



Han Kun Newsletter

Issue 182 (6th edition of 2022)

Legal Updates

- 1. Anti-monopoly Law Amendment Analysis Series– Concentrations of Undertakings: Enhanced Penalties and Transitional Issues**
- 2. CSRC to Accelerate the Mutual Fund Industry Development**

1. Anti-monopoly Law Amendment Analysis Series – Concentrations of Undertakings: Enhanced Penalties and Transitional Issues

Author: Corporate Compliance Division

Introduction

On June 24, 2022, the 13th NPC Standing Committee adopted an amendment to the Anti-monopoly Law at its 35th meeting, following the submission of a second deliberation draft on June 21, 2022. The amendment will enter into force on August 1, 2022. This is the first time the Anti-monopoly Law has been amended since its promulgation 15 years ago and is the legislative outcome of a four-year endeavor by China's lawmakers since the revision work was formally planned in 2018 by the Anti-monopoly Commission of the State Council. The amendment improves existing rules and systems related to antitrust matters by considering previous law enforcement practices, international practices, and new realities in domestic markets. It epitomizes China's stance on formulating and implementing competition rules compatible with a socialist market economy and the government's determination to foster a unified, open, competitive, and orderly market system.

This commentary is the first of a special series that will provide timely and granular analysis of the main changes in the amended Anti-monopoly Law based on all draft amendments and relevant media reports. This commentary addresses a critical aspect in practice regarding the amended Anti-monopoly Law: enhanced penalties for illegal concentrations of undertakings and related transitional issues.

Enhanced penalties for illegal concentrations of undertakings

Based on the draft amendments successively released during the legislative process, it was highly likely that the amended Anti-monopoly Law would impose significantly enhanced penalties against illegal concentrations of undertakings. Specifically, as amended, the Anti-monopoly Law will impose penalties on undertakings that implement illegal concentrations based on whether the illegal concentration has the effect of eliminating or restricting competition. For illegal concentrations that do not have the effect of eliminating or restricting competition, the upper limit of fines will be raised from the current RMB 500,000 to RMB 5 million; for illegal concentrations that may eliminate or restrict competition, the amended law will impose fines of no more than 10% of the violator's sales amount in the preceding year, in addition to existing measures such as ordering violators to cease their concentrations and to return to the status quo ante.

In addition, the amended Anti-monopoly Law will enable antitrust regulators to impose fines between two and five times the upper limits mentioned above in extreme cases of violations, i.e., where the circumstances are particularly serious, the impact is particularly adverse, and the consequences are particularly serious. That is, an undertaking that engages in an especially serious illegal concentration may be subject to a fine of up to 50% of its prior year turnover (with the effect of eliminating or restricting competition) or RMB 25 million (without the effect of eliminating or restricting competition). It is notable, however, that strict conditions must be met for this rule to apply that have yet to be clarified with more

detailed criteria, namely particularly serious circumstances, particularly adverse impact, and particularly serious consequences.

Enhanced penalties in the amended law should not be a surprise. A fine capped at RMB 500,000 is widely regarded as too powerless to deter violations in commercial transactions that can easily involve hundreds of millions of RMB. The introduction of enhanced penalties this time will greatly increase the cost of violations and spur undertakings to attach more importance to compliance issues regarding concentrations to fend off high penalties.

Relevant transitional issues

While a month remains before the amended Anti-monopoly Law takes effect on August 1, undertakings have expressed concern about the transition between the current law and the forthcoming amended version. Particularly, after August 1, which set of rules should be followed when penalizing undeclared transactions completed before the amendment enters into force?

Penalties imposed on concentrations of undertakings are essentially a type of administrative penalty. According to Article 36 of the Law on Administrative Penalty:

“An administrative penalty shall not be imposed for a violation of law that has not been discovered within two years of its commission; where such violation involves the security of a citizen’s life or health, or financial security, and has harmful consequences, the aforesaid period shall be extended to five years, except as otherwise prescribed by law.

The time period prescribed in the preceding paragraph shall be counted from the date on which the violation of law was committed; and if the violation is of a continual or continuous nature, it shall be counted from the date on which the violation is terminated.”

In applying the above provisions to transactions suspected of implementing an illegal concentration, the following questions arise:

First, from which point should the two-year period be counted? For transactions that are suspected of implementing an illegal concentration, if the legal standing and control structure of the entities involved remain unchanged after the transaction is completed, it is likely, at least theoretically, that the illegal concentration would be deemed continuous. Thus, a question exists as to whether illegal concentrations of undertakings are subject to Article 36, paragraph 2, which provides that “if the violation is of a continual or continuous nature, [the time period] shall be counted from the date on which the violation is terminated.”

Second, how should “a violation of law that has not been discovered within two years of its commission” be understood? Transactions suspected of implementing an illegal concentration of undertakings are typically large in scale and normally warrant numerous press releases for promotional purposes. Thus, a question arises as to whether law enforcement discovered the violative circumstances within the two-year time period.

Given the above concerns and questions, except for transactions that occur after the amended Anti-monopoly Law enters into force and transactions that have been issued penalty decisions before it enters

into force, other types of transactions suspected of implementing illegal concentrations still face uncertain legal consequences. Penalty rules for these transactions still need to be clarified by subsequent implementing rules and law enforcement practice. We also expect antitrust regulators to give full consideration to the derogation principle set out in Article 37 of the Law on Administrative Penalty when implementing the amended Anti-monopoly Law, formulating relevant implementation rules, and construing and enforcing relevant statutory provisions.

Conclusion

Fourteen years after the promulgation of the Anti-monopoly Law, the 2022 amendment is a result of China's unremitting efforts to address constantly emerging concerns along its fruitful journey toward making and implementing competition rules compatible with a socialist economy and fostering a unified, open, competitive, and orderly market system. The amended Anti-monopoly Law is bound to exert significant influence on all facets of China's market economy such as corporate compliance and antitrust law enforcement. This commentary will be followed by a special series of articles to give in-depth analysis of the amended Anti-monopoly Law by considering concerns and pain points market players face in their compliance with the country's antitrust laws.

2. CSRC to Accelerate the Mutual Fund Industry Development

Authors: Yin GE | Ellen MAO | Sherry SI | Angela NI

Mutual fund managers have long been important institutional investors in the capital markets. At present, there remain issues to be improved in the mutual fund industry, such as insufficient suitable professional capabilities, culture development weaknesses, and structural imbalances. In light of this, the China Securities Regulatory Commission has put forward the following guiding opinions to promote the developments of the mutual fund industry.

General requirements

Take the interests of investors as the core, and simultaneously promote development and improvement of both the industry and the interests of investors.

Facilitate the professionalization of asset management institutions

1. Support the differentiated development of mutual fund management companies (“FMCs”). Encourage eligible FMCs to set up subsidiaries specializing in publicly offered REITs, private equity investment, fund investment advisory, pension fund financial services, etc. Optimize the trading models of FMCs, switch outsourcing of FMC support operations from pilot to routine practice, and guide FMCs that fail to operate to realize market-oriented exits through applying for license cancellation, mergers and acquisition, reorganization, and other means.
2. Promote the corporate governance of FMCs. Give full play to the supervisory function of independent directors, supervisors, and chief compliance officers. Major shareholders and actual controllers are strictly prohibited from interfering with the daily operation and management of FMCs.
3. Actively promote commercial banks, insurance institutions, securities companies, and other eligible financial institutions to lawfully set up FMCs. Moderately reduce restrictions on the number of FMC licenses held by a single entity and support professional asset management institutions to lawfully apply for mutual fund manager licenses to engage in mutual fund business, such as asset management subsidiaries of securities companies, insurance asset management companies, and bank wealth management subsidiaries.
4. Support high-quality offshore financial institutions with long-term investment intentions to set up FMCs or expand current shareholding ratios, and encourage eligible FMCs to lawfully set up offshore subsidiaries. Expand QDII quotas and continuously promote the mutual recognition of funds between China’s mainland and Hong Kong, support qualified mutual funds to participate in the “Cross-Boundary Wealth Management Connect” business pilot program in the Greater Bay Area and promote the inclusion of stock ETFs in the Stock Connect between China’s mainland and Hong Kong.
5. Supervise FMCs to establish and improve long-term appraisal mechanisms covering key personnel such as senior management and portfolio managers and implement compensation deferral policies.

Encourage FMCs to attempt the implementation of diversified long-term incentive mechanisms with equity, options, restricted equity, dividend rights, etc.

Strengthen overall professional capabilities

6. Improve the investment and research capabilities of FMCs. Encourage FMCs to establish integrated and platform-based investment and research systems with teamwork instead of the “star portfolio managers-based” model. Facilitate FMCs to achieve full-dimensional macro, strategy, industry, and company research coverage.
7. Further strengthen compliance and risk control capabilities. Those illegal behaviors which harm the interests of investors such as “rat trading”, market manipulation, “tunnel” behaviors and unfair trading are strictly prohibited. Promote FMCs to continuously improve comprehensive risk management systems and strengthen the liquidity risk management. Supervise fund managers to conduct regular information system security assessments, stress tests, emergency drills, etc. Encourage FMCs to strengthen capital accumulation and to establish “living wills” and shareholder rescue mechanisms.
8. Encourage product and business innovation, and vigorously promote the development of equity funds, index products, and ETF products. Expand the investment scope and strategies of mutual funds and steadily promote investments in financial derivatives. Support the development of fixed income products for individual investors, develop fund products to match long-term individual pension funds, and continuously strengthen the AUM and risk management of money market funds.

Create a healthy industry environment

9. Cultivate a “compliance, integrity, professionalism and stability” industry culture and enhance personnel training on professional ethics and conducts. Encourage fund managers to comprehensively strengthen integrity risk management in key business steps, including investment research, commission allocation, and sales promotion.
10. Encourage fund managers and fund distributors to strengthen investor suitability management with investor interests as the core. Incorporate into assessment mechanisms the scale of sales retention and investors’ long-term returns. Steadily develop fund advisory business, enhance the accuracy of investor profiles, and focus on the role of advisors.
11. Support qualified fund custodians to carry out mutual fund operation outsourcing business and provide value-added services to funds such as liquidity facilities. Fund rating agencies are encouraged to further play leading roles in fund rating services.
12. Establish a multi-level supplementary pension system based on individual accounts and support more high-qualified fund managers to participate in pension management. Continue to promote insurance, wealth management, trust, and other asset management institutions to increase the proportion of equity investment through direct investment, entrusted investment, and mutual funds investment, etc., with long-cycle assessments.
13. Promote innovation-driven development and economic upgrading and transformation. Encourage

mutual funds to play a professional buy-side role and facilitate reform of the registration-based IPO system. Proactively guide the industry to summarize ESG investment rules, vigorously develop green finance and practice responsible investment concepts.

Constantly improve the effectiveness of regulatory transformation

14. Strengthen the building of industry infrastructure. Improve the quality of data interaction and monitoring and analysis ability of central data exchange platform in mutual fund industry. Accelerate the building of a unified inquiry platform for mutual funds accounts to provide investors with “one-stop” inquiry services called “Fund E-Account”. Improve the building of information platforms for individual pension funds to invest in mutual funds and explore sources for OTC investors to invest in publicly offered REITs and other investment instruments.
15. Accelerate regulatory transformation. Clarify the boundaries of regulatory responsibilities and adhere to “look-through supervision and full-chain accountability”. Use a combination of various penalties to fight against illegal activities such as monetary fines, qualification cancellations, and reputation penalties.
16. Continuously improve supervision efficiency. Integrate supervision processes with technology and further optimize the funds registration mechanism and the fund manager classification and evaluation mechanism, and distinguishably implement incentive, prudential and restrictive measures.

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.

If you have any questions regarding this publication, please contact:

| | | |
|------------------|-------------------|--------------------------|
| Beijing | Wenyu JIN | Attorney-at-law |
| | Tel: | +86 10 8525 5557 |
| | Email: | wenyu.jin@hankunlaw.com |
| <hr/> | | |
| Shanghai | Yinshi CAO | Attorney-at-law |
| | Tel: | +86 21 6080 0980 |
| | Email: | yinshi.cao@hankunlaw.com |
| <hr/> | | |
| Shenzhen | Jason WANG | Attorney-at-law |
| | Tel: | +86 755 3680 6518 |
| | Email: | jason.wang@hankunlaw.com |
| <hr/> | | |
| Haikou | Jun ZHU | Attorney-at-law |
| | Tel: | +86 898 3665 5000 |
| | Email: | jun.zhu@hankunlaw.com |
| <hr/> | | |
| Hong Kong | Dafei CHEN | Attorney-at-law |
| | Tel: | +852 2820 5616 |
| | Email: | dafei.chen@hankunlaw.com |
