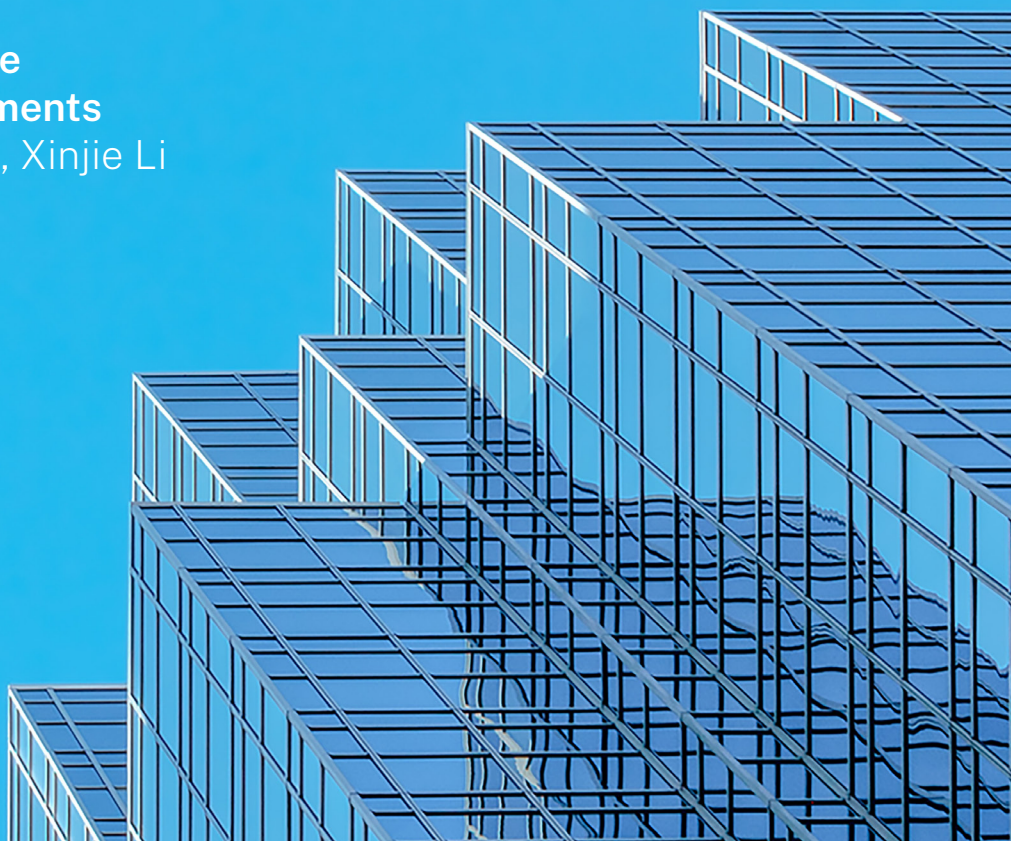

CHAMBERS GLOBAL PRACTICE GUIDES

Corporate Governance 2026

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China: Law and Practice & Trends and Developments

Chen Ma, Michelle Gon, Xinjie Li
and John Fitzpatrick
Han Kun Law Offices



CHINA

Law and Practice

Contributed by:

Chen Ma, Michelle Gon, Xinjie Li and John Fitzpatrick
Han Kun Law Offices

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Han Kun Law Offices is a leading full-service Chinese law firm specialising in complex domestic and cross-border transactions, banking and finance, compliance, intellectual property and dispute resolution. The firm's main practice areas include private equity, mergers and acquisitions, international and domestic capital markets, investment funds, asset management, compliance and investigation, banking and finance, aviation finance, foreign direct investment, antitrust/competition, data protection, private

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Authors



Chen Ma has almost 30 years of law practice experience, a veteran antitrust practitioner who has represented many multinational companies in high-profile merger filings and government antitrust

investigations. He has also argued a high-profile antitrust case before the Supreme People's Court of China. Before joining Han Kun in 2014, Mr Ma was a partner at Chinese law firms and an associate lawyer at several leading international law firms in their New York and Hong Kong offices. He actively participates in a variety of competition law legislative and rule-making efforts in China. Mr Ma also teaches as an adjunct professor at his alma mater, the University of International Business and Economics in Beijing.



Michelle Gon is a senior attorney with more than three decades of experience in the Greater China markets, helping multinational clients. She focuses her practice on representing clients in complicated

and challenging compliance and regulatory matters, including export control and sanctions, trade secret protection, anti-corruption, anti-dumping, anti-subsidy, anti-unfair competition, anti-monopoly, anti-fraud, export control and trade sanction areas. Most clients are leading MNCs doing business in China, or large, China-based MNCs doing business globally, across a wide range of sectors, including pharmaceuticals, medical devices, life sciences, healthcare, agriculture, food-related products, wine and spirits, hospitality, cruise lines, manufacturing, IT and high tech. Michelle previously held senior roles at other leading international law firms.



Xinjie Li focuses his practice on corporate compliance, data privacy, and foreign direct investment. He conducts internal investigations for multinational companies, including those concerning vendors and

company employee conflicts of interest, self-dealing, the UK Bribery Act, and the US Foreign Corrupt Practices Act. In addition, Mr Li often counsels clients on compliance matters relating to cybersecurity and data and personal information protection. He also advises multinational companies on their investments, acquisitions and daily business operations in China.



John Fitzpatrick focuses on compliance and risk management. He assists foreign investors to navigate the complexities of doing business in China, particularly with respect to data compliance, general corporate

compliance, and contract and document reviews. In addition, John assists the firm's corporate practice with internal investigative and corruption-related inquiries. He has worked with clients in the consulting, technology, retail, and automotive industries, amongst others. Prior to joining Han Kun, John worked at AllBright Law Offices in Shanghai. He holds a US Bar licence, is a certified public accountant, and also has previous Big Four accounting experience in the USA.

Han Kun Law Offices

9/F, Office Tower C1
Oriental Plaza
1 East Chang An Ave
Beijing
PRC

Tel: +86 10 8525 5500
Fax: +86 10 8525 5511
Email: beijing@hankunlaw.com
Web: www.hankunlaw.com



1. Corporate Governance Requirements

1.1 Corporate Forms and Governance Requirements

The principal forms of business organisation in China include the limited liability company (LLC) and the joint stock limited company. The LLC is the most common choice for private enterprises and foreign investors due to its flexible governance structure and lower administrative cost. Larger enterprises generally select the joint-stock company form, particularly those that intend to list on public stock exchanges, as their equity is divided into equal shares.

Beyond these forms, investors may also establish partnerships, which are further classified as general partnerships and limited partnerships. Limited partnerships are frequently utilised by private equity and venture capital funds to separate investment management from passive capital contributions. Each organisational form is governed by specific statutes, primarily the PRC Company Law and the PRC Partnership Enterprise Law, which dictate their respective internal governance frameworks.

1.2 Corporate Governance Legislation and Regulation

The primary source of corporate governance requirements in China is the PRC Company Law, which underwent a significant overhaul effective July 2024. This legislation establishes the fundamental “three-tier” governance structure comprising the shareholders’ meeting, the board of directors (or a single director for smaller companies), and the board of

supervisors (or audit committee). The law defines the fiduciary duties of loyalty and care that a company’s directors, supervisors and senior management owe to the company.

In addition to statutory law, governance is shaped by administrative regulations issued by the State Council and departmental rules from the State Administration for Market Regulation (SAMR). For state-owned enterprises (SOEs), the requirements are further influenced by policies from the State-owned Assets Supervision and Administration Commission (SASAC). Furthermore, a company’s articles of association serve as a critical, private contractual source of governance, allowing shareholders to tailor voting rights and management powers within the bounds of mandatory law.

1.3 Companies With Publicly Traded Shares

Publicly traded companies in China, primarily those listed on the Shanghai, Shenzhen and Beijing stock exchanges, are subject to more stringent and transparent governance standards. These requirements are largely administered by the China Securities Regulatory Commission (CSRC) and the respective stock exchanges. Key regulatory instruments include the Code of Corporate Governance for Listed Companies and various listing rules, which mandate specific board compositions and disclosure protocols.

The requirements for listed companies are mandatory and constitute a prerequisite for maintaining a listing status. Key mandatory features include the following.

- Independent directors – A requirement for a minimum proportion of independent directors on the

board to oversee related-party transactions and audit functions.

- Special committees – The mandatory establishment of committees under the board that focus on decision-making related to audit, nomination and remuneration functions.
- Stringent disclosure – Compulsory periodic reporting and immediate disclosure of material events that could impact the company's share price.
- Internal controls – Rigorous requirements for maintaining and auditing internal control systems to ensure financial integrity and compliance.

1.4 Stock Exchange Requirements Developments

Recent changes to listing requirements in China have been significantly influenced by the 2024 revision to the PRC Company Law and the CSRC's guidance on independent directors. These updates aim to strengthen the oversight role of independent directors and improve the protection of minority shareholders. A notable development is the transition from a traditional "board of supervisors" to an "audit committee" model within the board, providing companies with more flexibility with respect to their governance.

These changes have direct implications for board structures and shareholder engagement. Companies are now required to refine their internal voting mechanisms to prevent the abuse of control by majority shareholders. Furthermore, there is an increasing emphasis on ESG (environmental, social and governance) disclosures, with stock exchanges introducing mandatory reporting frameworks for larger listed companies. These developments reflect a shift towards a more market-oriented and internationally aligned governance environment.

2. Corporate Management

2.1 Principal Bodies or Functions

Under the Chinese corporate governance framework, the core management structure typically consists of:

- the power authority;
- the decision-making body;
- the supervisory body; and

- the executive arm.

The power authority is the shareholders' meeting (or the general meeting of shareholders), which serves as the highest authority of the company and determines the company's business policies and investment plans. The decision-making body is the board of directors, which is responsible for implementing shareholder resolutions and deciding on specific business plans and programmes.

The supervisory body is represented by the board of supervisors (or individual supervisors), whose duty is to oversee the conduct of directors and senior management in the performance of their duties. The executive arm consists of the management team, led by the general manager, who is responsible for daily operations. According to the PRC Company Law, LLCs now have the option to forgo a board of supervisors and instead establish an audit committee composed of directors within the board to exercise supervisory functions, providing greater flexibility in their governance.

2.2 Types of Decisions

The shareholders' meeting is typically responsible for major decisions involving the company's fundamental interests, such as amending the articles of association, increasing or decreasing registered capital, mergers, divisions, dissolution, or changes in corporate form. It also has the authority to elect and replace directors and supervisors. These matters are often "statutory reserved matters" under the law and must be resolved by the shareholders.

The board of directors is primarily responsible for specific operational decisions, including formulating the company's annual financial budget, final accounts, profit distribution plans, and loss recovery plans. Furthermore, the appointment or dismissal of the company manager and their remuneration is a core function of the board. In daily operations, the management team is authorised to handle specific business execution and administrative affairs, but their actions remain subject to the resolutions and oversight of the board of directors.

2.3 Decision-Making Processes

The deliberation methods and voting procedures of each corporate body are usually stipulated by law and detailed in the company's articles of association. Shareholder meetings are divided into regular and extraordinary meetings, with voting typically following the "one share, one vote" principle for joint stock companies or based on capital contribution ratios for LLCs. For major matters such as amending the articles, approval by shareholders representing more than two thirds of the voting rights is required.

The board of directors operates on a "one person, one vote" system. Board resolutions generally require more than half of all directors to be present and must be passed by a majority of all directors. To ensure the validity of decisions, the law requires that a board meeting be held only when more than half of the directors are in attendance, and directors must attend in person or appoint another director in writing to attend on their behalf. These procedural requirements aim to balance efficiency with compliance, ensuring the robust operation of corporate governance.

3. Directors and Officers

3.1 Board Structure

In China, the board structure typically follows a one-tier model, although it incorporates elements of oversight that resemble two-tier systems. A company generally establishes a board of directors as its decision-making body, which is accountable to the shareholders' meeting. For smaller LLCs with a limited number of shareholders, the company may elect to appoint a single executive director instead of a full board to streamline management.

Recent legislative changes have introduced more flexibility with respect to governance. Companies can now choose between a traditional board of directors accompanied by a board of supervisors, or a board of directors that includes an internal audit committee. This change allows the board to have a more integrated oversight mechanism. In listed companies, the board must also include independent directors to ensure balanced decision-making and to protect the interests of minority shareholders.

3.2 Board Members

The company board of directors is composed of multiple members who are each required to fulfil distinct roles. The chairperson of the board serves as the principal decision-maker, presides over meetings, and ensures the board functions effectively. In many Chinese companies, the chairperson also serves as the "legal representative" as a result of previous mandatory legal requirement, which means they have authority to sign contracts and represent the company in legal proceedings. The legal representative role can be held by any director or manager who manages company affairs under the current framework.

In corporate practice, board members are often functionally categorised into executive directors, who are involved in the daily operations of the company, and non-executive directors who provide strategic guidance. For listed companies, independent directors play a crucial role by providing unbiased opinions on significant matters such as related-party transactions and executive compensation. These diverse roles are designed to create a system of checks and balances that enhances the quality of corporate governance.

3.3 Board Composition

Chinese law prescribes certain requirements for board composition to ensure professional and ethical management. An LLC board of directors typically consists of three members or more, while a joint stock limited company is similar. There is a growing emphasis on diversity and professional expertise, particularly for companies in regulated industries or those listed on stock exchanges.

A popularly elected employee representative may need to be appointed to the board for companies in which the state is a shareholder or for those with a significant employee base. In the case of listed companies, at least one third of the board must consist of independent directors, and at least one independent director must be an accounting professional. These composition rules aim to prevent the concentration of power and ensure that the board possesses the necessary skills to oversee complex business operations.

3.4 Appointment and Removal of Directors/Officers

Directors are typically appointed or removed by the shareholders' meeting through an ordinary resolution. The process for appointing senior officers, such as the general manager, chief financial officer and board secretary, falls under the authority of the board of directors. Appointments are generally based on professional qualifications and a "fit and proper" assessment to ensure the individuals have the integrity and capability to lead.

Specific legal conditions restrict who may serve as a director or officer. Individuals are prohibited from holding such positions for a specified period if they have a criminal record related to economic crimes or have been judicially or administratively determined to bear personal responsibility for the bankruptcy of a company due to mismanagement. Directors can be removed by a shareholder resolution before the expiration of their term, although the company may be liable for compensation if the removal is deemed to be without "just cause", as defined in the company's articles of association.

3.5 Independence of Directors

Independence is a cornerstone of governance for public companies in China. Independent directors must maintain both actual and perceived independence from the company, its major shareholders and its actual controllers. They are prohibited from holding significant shares in the company or having any material business relationships that could impair their objective judgement.

To manage potential conflicts of interest, directors are required to disclose any personal interests in contracts or transactions involving the company. In such cases, interested directors must recuse themselves from voting on the relevant board resolution. Furthermore, independent directors are specifically tasked with reviewing and issuing public opinions on matters where the interests of controlling shareholders might conflict with those of the company or minority investors.

3.6 Legal Duties of Directors/Officers

Directors and officers in China owe two primary fiduciary duties to the company: (i) the duty of loyalty, and (ii) the duty of care. The duty of loyalty requires the avoidance of self-dealing, refraining from competing with the company, and protecting the company's assets and confidential information. A company's directors and officers must prioritise the company's interests above their own or those of any third party.

The duty of care requires directors and officers to act with the diligence and skill that a reasonably prudent person would exercise in a similar position. This includes staying informed about the company's business, attending board meetings, and making decisions based on adequate information. The 2024 Company Law has further clarified these duties, emphasising that directors may be held personally liable for losses caused to the company if they fail to perform these obligations with the required standard of care.

3.7 Responsibility/Accountability of Directors

Directors primarily owe their fiduciary duties to the company as a legal entity. Their responsibility is to ensure the company's sustainable growth and long-term value. While directors are appointed by the company's shareholders, their legal obligation is to act in the best interests of the company itself, which sometimes requires balancing the competing demands of various stakeholders.

In addition to shareholders, directors are increasingly expected to take into account the interests of other stakeholders, such as employees, creditors and the broader community. For instance, in situations of financial distress, directors have an increased duty to protect the interests of creditors. The modern governance trend in China also encourages boards to consider environmental and social impacts (ESG) as part of their broader responsibility to ensure the company remains a responsible corporate citizen.

3.8 Breach of Directors' Duties

Breaches of fiduciary duties can be enforced through several mechanisms. The company itself, acting through the board or a shareholder meeting, can sue a director for damages. If the company fails to act, shareholders holding a certain threshold of shares

may initiate “derivative lawsuits” in their own name on behalf of the company to hold the director accountable.

The consequences of a breach can be severe, ranging from the disgorgement of personal profits gained through the breach to the payment of significant monetary damages to the company. In cases involving fraud or serious misconduct, directors may also face administrative penalties from regulators such as the CSRC or even criminal prosecution. These enforcement mechanisms are designed to deter misconduct and ensure that those in positions of trust act with integrity.

3.9 Other Claims/Enforcement Against Directors/Officers

Beyond breach of fiduciary duties, directors and officers can be held liable for violations of securities laws, environmental regulations or labour laws. For example, in cases of fraudulent financial reporting or market manipulation, regulators can impose heavy fines and issue “market entry bans”, prohibiting individuals from serving as directors of any public company for several years or even for life.

A director’s liability can sometimes be limited through indemnification agreements or directors and officers (D&O) liability insurance, which is becoming more common in China. However, such protections generally do not cover acts of intentional misconduct, gross negligence or criminal behaviour. The ability to limit liability is subject to the articles of association and must not contravene mandatory provisions of law aimed at protecting the public and the company’s creditors.

3.10 Payments to Directors/Officers

The remuneration of directors must be approved by the shareholders’ meeting, while the compensation of senior officers is determined by the board of directors. This separation of powers is intended to prevent management from unilaterally setting their own pay. Companies must ensure that compensation structures are reasonable and do not encourage excessive risk-taking that could jeopardise the company’s stability.

Publicly traded companies are subject to strict disclosure requirements regarding executive compensation. They must disclose the total remuneration paid to directors and senior officers in their annual reports, often including a breakdown of salaries, bonuses and other benefits. Failure to comply with these approval and disclosure requirements can lead to the invalidation of the payment resolutions and potential regulatory sanctions against the company and the responsible individuals.

4. Shareholders

4.1 Companies and Shareholders

The relationship between a company and its shareholders is defined by the principle of limited liability, where shareholders are generally not personally liable for the company’s debts beyond their capital contributions. This relationship is primarily governed by the PRC Company Law and the company’s articles of association, which function as a binding contract between the shareholders and the legal entity. Shareholders hold fundamental rights, such as:

- the right to receive dividends;
- the right to participate in major decision-making; and
- the right to share in the distribution of remaining assets upon liquidation.

In China, there is no single, consolidated public registry that displays every individual shareholder of every private company to the general public. However, basic shareholder information for LLCs is recorded with the SAMR and is accessible via the National Enterprise Credit Information Publicity System. For publicly traded companies, information regarding major shareholders and the top ten shareholders is disclosed in periodic reports, while the full shareholder register is maintained by the China Securities Depository and Clearing Corporation (CSDC) and is generally not available for public inspection.

4.2 Role of Shareholders

Shareholders participate in management primarily by exercising their voting rights at shareholders’ meetings to decide on the company’s strategic direction and

high-level appointments. While they do not engage in the day-to-day administrative or operational activities – which are delegated to the board of directors and senior management – they hold the ultimate authority over fundamental corporate changes. This includes approving mergers, acquisitions, and amendments to the company's constitutional documents.

Under Chinese law, shareholders are generally not permitted to directly interfere with the board's specific management decisions or bypass the formal corporate structure to issue orders to staff. However, because shareholders appoint and can remove directors, they exert significant indirect influence. In many Chinese private enterprises, the controlling shareholder may also hold a concurrent position as the chairperson or legal representative, effectively bridging the gap between ownership and active management.

4.3 Shareholder Meetings

Shareholder meetings are a mandatory requirement for both LLCs and joint stock companies. These meetings are classified as either annual general meetings, which must be held once every year, or extraordinary meetings, which are convened as needed to address urgent matters. The law requires a formal notice period – typically 20 days for annual meetings of joint stock companies – to ensure all shareholders have sufficient time to review the agenda and prepare for voting.

The conduct of these meetings is strictly regulated to protect shareholder participation. Resolutions are passed based on voting thresholds: ordinary resolutions usually require a simple majority of the voting rights present, while “special resolutions” (such as capital increases or mergers) require a two-thirds majority. Modern regulations also allow the use of electronic voting and online participation, especially for listed companies, to facilitate engagement from minority shareholders who cannot attend in person.

4.4 Shareholder Claims

Shareholders have several legal avenues to seek redress against the company or its directors for misconduct or negligence. A shareholder may file a direct lawsuit against the company if a director or senior officer violates laws or the articles of association, causing direct harm to the shareholder's personal

rights and interests as an investor (such as the right to vote or receive dividends). Furthermore, if a resolution passed by the board or a shareholder meeting violates the law or the company's articles, shareholders can petition the court to have that resolution revoked or declared null and void.

Shareholders may also initiate derivative lawsuits in cases where the company suffers losses due to a director's breach of fiduciary duty but the company itself refuses to take action. Under this mechanism, eligible shareholders sue the wrongdoers in their own name on behalf of the company, and any damages recovered are paid to the company. These claims serve as a critical check on management power and help ensure that directors remain accountable to the corporation as a whole.

4.5 Shareholders in Publicly Traded Companies

Shareholders in publicly traded companies are subject to rigorous disclosure obligations to ensure market transparency and prevent insider trading. Any shareholder whose holdings reach 5% of the company's total issued shares must notify the securities regulatory authorities and the stock exchange, and make a public announcement within a specified timeframe. Subsequent changes in ownership that hit certain thresholds trigger additional reporting requirements (typically every 1% or 5% change in ownership).

There is also a strong emphasis on disclosing the “ultimate beneficial owner” (UBO) of publicly traded companies. Chinese regulations require listed companies to look through layers of corporate vehicles to identify the natural persons who actually control or benefit from the shareholding. This transparency is intended to expose potential “shadow” controlling shareholders and manage risks related to related-party transactions and market manipulation. Compliance with these rules is mandatory, and failure to disclose can result in administrative fines or the suspension of voting rights.

5. Corporate Reporting and Disclosures

5.1 Financial Reporting Requirements

Under the PRC Company Law, all companies established in China are required to prepare financial and accounting reports at the conclusion of each fiscal year. These reports must be audited by a certified public accounting firm and typically encompass:

- a balance sheet;
- a profit and loss statement;
- a cash flow statement; and
- comprehensive explanatory notes.

For LLCs, these audited reports must be presented to shareholders for approval, ensuring transparency regarding the company's fiscal health and operational performance.

Publicly traded companies face more rigorous periodic reporting obligations mandated by the CSRC. They are required to disclose audited annual reports within four months of the fiscal year-end, alongside unaudited semi-annual and quarterly reports within specified windows. These disclosures are central to market integrity, as they provide investors with the standardised data necessary to assess the company's valuation and financial stability.

5.2 Corporate Governance Arrangement Disclosure

Companies in China are increasingly required to disclose their internal governance frameworks to provide stakeholders with clarity on oversight mechanisms. For private companies, such disclosures are primarily internal and are contained within the articles of association or shareholder resolutions. However, for listed companies, there is a mandatory requirement to include a dedicated "corporate governance" section in their annual reports, detailing the company's compliance with the Code of Corporate Governance for Listed Companies.

These disclosures must specify:

- the composition of the board;
- the functions of independent directors; and

- the activities of specialised board committees, such as audit and remuneration committees.

Any deviations from recommended governance standards must be explained under a "comply or explain" regime, which encourages continuous improvement in corporate behaviour. Furthermore, significant related-party transactions and potential conflicts of interest involving directors or senior officers must be transparently reported to prevent the abuse of corporate power.

5.3 Incorporation and Registration

The primary body responsible for the incorporation and registration of companies in China is the SAMR through its local branches. Companies are required to file their articles of association, capital structure, and identity information of legal representatives and directors with the SAMR's registry. Most of these filings are accessible to the public via the National Enterprise Credit Information Publicity System, which serves as a critical tool for commercial due diligence and transparency.

Failure to maintain accurate and timely filings can result in administrative penalties, including fines or being placed on the List of Enterprises with Abnormal Business Operations. In severe cases of non-compliance, the registry has the authority to revoke a company's business licence. The registry maintains significant supervisory powers and conducts periodic "double random" inspections to ensure that the information of each registrant aligns with the actual operational status of the business.

5.4 Global Anti-Money Laundering

Chinese anti-money laundering (AML) regulations require companies to implement robust Know Your Customer (KYC) protocols and maintain detailed records of high-value transactions. Boards are increasingly expected to oversee AML compliance as part of their broader risk management mandate, ensuring that internal control systems can detect and report suspicious activities to the China Anti-Money Laundering Monitoring and Analysis Centre. This oversight is particularly critical for companies in the financial services sector or those engaged in extensive cross-border investment activities.

Directors face significant personal liability risks if a company is found to have facilitated money laundering due to gross negligence or a lack of internal oversight. Regulators can impose substantial personal fines on responsible directors and, in cases involving criminal intent or severe systemic failure, individuals may face market entry bans or criminal prosecution. Consequently, boards are advised to appoint a dedicated compliance officer and conduct regular AML training and audits to mitigate these legal and reputational risks.

6. Audit, Risk and Internal Controls

6.1 External Auditors

Under the PRC Company Law, companies are generally required to appoint a certified public accounting firm to conduct an annual audit of their financial statements. The relationship between the company and its external auditor is primarily governed by the terms of the engagement letter and mandatory independence standards issued by the PRC Ministry of Finance. For listed companies, the appointment, reappointment or dismissal of external auditors must be proposed by the audit committee and approved by the shareholders' meeting to ensure objectivity and prevent management interference.

To maintain audit quality, regulations often require the rotation of lead audit partners every five years for publicly traded companies. Furthermore, auditors are prohibited from providing certain non-audit services, such as internal book-keeping or management consulting, which could create a conflict of interest. The board of directors is responsible for ensuring that the auditor has access to all necessary financial records and that the audit process is conducted in accordance with Chinese Auditing Standards.

6.2 Risk Management and Internal Controls

Geopolitical risk has become a critical focus for regulators in China, particularly for companies engaged in cross-border trade or high-tech industries. These risks are typically monitored at the board level, often within a dedicated risk management committee or the audit committee, where directors assess the impact of international relations on supply chains and market

access. Boards are expected to incorporate geopolitical scenarios into their long-term strategic planning to ensure corporate resilience against external political shocks.

Regarding international sanctions, Chinese regulators expect boards to maintain high-level oversight of compliance frameworks to avoid being secondary targets of foreign sanctions, while complying with domestic anti-foreign sanction laws. The board is responsible for ensuring that the company's internal control systems include screening mechanisms for transactions involving sanctioned entities or jurisdictions. Senior management is typically tasked with the day-to-day execution of these controls, while the board receives periodic reports on the company's exposure and the effectiveness of its mitigation strategies.

7. Environmental, Social and Governance

7.1 ESG Requirements

In China, ESG requirements have transitioned from voluntary initiatives to a more structured regulatory framework, particularly for state-owned enterprises (SOEs) and listed companies. While there is no single ESG law, requirements are embedded across various regulations, including the PRC Company Law, which encourages companies to consider social and environmental impacts. For listed companies, the Code of Corporate Governance and specific guidelines from the CSRC mandate the disclosure of environmental protection efforts and social responsibility activities.

The burden of ESG compliance is increasingly significant for companies operating in heavy-pollution industries, where environmental disclosure is mandatory. For other sectors, regulators follow a "comply or explain" approach, encouraging transparency regarding carbon emissions, energy consumption and labour practices. These requirements aim to align corporate behaviour with national strategic goals, such as the Dual Carbon targets (peaking carbon emissions by 2030 and achieving carbon neutrality by 2060).

7.2 ESG Developments

The global shift towards sustainable investment has led to material changes in how Chinese companies report and consider ESG issues. A key development is the standardisation of reporting frameworks, with the Shanghai, Shenzhen and Beijing stock exchanges recently releasing specific ESG disclosure guidelines. These guidelines place a heavy emphasis on “green development”, reflecting China’s unique domestic priorities, such as rural revitalisation and common prosperity, alongside traditional environmental metrics.

There is also a growing focus on the “governance” component of ESG, particularly concerning data security and anti-corruption. As digital transformation accelerates, how companies manage user privacy and algorithmic transparency has become a critical part of their social responsibility profile. Furthermore, the integration of ESG performance into the enterprise credit evaluation system means that a company’s ESG standing can now directly influence its access to financing and its overall cost of capital.

8. Artificial Intelligence

8.1 Board Oversight of AI

In China, there are currently no specific statutes that mandate a particular board composition or committee structure solely for AI oversight. However, under the broader fiduciary duties of loyalty and care established by the PRC Company Law, boards are increasingly expected to oversee the digital transformation and technological risks of their enterprises. For companies in the technology sector or those utilising generative AI, regulatory authorities such as the Cyberspace Administration of China (CAC) emphasise that the “legal representative” and the board bear ultimate responsibility for ensuring that AI systems align with “core socialist values” and maintain data security.

Existing departmental rules, such as the Interim Measures for the Management of Generative Artificial Intelligence Services, indirectly require board-level attention to compliance. Boards are expected to ensure that the company has established internal mechanisms for content moderation, data labelling and protection of intellectual property. While not mandatory

for all, many leading Chinese technology firms have voluntarily established technical committees or Ethics Committees that report to the board to manage the complex regulatory landscape surrounding AI ethics and safety.

8.2 AI Use-Related Risks

The governance framework for addressing AI risks in China is characterised by a “layered” approach, focusing on specific technologies such as algorithmic recommendations, deep synthesis and generative AI. The CAC, together with other ministries, has issued regulations requiring service providers to conduct security assessments and algorithm filings for any AI systems with “public opinion properties” or “social mobilisation capabilities”. These filings require companies to demonstrate that their AI models have robust internal controls to prevent the generation of discriminatory or harmful content.

For 2025 and 2026, the key governance development is the anticipated progression of the “PRC Artificial Intelligence Law”, which aims to provide a unified framework for AI development and security. Responsibility for AI strategy and risk management typically falls to a cross-functional team involving the Chief Technology Officer (CTO), the legal department and, increasingly, the audit or risk committee. This integrated approach ensures that AI risks – including reputational risks arising from “hallucinations” or biased outputs – are monitored from both a technical and a compliance perspective.

8.3 Liability Exposures Arising From AI Use

Boards and officers face several layers of liability exposure arising from the use of AI, ranging from administrative penalties to civil litigation. A primary risk is “disclosure failure”, where a company fails to accurately inform users or regulators about the use of AI algorithms, as required by transparency rules. Additionally, safety incidents or the output of prohibited content can lead to severe administrative sanctions, including the suspension of AI services or the revocation of business licences, for which senior management may be held personally accountable.

Intellectual property (IP) and data breaches constitute another significant area of exposure. If an AI system

is trained on unauthorised copyrighted materials or leaks sensitive personal data, the company may face lawsuits from third parties or collective actions initiated by consumer protection organisations. Enforcement is primarily carried out by the CAC and the SAMR. However, with the growing awareness of data rights, individual users are increasingly bringing civil claims against companies for privacy violations or unfair algorithmic practices, such as “algorithmic price discrimination”.

8.4 Key Disclosure Requirements for AI Use

Disclosure requirements for AI use in China are currently focused on transparency and security. Under the Provisions on the Management of Algorithmic Recommendations, companies must conspicuously notify users when AI is used to push content or influence decision-making. For publicly traded companies, the

CSRC and stock exchanges have begun encouraging the disclosure in annual reports of “technological risks”, which include the potential impact of AI on the company’s business model and the regulatory risks associated with data compliance.

Furthermore, for companies providing generative AI services to the public, there is a mandatory requirement to label AI-generated content (such as images or videos) with clear watermarks to prevent public deception. In sustainability or ESG reports, leading firms are also beginning to disclose their AI Ethics frameworks and the measures taken to ensure algorithmic fairness. As the regulatory environment matures, it is expected that more granular disclosures regarding AI training data sources and the results of internal robustness testing will become standard practice for large-scale AI adopters.

Trends and Developments

Contributed by:

Chen Ma, Michelle Gon, Xinjie Li and John Fitzpatrick
Han Kun Law Offices

Han Kun Law Offices is a leading full-service Chinese law firm specialising in complex domestic and cross-border transactions, banking and finance, compliance, intellectual property and dispute resolution. The firm's main practice areas include private equity, mergers and acquisitions, international and domestic capital markets, investment funds, asset management, compliance and investigation, banking and finance, aviation finance, foreign direct investment, antitrust/competition, data protection, private

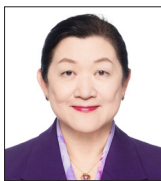
client/wealth management, intellectual property, bankruptcy and restructuring, and dispute resolution. With more than 900 professionals located in Beijing, Shanghai, Shenzhen, Hangzhou, Wuhan, Haikou, Hong Kong, Singapore, New York, Silicon Valley and London, over 90% possess bilingual proficiency and overseas credentials. Han Kun Law Offices focuses on high-technology and high-growth sectors, including AI and robotics, energy, life sciences, and advanced manufacturing.

Authors



Chen Ma has almost 30 years of law practice experience, a veteran antitrust practitioner who has represented many multinational companies in high-profile merger filings and government antitrust

investigations. He has also argued a high-profile antitrust case before the Supreme People's Court of China. Before joining Han Kun in 2014, Mr Ma was a partner at Chinese law firms and an associate lawyer at several leading international law firms in their New York and Hong Kong offices. He actively participates in a variety of competition law legislative and rule-making efforts in China. Mr Ma also teaches as an adjunct professor at his alma mater, the University of International Business and Economics in Beijing.



Michelle Gon is a senior attorney with more than three decades of experience in the Greater China markets, helping multinational clients. She focuses her practice on representing clients in complicated

and challenging compliance and regulatory matters, including export control and sanctions, trade secret protection, anti-corruption, anti-dumping, anti-subsidy, anti-unfair competition, anti-monopoly, anti-fraud, export control and trade sanction areas. Most clients are leading MNCs doing business in China, or large, China-based MNCs doing business

globally, across a wide range of sectors, including pharmaceuticals, medical devices, life sciences, healthcare, agriculture, food-related products, wine and spirits, hospitality, cruise lines, manufacturing, IT and high tech. Michelle previously held senior roles at other leading international law firms.



Xinjie Li focuses his practice on corporate compliance, data privacy, and foreign direct investment. He conducts internal investigations for multinational companies, including those concerning vendors and

company employee conflicts of interest, self-dealing, the UK Bribery Act, and the US Foreign Corrupt Practices Act. In addition, Mr Li often counsels clients on compliance matters relating to cybersecurity and data and personal information protection. He also advises multinational companies on their investments, acquisitions and daily business operations in China.



John Fitzpatrick focuses on compliance and risk management. He assists foreign investors to navigate the complexities of doing business in China, particularly with respect to data compliance, general corporate compliance, and contract and document reviews. In addition, John assists the firm's corporate practice with internal investigative and corruption-related

inquiries. He has worked with clients in the consulting, technology, retail, and automotive industries, amongst others. Prior to joining Han Kun, John worked at AllBright Law Offices in Shanghai. He holds a US Bar licence, is a certified public accountant, and also has previous Big Four accounting experience in the USA.

Han Kun Law Offices

9/F, Office Tower C1
Oriental Plaza
1 East Chang An Ave
Beijing
PRC

Tel: +86 10 8525 5500
Fax: +86 10 8525 5511
Email: beijing@hankunlaw.com
Web: www.hankunlaw.com



Officer Risks and Governance Restructuring for Multinational Corporations Under the Revised PRC Company Law

Introduction and executive summary

As the five-year transition period for the revised Company Law of the People's Republic of China (the "Company Law"; effective 1 July 2024) enters its critical second half, corporate governance in China is highly anticipated to shift towards an era of look-through "substantive compliance". This evolving regulatory regime is structured to expand the statutory liability baseline for directors, supervisors and senior management (D&Os) of limited liability companies (LLCs) and joint stock companies (JSCs).

It is predicted that traditional group-wide compliance arrangements – such as relying on offshore nominee directors or executing parent company "shadow instructions" – will face heightened risk exposure in upcoming regulatory scrutiny cycles. Regulatory and judicial bodies are expected to increasingly look through corporate formalities to examine physical fund flows and internal resolution histories. Consequently, failure to adapt may leave subsidiaries in

China vulnerable to compliance issues with respect to capital verification or the unlawful withdrawal of capital. Local D&Os may also face direct exposure to personal joint and several liability, asset freezes and administrative exit controls (exit bans).

To proactively insulate local management against these new risks, multinational corporations (MNCs) should consider restructuring subsidiary governance away from previous formalistic, check-the-box routines and towards a localised, predictive compliance framework. This chapter of the guide offers a look at this framework across three core areas.

- *Rise of the audit committee* – Examines the single-tier governance model and the phase-out of mandatory supervisor employee representatives; explores how to streamline structures while mitigating the oversight liabilities of functional integration.
- *Redefining fiduciary duties* – Delineates the statutory duties of loyalty and diligence under PRC law, details why the "superior orders" defence fails nominee D&Os under controlling shareholder joint

liability regimes and outlines how to construct evidentiary chains via granular board minutes.

- *Capital maintenance and creditor protection* – Anchors the new personal liability baselines for D&Os regarding capital calls, unlawful dividends and capital withdrawals, establishing the mandatory use of ex-ante solvency testing to defeat third-party creditor leapfrog claims.

Rise of the audit committee

The single-tier governance model: benefits and potential risk exposure

The revised Company Law introduces a more flexible single-tier governance model, permitting both LLCs (Article 69, paragraph 1) and JSCs (Article 121, paragraph 1) to dispense with a traditional board of supervisors and instead establish an audit committee under the board of directors. This offers MNCs a significant opportunity to streamline their corporate structures and bypass the traditional employee representative proportion requirements (Articles 71 and 130), achieving a smooth transition from passive external oversight to active internal governance.

However, this single-tier model, which integrates supervisory and decision-making functions, also introduces a significant potential risk. Given that Article 136 of the revised law only mandates the establishment of an independent director system for listed JSCs, LLC subsidiaries commonly utilised by MNCs have no statutory requirement to ensure the independence of their audit committees. Consequently, these committees are likely to be staffed by internal senior executives, creating an inherent conflict of interest. Should any internal control deficiencies be revealed during a regulatory look-through examination, these members face a heightened risk of liability for negligent oversight, as the integrated functional structure makes it difficult to demonstrate objective and rigorous supervision.

Substantive record-keeping as risk mitigation

To mitigate risk, substantive record-keeping by the audit committee regarding financial compliance and related-party transactions naturally serves as the basis for any legal defence. The importance of good record-keeping is compounded by provisions of the revised Company Law. For example, it is anticipated that courts will no longer treat the audit committee's

signatures as a mere procedural formality. Instead, the courts will deeply scrutinise whether an audit committee has established internal control systems and reporting lines that are independent of daily executive management.

Redefining fiduciary duties

Harmonisation of the duties of loyalty and diligence across organisational forms

The 2026 legal environment has transformed the traditional, abstract concept of “fiduciary duties” into concrete adjudicative criteria for pursuing personal liability in civil and administrative litigation. Compared to the relatively broad provisions of Articles 147 and 148 of the previous Company Law (2018 Revision), Articles 179 and 180 of the revised Company Law establish more operable fiduciary duty standards for D&Os of both LLCs and JSCs: the duty of loyalty (*zhongshi yiwu*) and the duty of diligence (*qingmian yiwu*).

The statutory “duty of diligence”, which serves as the PRC law equivalent to the common law “duty of care”, is explicitly defined in Article 180, paragraph 2 of the revised Company Law as requiring D&Os to exercise the reasonable care expected of a manager acting in the best interests of the company. When facing director liability lawsuits, courts will utilise these refined, updated statutory definitions to determine whether the management of either type of company has fulfilled its compliance oversight obligations.

Risk exposure for D&O joint liability with controlling shareholders; anticipated failure of the “passive execution” defence

Under the statutory logic of the revised Company Law, legal experts predict that the deeply ingrained commercial practice within many MNC subsidiaries – where local management treats the execution of global group policies or explicit directives from overseas headquarters as an absolute, self-evident internal justification – will face an unprecedented challenge in upcoming judicial enforcement cycles.

While Article 180 (paragraph 3) and Article 192 of the revised law progressively establish statutory joint and several liability for controlling shareholders and actual controllers who issue wrongful instructions,

this mechanism is expected to be enforceable against both controllers and local management.

Article 192 presupposes that the controlling shareholder's instruction is carried out through the unlawful performance of duties by the local D&Os. As a result, future judicial rulings are expected to look through formal corporate hierarchies and hold that blindly implementing an overseas instruction that violates PRC law (such as an improper capital sweep or unauthorised asset transfer) constitutes an independent breach of the local D&Os' statutory duty of diligence.

Consequently, local D&Os may now face personal legal risk if they choose to act as passive conduits for non-compliant parent company directives (referenced via Articles 188 and 192). This anticipated trend should cause nominee D&Os to cultivate an independent compliance review perspective to avoid this personal legal risk.

Eliminating formalistic single-page board resolutions

The new Company Law paradigm means it is a necessity for MNC subsidiaries in China to maintain detailed, contemporaneous board minutes. These minutes should fully reflect that the directors have made "reasonable inquiries". Although the law does not clearly define what constitutes a "reasonable inquiry", courts are expected to conduct substantive look-through reviews to verify whether directors have actively reviewed professional reports.

For instance, regarding JSCs, Article 125, paragraph 2 of the Company Law expressly provides that the board of directors shall be liable for board resolutions that violate laws, administrative regulations or the company's articles of association and cause serious losses to the company. A director may be exempted from liability only if they are recorded in the minutes as having expressed dissent. In future regulatory campaigns or shareholder derivative actions where a corporate failure or unlawful behaviour triggers an investigation into board conduct, a board of directors that fails to properly preserve the deliberation process and supporting decision-making materials is likely to face significant risk of being deemed in violation of its statutory duty of diligence due to an inability to demonstrate procedural compliance.

Capital maintenance and creditor protection mechanisms

Personal liability for board directors

Capital maintenance has now shifted for the board of directors from a mainly financial accounting concern to a corporate governance and statutory joint liability issue. Under the framework of the revised Company Law, boards of both LLCs and JSCs are subject to explicit capital contribution verification and call duties. In contrast to the previous Company Law, these newly revised provisions require the board of directors to act as a substantive capital maintenance gatekeeper. If the board fails to timely perform its verification and written capital call notice obligations, thereby causing losses to the company, the responsible directors may directly face severe legal consequences, including liability attached to their personal assets (Article 51, paragraph 2).

Record-keeping requirements

With the establishment of this statutory "gatekeeper" liability, it is predicted there will be a significant surge in future lawsuits in which external creditors, faced with an insolvent company, directly sue the company's directors to demand personal compensation based on claims such as permitting "unlawful dividend distributions" or "improper capital reductions". Empowered by the revised Company Law, these litigants may bypass shell or insolvent PRC subsidiary entities and directly target the personal assets of defaulting board members.

To satisfy future substantive compliance requirements, boards of directors should conduct thorough, well-documented solvency and asset impairment tests before approving any profit distribution plans, implementing capital reductions or executing major capital restructurings. A board that fails to retain and record these forward-looking financial evaluation reports will face higher risk of liability for breach of fiduciary duty with respect to capital maintenance.

Joint liability for unlawful withdrawals of capital

The revised Company Law establishes significantly stricter liability standards for boards with respect to the unlawful withdrawal of capital (*choutao chuzi*). For LLCs, Article 53 of the revised Company Law provides that responsible directors, supervisors and senior

management shall bear joint and several liability with the withdrawing shareholder for any losses caused to the company. Article 117 enacts equivalent joint and several liability provisions for JSCs.

By comparison, the previous version of the Company Law only prohibited shareholders from unlawfully withdrawing capital, without providing for D&O joint liability. This expansion of liability for joint and several liability exposes any subsidiary D&O who approves, assists or conceals the unlawful outward flow of funds in the compliance workflow to joint and several liability. This introduces complex cross-border governance challenges for MNCs that utilise multi-tier holding structures or frequently leverage intra-group cross-border cash pooling for centralised fund sweeping in China.

Conclusion

In summary, the revised Company Law has brought about a fundamental change in how corporate governance is regulated in China, moving away from formalistic requirements and towards substantive compliance. This change means that defences to D&O liability that MNCs have historically relied upon may no longer serve that purpose. Accordingly, local D&Os should no longer act as passive execution tools for overseas parent companies, lest they face personal risk exposure, including statutory penalties, creditor claims and administrative exit controls.

In response, MNCs need to proactively restructure their subsidiary governance frameworks – leveraging active audit committees, implementing exhaustive, contemporaneous record-keeping protocols, and mandating ex-ante solvency tests for all significant capital movements. Ultimately, transforming compliance from a check-the-box formality into a robust, localised corporate defence mechanism is the only viable pathway to insulate local management and secure sustainable cross-border operations in China.

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