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Newsletter

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Legal Updates

1. PRC Legal and Regulatory Requirements for Protecting Personal Information Online (Author: David TANG)

Cybersecurity concerns have become an increasing focus of legislative and regulatory efforts globally. A recent example of this trend is the U.S. Securities and Exchange Commission's ("**SEC**") settlement with Morgan Stanley Smith Barney LLC ("**MSSB**") for USD one million over high-profile allegations that the firm was in violation of the "Safeguards Rule," a provision of U.S. federal law that specifically mandates the protection of customer information by broker-dealers and investment advisers registered with the SEC. The allegations arose from the actions of an MSSB employee whose unauthorized access to MSSB databases compromised approximately 730,000 customer accounts. This case reinforces the notion that companies must be cognizant not only of external threats, but must also maintain robust internal controls and preventative measures.

Whereas U.S. federal law generally focuses on data protection in specific industries, existing legislation in China is more broadly focused and should thus be of concern to any company operating in China which regularly handles or processes user information. Below, we highlight some of the recently enacted laws, the issues about which PRC operating companies should be most concerned, and some thoughtful measures for how to mitigate cybersecurity risk.

Current legal and regulatory approach to the protection of personal information

Company protection of personal user information in China is presently governed by a number of interrelated laws and regulations. The current provisions applicable to the protection of personal user information include: *Administrative Measures for Online Trading, the Law of the People's Republic of China on the Protection of Consumer Rights and Interests*, the *Decision of the Standing Committee of the National People's Congress on Strengthening Network Information Protection, Several Provisions on Regulation of the Order of the Internet Information Service Market,* and *Provisions on Protection of Personal Information of Telecommunication and Internet Users*. Collectively, these laws and regulations require companies that collect or use personal information, particularly with an online component, to protect such information and provide for certain safeguards to ensure information security and prevent information from being compromised or lost. When any information is or may have been compromised or lost, the parties responsible must promptly undertake remedial measures.

The laws and regulations in this area generally apply to "internet information service providers" ("**Providers**"), which may include website operators, and e-commerce, social media, and online game providers, among others. Certain overlapping financial information provisions also apply to

bank financial institutions that are jointly administered by the Ministry of Industry and Information Technology and the People's Bank of China.

Personal user information protection requirements for Providers are wide-ranging

Some of the specific legal and regulatory requirements for Providers with respect to the protection of personal user information include:

- Determining departmental security management responsibilities for personal user information.
- Establishing internal control systems to prevent the unauthorized transfer, disclosure, or any kind of sale of personal user information.
- Carrying out authoritative management of personal user information.
- Examining the batch exporting, copying or destroying of information, and taking data protection measures.
- Properly storing paper media, optical media, electronic media or other forms of media for recording personal information of users, and taking corresponding safe storage measures.
- Examining the connectivity of information systems storing personal user information, and taking anti-hacking and anti-virus measures, etc.
- Recordkeeping with respect to access and use of personal user information.
- Conducting routine internal cybersecurity-related audits, at least once annually.
- Promptly notifying the relevant authority when data breaches are found to have occurred.

The relevant authorities are authorized to examine compliance with the personal information protection measures when undertaking annual operating license inspections, and they may also undertake inspections in the case of complaints or reports of noncompliance. Failure to comply can lead to remediation orders, administrative fines, or even criminal liability in certain instances.

Complying with PRC personal information protection requirements

Based on the current PRC cybersecurity laws with respect to the protection of personal user information, we would suggest that businesses should take reasonable precautions when handling any form of personal information or acting as a manager of personal information for others. Based on our experience, some specific recommendations include:

- Establishing sufficient technical measures and internal protocols to maintain information security and prevent hacking or illegal access, either internally or externally.
- Providing clear disclosures to the providers of information and receive consent (written or electronic) with respect to the collection, use, or transfer of personal user information. Such

consents should be drafted with great care so to allow for flexibility to the extent permissible under the law.

- Restricting the collection, use, and transfer of personal information to that which is within the scope of consent and necessary for business purposes.
- Not transferring without due authorization, or selling, any personal information under any circumstance.
- Promptly notifying concerned parties if material information leaks or hacking has or is suspected to have occurred and take remedial measures accordingly.

Outlook for Cybersecurity Regulation in China

While no fully comprehensive cybersecurity law is currently in force, the PRC government is moving to introduce new laws and regulations to better address cybersecurity concerns such as the proposed Network Security Law, the second draft of which was recently reviewed by the Standing Committee of the National People's Congress and may be formally issued this year. The second draft provides that penalties on activities jeopardizing network security will be further enhanced through measures such as interviews, credit record disclosures and preventing violators of the law from engaging in related businesses. Meanwhile, the second draft contains added provisions, such as stipulating that network operators retain web log files for at least six months, and cooperate with administrative supervision and inspections. Additionally, several supporting measures are proposed in the second draft to strengthen network security, and to further facilitate network security and development through concerted efforts. We are certain that this new law will help to decrease the current complexity of cybersecurity-related supervision. We will continue to monitor the legal and regulatory environment in this area and provide updates as they become available.

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2. AMAC Opens Registration to Wholly/Majority Foreign Owned Private Securities Fund Managers (Authors: James WANG, Autumn WANG, Jiayi XU)

While international private equity and venture capital firms have been managing and operating investment funds in China for many years, their hedge fund brethren have found it difficult if not impossible to participate in China's securities market due to tight regulatory restrictions. Some hedge fund managers tried to tap China's securities market indirectly by collaborating with Chinese asset managers as "investment or technology consultant", thus operating in a regulatory grey area. However, the regulatory landscape for foreign securities fund managers is about to change

significantly with the recent new regulatory guidance from the Assets Management Association of China (**"AMAC"**), China's de facto regulator for the fund industry.

On June 30, 2016, AMAC issued and released the *Q&A Concerning Registration and Filing of Private Funds (X)* (**"Q&A (X)"**), which clearly allows wholly foreign-owned and Sino-foreign joint private securities fund managers that meet certain conditions to manage private funds in accordance with relevant rules. At the same time, Q&A (X) clearly specifies the necessary information that this kind of managers shall provide to AMAC for the purpose of private securities investment fund managers registration.

The release of Q&A (X) marks an important breakthrough on the supervision and regulation of foreign-owned private securities investment fund managers. According to the *Guidance Catalogue of Foreign Investment Industries*, the foreign shareholding of mutual fund managers shall not exceed 49%. Since hedge funds and mutual funds both invest in the secondary securities market, the view of many among the regulators was that the same foreign shareholding restriction should apply to private securities investment fund managers by reference. Thus, while quite a number of wholly foreign-owned or majority foreign-owned private securities fund managers had submitted applications for registration to AMAC, no application was approved. The recently concluded 8th Round China-US Strategic & Economic Dialogue, however, brought forth a commitment to allow qualified wholly or majority foreign-owned securities investment fund managers to apply for registration with AMAC. In a parallel development, in accordance with "Supplement X to the Mainland and Hong Kong Closer Economic Partnership Arrangement" (**"CEPA"**), a Hong Kong-funded financial institution meeting certain conditions is allowed to establish a joint venture fund management company in Mainland China as the majority shareholder. On June 16, 2016, the China Securities Regulatory Commission approved the first majority foreign-owned mutual fund manager (HangSeng Qianhai Fund Management Co. Ltd.), in which Hang Seng Bank holds a 70% stake, the first breakthrough case on the 49% foreign ownership cap for mutual fund managers.

Q&A (X) clearly sets forth the conditions for foreign-invested private securities fund management institutions to be registered as private securities fund managers, including:

(1) The company shall be incorporated within China;

(2) The foreign shareholder shall be a financial institution approved or licensed in the country or region of its domicile, and the securities regulatory authority of the country or region of its domicile shall have signed a memorandum of understanding cooperation on securities regulation with the China Securities Regulatory Commission or its ratified organizations;

(3) The institution and its foreign shareholder shall not have been subject to severe sanction by any regulatory authority or judicial organization;

(4) For private securities fund managers that have de facto foreign controlling persons, the de facto foreign controlling persons shall also meet the conditions (2) and (3).

The implementation of Q&A (X) in practice remains to be seen.

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3. SAIC Promulgates Interim Administrative Measures for Internet Advertising (Authors: Tracy ZHOU, Kaiying WU)

On July 4, 2016, the State Administration for Industry and Commerce of the People's Republic of China ("**SAIC**") promulgated the *Interim Administrative Measures for Internet Advertisements* (the SAIC Order [2016] No. 87) ("**Interim Measures**") so as to regulate advertising activities on the Internet, which will become effective on September 1, 2016.

The Interim Measures mainly specify the scope and restrictions for Internet advertising, and also set forth the responsibilities and obligations for business operators related to Internet advertising, including those business operators that engage in programmatic advertisement buying. Furthermore, the Interim Measures provide for the jurisdiction and handling of Internet advertising law violations.

Scope of Internet Advertising

Internet advertising in the Interim Measures refers to commercial advertising whether in the form of text, images, audio, video or other forms through websites, webpages, web applications and other web media for the purpose of marketing goods or services, directly or indirectly, including:

a. Advertisements for marketing goods or services in the form of text, images, video and others that contain web links;

b. E-mail advertisements for marketing goods or services;

c. Paid search advertisements for marketing goods or services;

d. Advertisements for marketing goods or services that are contained in commercial display materials; where certain information shall be displayed by operators to consumers as required by any laws, rules or regulations, such laws, rules or regulations shall apply;

e. Other commercial advertisements for marketing goods or services through Internet media.

It is worth noting that the Interim Measures clearly define paid search advertising as a specific type of Internet advertising. The Interim Measures also specify that, in addition to the regulations

provided herein, Internet advertising must also conform to the relevant provisions stated in the Advertising Law and other laws and regulations with respect to the content of the advertising, obligations and responsibilities of the operators and tax payment issues.

Restrictions Related to Internet Advertising

The Interim Measures clearly specify a number of restrictions with respect to Internet advertising, including prohibiting Internet advertisements for goods or services that are banned from manufacturing and selling or for which advertising is prohibited by laws and regulations; prohibiting Internet advertisements for prescription drugs and tobacco, and requiring advertisements for certain other goods and services such as health care, drugs, foods formulated for special medical purposes, medical equipment, pesticides, veterinary drugs, and health foods to undergo examination and approval before being released. In addition, the Interim Measures state that the release and publication of advertisements through Internet shall not affect normal use of the network, and pop-up advertisement pages should clearly mark the close button to allow for users to close the page with one click. It is prohibited to force users to click on advertisements by deceptive means, and it is also prohibited to add advertisements or links to advertisements to a user's e-mails without consent. Furthermore, the Interim Measures specify that the Internet advertisements must be in a distinguishable form by being prominently marked as an "advertisement" so that consumers are readily able to identify them as such. The Interim Measures also explicitly require that paid search advertisements must be clearly distinguished from natural search results. According to the previously promulgated *Administrative Provisions on Internet Information Search Services*, Internet information search service providers must also clearly specify the proportional limit for paid search information on webpages.

Responsibilities and Obligations Relevant to Business Operators Related to Internet Advertising

The Interim Measures generally specify the requirements for advertisers, advertising operators and advertising publishers of Internet advertising as below:

a. Internet advertiser shall be responsible for the authenticity of the advertisement content, the identity of the advertiser, administrative permits, the content cited and other certificates required for release of Internet advertisements must be genuine, legitimate and effective; if the advertiser authorizes Internet advertising operator or Internet advertising publisher to release or revise an advertisement, the advertiser must issue a notice to the corresponding service providers.

b. Internet advertising publishers and operators shall, in accordance with relevant state regulations, establish an Internet advertising business registration and management system; verify and file the advertisers' information and make updates on a regular basis, verify relevant

certificates and check the content of advertisements. Publishers and operators may not to design, produce, act as an agent for or publish advertisements with content failing to conform to the requirements or with incomplete documentation, and are required to employ personnel familiar with the advertising laws to review advertisements or, if permitted, set up a special Internet advertisement review department.

The Interim Measures also set forth the obligations of the advertising demand side platform operators, media platform operators, information exchange platform operators and media platform members. When entering into an Internet advertising contract, platform operators and members shall verify the contract counterparty's personal identification documents, real name, address and valid contact information, and they are required to set up a registration file for recording such information and make updates on a regular basis. Besides these requirements, platform operators and members are required to take technical and management measures against illegal advertisements that they know or should know as by removing, blocking, or breaking links to such advertisements.

In addition, the Interim Measures also list the acts of unfair competition that are prohibited in Internet advertising. The Interim Measures specify that Internet information service providers that do not engage in Internet advertising, but merely provide information services for Internet advertising, are also obligated to crack down on illegal advertisements that are released through the use of the provider's information services and which the provider know or should know.

Finally, the Interim Measures define the jurisdiction of the industrial and commercial administrative departments with respect to implementing administrative penalties for illegal Internet advertising activities, and the powers that the departments may employ to investigate and handle illegal advertisements. The Interim Measures also detail penalty provisions for Internet advertising law violations.

Important Announcement

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