sales revenue of the enterprise from its principal business should account for more than 80% of the total sales revenue;
- Good credit records: The enterprise should have good credit records;
- Legal compliance: The enterprise should comply with the PRC laws and regulations and should not have been involved in any major cases or committed any serious violations of the laws or regulations during the immediately preceding two years; and
- Other conditions of prudence: The enterprise should meet other conditions of prudence specified by the CBRC.

(b) Qualification Requirements for the General Investors

Any person fulfilling the qualification requirements for principal investors can also serve as a general investor in CBRC FLCs. In addition, other domestic and foreign financial institutions (not limited to banks or leasing companies) as well as domestic non-financial institutions (not limited to large-scale manufacturing enterprises) may also act as general investors for CBRC FLCs, provided that they satisfy a less stringent qualification requirement. In particular, foreign investors acting as a general investor must be a financial institution, and should meet the following

conditions:

- Total assets: The total assets at the end of the immediately preceding year should in principle be no less than RMB 1 billion;
- Continued profitability: The financial institution should have been profitable for the last two consecutive years;
- Capital adequacy ratio: If the financial institution is a commercial bank, the capital adequacy ratio of the bank should not be less than 8%; for other financial institutions, they must conform to the local prudential regulatory requirements at its jurisdiction of registration;
- Internal control system: The financial institution should have sound and effective internal control system;
- Sophisticated local regulatory regime: The jurisdiction where such financial institution is registered should have sophisticated financial supervisory and regulatory legal regime;
- Good economic condition: The jurisdiction where such leasing company is incorporated should be in good economic conditions; and
- Other conditions of prudence: The financial institution should meet other conditions of prudence specified by the CBRC.

In addition, the general investors should undertake not to (i) transfer the equity interest held in CBRC FLCs (except as ordered by the CBRC); (ii) pledge such equity interest; or (iii) establish a trust on such equity interest, in each case within three years. Such undertakings of the general investors should be explicitly stated in the articles of association of the CBRC FLCs.

3.2 Other Establishment Conditions

(a) Registered Capital

The minimum amount of registered capital of a CBRC FLC is RMB 100 million (or the equivalent amount of a freely convertible foreign currency). The registered capital of a CBRC FLC should have been fully paid-in.

(b) Corporate Governance and Place of Business

The proposed CBRC FLC must have its articles of association in compliance with the *PRC Company Law* and Measure 1. Further, the proposed CBRC FLC should also have sound corporate governance, internal control, business operation and risk prevention systems. The proposed CBRC FLC must operate in a proper business premise with safety measures and other business related facilities installed.

(c) Proper Personnel

The directors and senior management of the proposed CBRC FLC should be subject to the approval by the CBRC as regards their qualification to take up such positions.

The proposed CBRC FLC should also be staffed with qualified personnel familiar with the financial leasing business.

3.3 Establishment Procedure for CBRC FLCs

Pursuant to Article 12 of Measure 1, the establishment of a CBRC FLC shall go through the preparation stage ("筹建") and the commencement of business stage ("开业").

4. Permitted Business Scope of CBRC FLCs

Unlike MOFCOM FLCs, a CBRC FLC may, in addition to engaging in the financial leasing activities, carry out the following businesses upon approval by the CBRC:

- Accepting one-year or longer fixed-term deposits from the shareholders;
- Accepting security deposit from lessees;
- Assignment of leasing receivable to commercial banks;
- Issuance of financial bonds upon approval;
- Interbank lending and borrowing;
- Borrowing from financial institutions;
- Foreign exchange borrowing from overseas;
- Remarketing and disposition of residual value of the leased goods;
- Economic consultancy; and/or
- Other businesses as approved by the CBRC.

However, pursuant to Article 23 of Measure 1, CBRC FLCs may not take deposits from its shareholders that are banks.

5. Financial Lease of Special Assets

As CBRC FLCs are permitted to be engaged in the Financial Lease of fixed assets, they are in principle eligible to carry out financial leasing businesses in respect of ships and aircrafts. In practice, many CBRC FLCs conduct such leasing activities through project companies established in free trade zones, in which case additional approvals should be obtained. Please note that the legal regimes with respect to the leasing of ships and aircrafts are very complicated. A legal analysis will highly depend on the structure of each deal, and additional governmental approvals may also be involved. Therefore, a case-by-case analysis would be recommended in relation to the leasing of ships and aircrafts.

As for medical devices, pursuant to the *Reply on the Regulation of Financial Lease of Medical Devices* issued by the State Food and Drug Administration of the PRC ("**SFDA**") on June 1, 2005,

and Article 24 of the *Regulations on Supervision and Administration of Medical Devices* promulgated by the State Council of the PRC on January 4, 2000, CBRC FLCs that wish to carry out the Financial Lease of medical devices should first either make a filing to the drug supervision and administration department at the provincial level or obtain a Medical Device Operating Enterprise Permit from the SFDA.

6. Operation of Financial Leasing Companies

6.1 Material Compliance Issues

Pursuant to Chapter 5 (*Supervision and Administration*) of Measure 1, a CBRC FLC should at all times comply with the following regulatory requirements:

(a) Capital adequacy ratio. The amount of net capital of a CBRC FLC should not be lower than 8% of the risk-weighted assets;

(b) Financial concentration to a single customer. The balance of financing (after deducting the amount of security deposit) to a single lessee should not exceed 30% of the CBRC FLC's net capital;

(c) Degree of affiliation with a single customer. The balance of financing to an affiliated party of the CBRC FLC should not exceed 30% of its net capital;

(d) Degree of affiliation with customers of the same group. The balance of financing to all affiliated parties of the CBRC FLC should not exceed 50% of its net capital; and

(e) Inter-bank borrowing ratio. The balance of inter-bank borrowing of CBRC FLCs should not exceed 100% of its net capital.

The CBRC may make appropriate adjustments to the restrictions above from time to time in light of the actual needs of its regulatory works.

6.2 Material Changes

Pursuant to Article 17 of Measure 1, the following changes to a CBRC FLC shall require prior approval from the CBRC:

(a) Name change;

(b) Change of organization type;

(c) Adjustment to business scope;

(d) Change in registered capital;

(e) Change in equity;

(f) Amendment to its articles of association;

(g) Change in registered place or business premises;

(h) Change in directors and senior executives;

(i) Merger and division; or

(j) Other changes as specified by the CBRC.

6.3 Establishment of Branch Offices

Pursuant to Article 15 of Measure 1, the establishment of any branch office by a CBRC FLC shall be subject to the prior approval by the CBRC.

6.4 Reporting Requirements

Pursuant to Articles 39 to 41 of Measure 1, CBRC FLCs shall comply with the following requirements:

(a) Financial statements: CBRC FLCs should prepare and submit to the CBRC its balance sheet, profit and loss statement, and other financial statements as required by the CBRC. The legal representative and directly responsible persons of the CBRC FLC shall assume legal liabilities for the authenticity of the statements submitted;

(b) Affiliated transactions: CBRC FLCs should submit to the CBRC or its regional offices a report on affiliated transactions of the immediately preceding accounting year within four months after the end of each accounting year. The report should include, among other things, the affiliated parties, types of transactions, amount and subject matters of the transactions, the transaction price and pricing method, profit or loss of the transactions, nature and proportion of the affiliated party's rights and interests in the transactions; and

(c) Audit report: CBRC FLCs should develop a system for regular external audits and submit the annual audit report signed by its legal representative within four months after the end of each accounting year to the CBRC and its regional offices.

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Legal Updates

1. Overview of the EIT Treatment on Interest Income Earned by QFIIs and RQFIIs (Authors: James WANG, Fang JI, Li YANG)

On March 4, 2013, the Shenzhen branch of the China Securities Depository and Clearing Company Limited ("**CSDCC**") issued the *Notice on Payment of After-tax Bond Interest to QFIIs (RQFIIs)*[1] *(Zhong Guo Jie Suan Shen Ye Zi [2013] No.6)* ("**Notice**"). The Notice states that according to the *Provisional Measures on the Administration of Withholding at Source of Income Tax of Non-resident Enterprises (Guo Shui Fa [2009] No.3)* ("**Circular 3**"), bond interests obtained by QFIIs and RQFIIs are subject to an Enterprise Income Tax ("**EIT**"), and bond issuers are the withholding agent ("**Withholding Agent**") for such EIT. Accordingly, the Shenzhen branch of the CSDCC specifies that it would generally pay after-tax bond interests when carrying out payments to those claims registered after March 1, 2013. The EIT withheld would be returned to the relevant bond issuers, and then be paid directly to the local tax authorities by the bond issuers.

By adopting this withholding approach, it can be ensured that the tax on the interest income of QFIIs and RQFIIs can be withheld in a timely manner in accordance with Circular 3 as well as other relevant tax laws and regulations. This commentary hereby briefly summarizes the relevant laws, regulations, and policies of the People's Republic of China (the "**PRC**" or "**China**") in relation to the withholding of the EIT on the interest income of both QFIIs and RQFIIs.

Tax Treatment of QFIIs and RQFIIs' Interest Income

Under the *Law of the PRC on Enterprise Income Tax* that came into effect on January 1, 2008 (the "**New EIT Law**"), enterprises are divided into resident and non-resident enterprises. According to the New EIT Law, a non-resident enterprise refers to an enterprise lawfully incorporated pursuant to the laws of a foreign country/region, which is not effectively managed in China and either (i) has set up an establishment/place of business within the PRC or (ii) derives PRC-sourced income despite the lack of an establishment/place of business within the PRC. Pursuant to the *Measures on the Administration of Domestic Securities Investment by QFIIs* and the *Pilot Measures on Domestic Securities Investments by RQFIIs for Fund Management Companies and Securities Companies,* only institutions incorporated outside the territory of the PRC may be eligible to be QFIIs or RQFIIs, and the QFIIs and RQFIIs' place of effective management is usually located outside of China. Therefore, QFIIs and RQFIIs may in principle be recognized as non-resident enterprises defined in the New EIT Law.

[1] QFII is the abbreviation for "Qualified Foreign Institutional Investor," and RQFII stands for "RMB (Renminbi) Qualified Foreign Institutional Investor."

According to the New EIT Law, non-resident enterprises are subject to EIT on its China sourced income in the absence of an establishment/place of business in China. Non-resident enterprises' China-sourced income includes dividends and interests it received from domestic investees. Pursuant to the New EIT Law and its implementing rules, the total amount of China-sourced interest income derived by a non-resident taxpayer shall be subject to an EIT at the rate of 10%. The *Notice on Relevant Issues Regarding the Withholding of Enterprise Income Tax on Dividends, Bonuses, and Interests Paid by Chinese Resident Enterprises to QFIIs* (Guo Shui Han [2009] No. 47) ("**Circular 47**"), which was promulgated by the State Administration of Taxation (the "**SAT**") on January 23, 2009, has further clarified that QFIIs are liable to a 10% withholding EIT for their dividends and interests income derived from China in accordance with the New EIT Law. In the event that the relevant tax treaties/arrangements between the QFIIs' resident jurisdiction and the PRC provide for a more preferential tax rate or withholding arrangement with respect to dividends and interests, the QFIIs may apply to the relevant tax authorities in order to benefit from such treatment. Circular 47 should be applicable to RQFIIs as well.

EIT Withholding Mechanisms on the Interest Income of QFIIs

Pursuant to the New EIT Law and Circular 3, the EIT on the China-sourced income of non-resident enterprises should be withheld at the source of the income. The Chinese payer (either obligated to pay the non-resident enterprise by law or contractual arrangement) should act as the Withholding Agent, and withhold and deduct the EIT payable by the non-resident enterprise from the relevant payment. The Withholding Agent should file and pay the EIT withheld to the relevant tax authorities within 7 days from the date of withholding, together with the submission of an "EIT Withholding Report" and other relevant documents. The SAT further specifies in Circular 47 that the bond issuers should withhold the EIT charged on the China-sourced interest income of QFIIs when such interest is paid or becomes payable.

In practice, bond issuers often entrust the CSDCC to handle bond interest payments. Pursuant to the CSDCC's *Rules on Bond Registration, Depository, and Clearing Business*, after the full amount of interests payable to bond holders and the service fees payable to the CSDCC have been transferred by bond issuers to the CSDCC designated bank account, the CSDCC shall pay the interest to the relevant securities companies and other institutions ("**Redemption Institutions**") through a fund clearing system. Thereafter the bondholders may withdraw the interest from the Redemption Institutions. In the CSDCC's *Implementing Rules for Registration and Settlement of Domestic Securities Investments of QFIIs*, it specifies that the interests payable to QFIIs would firstly be paid to the Custodian Banks of QFIIs, which will then distribute the interests to the relevant QFIIs.

The Notice specifies that the Shenzhen branch of the CSDCC will withhold the EIT when paying bond interests to the Custodian Banks of QFIIs. However, as the bond issuers themselves are the statutory Withholding Agents for the EIT withheld, the Shenzhen branch of the CSDCC would return

the EIT withheld to the bond issuers to allow the bond issuers to directly pay the withheld EIT to the relevant tax authorities.

Having the CSDCC, a professional institution, withhold the EIT payables of QFIIs and RQFIIs could relieve the bond issuers from the burden of calculating and withholding the relevant taxes. It could also help avoid improper withholding practices (e.g. failures to withhold the relevant taxes in a timely manner, wrongful calculation of applicable taxes, etc.) due to the bond issuers' ignorance of the relevant tax laws and regulations. Such arrangement could prevent the government from losing its tax revenue. In addition, it is also helpful for QFIIs and RQFIIs to apply for a Tax Certificate for Outbound Payment,[2], when the custodian banks release the payment.

It should be noted that Circular 3 requires the Withholding Agent to pay the EIT withheld to the relevant tax authorities within 7 days from the date when the taxes are withheld. As it may take extra time for the CSDCC to return the EIT withheld to the competent bond issuers, the issuers shall promptly pay the withheld EIT to the appropriate tax authorities upon receiving the EIT returned by the CSDCC. Although the Notice does not contain any provisions regarding business taxes or surcharges, the interest income of QFIIs and RQFIIs is also subject to those taxes. Thus, the bond issuers may still have to withhold those taxes in practice. According to the relevant regulations, the Notice may only apply when an enterprise listed in the Shenzhen Securities Exchange entrusts the Shenzhen branch of the CRDCC to handle its bond interests payment. When an enterprise listed in the Shanghai Securities Exchange entrusts the Shanghai branch of the CRDCC to handle its bond interest payment, the tax withholding mechanism would be determined in accordance with the relevant regulations provided by the Shanghai branch of the CRDCC.

2. Analysis of New RQFII Rules (Authors: James WANG, Sheldon CHEN)

On March 6, 2013, the China Securities Regulatory Commission released the *Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* and its implementation regulation (the "**New RQFII Rules**"), signifying that the RQFII Pilot Program has entered into a new phase of development. Compared with the *Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* and its implementing regulation (the "**Original RQFII Rules**"), the New RQFII Rules have mainly expanded the scope of pilot institutions, relaxed restrictions on the scope of permissible investment products, and simplified application qualifications and

[2] According to *the Notice of the State Administration of Foreign Exchange and the State Administration of Taxation on Issues relating to the Provision of Tax Certificate for Outbound Payments under Service Trade, and etc. (Hui Fa [2008] 64),* where domestic organizations or individuals intend to make a single-sum of bond interest payment or certain other kinds of payment equivalent to more than US$30,000 (excluding US$30,000 equivalent) to foreign parties, it shall apply for a "Tax Certificate for Outbound Payments under Service Trade, Gains, Current Transfers and Certain Capital Projects" with the relevant tax authorities pursuant to the relevant State provisions. This "Tax Certificate" confirms the full payment of the relevant PRC taxes on the income to be repatriated.

documents.

Expand the Scope of Pilot Institutions

Pursuant to the New RQFII Rules, the pilot institutions have been currently extended to include Hong Kong subsidiaries of Mainland Chinese commercial banks and insurance companies, as well as financial institutions that are registered and have major operations in Hong Kong. Under the Original RQFII Rules, pilot institutions were limited to Hong Kong subsidiaries of Mainland Chinese investment funds and securities brokerages.

The involvement of more types of pilot institutions will help to promote positive competition as well as further development of the RQFII Pilot Program.

Relax Restrictions on the Scope of Permissible Investment Products

The New RQFII Rules have removed restrictions on the proportion of investments in equities and fixed income securities previously imposed by the Original RQFII Rules, allowing pilot institutions to allocate the investment quota at their own discretion. Furthermore, the New RQFII Rules have specified stock index futures as one of the permissible RMB investment products.

Following the implementation of the New RQFII Rules, pilot institutions will be allowed to invest 100% of their capital within approved investment quotas in the A share market. This relaxation of investment restrictions reflects the demands of the foreign investors and helps lift the A share market's performance. For the purpose of risk management and control, pilot institutions' shareholding of listed companies shall be subject to the following restrictions under the New RQFII Rules:

a) The shares of a single listed company held by a single pilot institution shall not exceed 10% of the total number of shares of such listed company.; and

b) The shares of any single listed company held by all the pilot institutions in total shall not exceed 30% of the total number of shares of such listed company.

However, the foreign investors who make strategic investments in listed companies under the *Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors* shall not be subject to such restrictions on the shareholding of listed companies.

Simplify Application Qualifications and Required Documents

The New RQFII Rules have removed the requirements under the Original RQFII that an applicant's parent company in the PRC:

a) has the qualifications to engage in securities assets management; and

b) has not been subject to any serious punishments imposed by any regulatory authority at their respective jurisdictions during the past three-year period from the application qualifications for pilot institutions.

The required application documents are also simplified under the New RQFII Rules. The applicant no longer needs to provide:

a) a statement on whether the applicant's parent company in PRC has been subject to punishments by any regulatory authority at their respective jurisdiction during the past three-year period;

b) a statement on the internal control system of the applicant; and

c) a legal opinion.

Furthermore, the draft custodian agreement to be entered into with a custodian in the PRC as required by the Original RQFII Rules will be replaced by the power of attorney to the custodian, which is much simpler.

The New RQFII Rules reflect the demands of the market and foreign investors. Therefore, it can be ascertained that the implementation of the New RQFII Rules will further promote both the opening up of China's domestic capital market as well as RMB internationalization.

3. NPC Standing Committee's Decision to Strengthen Network Information Protection (Authors: Jason WANG, Jialin ZHONG, Li YANG)

On December 28, 2012, the Standing Committee of the 11th National People's Congress passed the *Decision of the Standing Committee of the National People's Congress on Strengthening Network Information Protection* ("**Decision**") during its 30th session. The Decision has been in effect since the date of its promulgation. Prior to the release of the Decision, provisions relating to network information protection in China were scattered throughout various laws, administrative regulations, and administrative rules including but not limited to *Criminal Law*, *Tort Law*, and *Administrative Measures Governing Internet Information Services*.

The Decision has twelve (12) clauses that all regulate issues relating to network information protection such as the scope of protection, the entities to bear obligations and their specific obligations, the remedies to infringement, and the legal liabilities for violating the Decision. The key provisions of the Decision are as follows.

Specifies the Scope of Protected Network Information

The first paragraph of Clause I of the Decision states that "the State protects electronic information

that identifies a citizen and involves a citizen's privacy." This provision specifies that "electronic information" that "identifies a citizen and involves a citizen's privacy" ("**Citizen's Personal Electronic Information**") is the type of network information protected by the Decision.

Prohibits Stealing, Illegally Acquiring, Selling, or Illegally Providing Citizens' Personal Electronic Information

The Decision explicitly prohibits any organization and/or individual from stealing, illegally acquiring, selling, or illegally providing to others Citizens' Personal Electronic Information. This provision applies to "all/any organization(s) and/or individual(s)." While the Decision bans the act of illegally acquiring and/or providing Citizens' Personal Electronic Information, such information may be acquired or provided to others legally under certain situations (refer to Section 4 for more detail).

Prohibits Commercial Electronic Spam Information

The Decision also clearly prohibits any organization and/or individual from sending commercial electronic information to an individual's fixed line telephone, mobile phone, or e-mail box unless the electronic information recipient has agreed to or made a request to receive such information. This prohibition also applies if the recipient explicitly expresses his/her refusal. The primary purpose of this provision is to curb the flood of "audio advertisements," "short spam text messages," "spam email," and other kinds of commercial electronic spam information. This prohibitive provision also applies to "all/any organization(s) and/or individual(s)." Electronic information prohibited from being sent arbitrarily is limited to commercial electronic information.

Regulates the Collection, Utilization, and Preservation of Citizens' Personal Electronic Information in Business Activities

Besides those provisions that apply to all/any organization(s) and individual(s) as described above, the Decision also contains provisions that only apply to specific organizations and individuals. Network service providers as well as other enterprises and public institutions may need to collect, use, and preserve Citizens' Personal Electronic Information during business activities. The Decision acknowledges such needs, and provides certain rules they must follow to make such collection, utilization, and preservation more regulated. Specifically, they shall: (1) follow the principles of lawfulness, reasonableness, and necessity; (2) explicitly state the purpose, method, and scope of collection and/or use of the information; (3) obtain the consent of the those whose information is collected; (4) collect and/or use such information in accordance with the provisions of the relevant laws and regulations, and the agreement of the parties; and (5) make public their policies for collection and/or use.

The Decision requires network service providers as well as other enterprises and public institutions and their employees to keep strictly confidential Citizens' Personal Electronic information collected

during their business activities, and prohibits them from disclosing, falsifying, damaging, selling, or illegally providing such information to others. Moreover, they shall also adopt technical and other necessary measures to ensure information security, and prevent the disclosure, damage, or loss of Citizens' Personal Electronic Information collected during their business activities. They shall immediately adopt remedial measures when information is or may be disclosed, damaged, or lost.

Specifies the Special Obligations of Network Service Providers

In addition to the above-mentioned obligations, network service providers[3] are subject to special obligations relating to network information protection, including:

a) Obligation to Manage the Information Released by Users

The Decision requires network service providers to strengthen their management of information released by their users. Once information prohibited from publication or transmission by laws or regulations is discovered, they shall immediately cease the transmission of such information, adopt measures such as removing and retaining relevant records and reporting to the relevant competent authorities. The *Administrative Measures Governing Internet Information Services* ("**Measures**") issued by the State Council in 2000 has a similar provision requiring all Internet information service[4] providers to manage information transmitted on their respective websites. The difference is that while the Measure requires Internet information service providers to assume this managerial obligation, the Decision imposes such obligation on all network service providers.

b) Obligation to Require Users to Provide Genuine Identification Information

The Decision also states that network service providers providing network access services, fixed-line telephone services, mobile phone services, or information posting services to users shall require the users to provide genuine identification information when signing a contract or when the provision of service is confirmed.

c) Obligation to Cooperate with and Provide Technical Support to Relevant Authorities

According to the Decision, when the relevant authorities perform duties in accordance with the law, network service providers shall cooperate with and provide technical support for them.

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[3] Under the current PRC laws and regulations, there is no clear and unified definition of the term "network service providers." As such, the discussion on the definition of the term still remains at the academic level. Some scholars think that the term "network service providers" refers to any institution that provides information to the public though an information network or provides the services necessary for obtaining network information. Such "network service providers" shall include individual users, Internet service providers, and non-profit organizations that provide facilities, information, or technical services such as intermediary and access services. Depending on the type of service provided, network service providers may be classified into network access service providers, network platform service providers, and network content and product providers.

See http://www.sipo.gov.cn/yl/2011/201102/t20110222_580220.html (last visited on February 22, 2013).

[4] According to the *Administrative Measures Governing Internet Information Services*, the term "Internet information services" is defined as "services providing information to online users through the Internet".

Specifies the Duties of Relevant Authorities for Network Information Protection

The Decision specifies that all relevant authorities shall carry out their duties within the scope of their functions and powers in accordance with law. They shall adopt technical and other necessary measures to prevent, stop, and investigate the criminal act of stealing, illegally acquiring, selling, or illegally providing Citizens' Personal Electronic Information, as well as any other network information-related criminal acts. However, the Decision does not specify the authorities related to network information protection. The particular authorities for network information protection are to be further clarified by more detailed rules/regulations regarding the Decision so that the relevant authorities may better perform their duties.

Specifies Infringement Remedies

According to the Decision, any citizen who discovers network information disclosing an individual's identity, distributing an individual's private information or otherwise infringing on his/her legitimate rights and interests, or whoever suffers harassment from commercial electronic information, has the right to require the network service provider to delete such information or take other measures necessary to stop the infringing act. By contacting network service providers directly and requiring them to stop the infringement, the infringed party may prevent more severe and extensive damages from occurring.

The Decision also provides that in the event of any network information-related illegal or criminal act[5] being discovered, both the party whose legal interests was infringed and any other third parties have the right to report or file a complaint with the relevant authorities and require such authorities to promptly handle any discovered illegal or criminal acts in accordance with the law.

The infringed party may also bring a lawsuit against the infringer according to the relevant laws and regulations. The infringer shall be held accountable for the civil liability of infringement.

Specifies the Legal Liabilities for Violating the Decision

According to the Decision, the legal liabilities for violating the Decision include:

a) Administrative liability. In the event of violating the Decision, administrative punishments that may be imposed include: warnings, fines, confiscating unlawful gains, revoking licenses or cancelling registrations, closing down websites, banning liable employees from engaging in network services business, and recording such employees in social credit files and making public thereof. Any act that constitutes a violation of public security administration shall be given public security administration punishments in accordance with the law.

[5] Such acts can include stealing, illegal acquiring, selling, or illegally providing to others Citizens' Personal Electronic Information.

b) Criminal liability. If such violation constitutes a crime, the offender shall be investigated for criminal liability accordingly.

c) Civil liability. In case of any act violating the Decision infringes on a citizen's civil rights and interests, the offender shall be subject to civil liability in accordance with the law.

It should be noted that the Decision only provides abstract principles on the legal liabilities for violating the Decision. Specific regulation is to be further clarified by the forthcoming detailed regulations/rules. The assumptions of legal liability shall also be determined according to other relevant criminal, administrative, and civil laws and regulations. We will continue keep an eye out for any future developments in the regulations/rules regarding Network Information Protection.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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