

# 2<sup>nd</sup> SINO-FRENCH FINANCIAL FORUM

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中法金融论坛 SINO-FRENCH FINANCIAL FORUM

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# Regulatory Mechanism for Securities Dealers Based on Risk Control

Department of Intermediary Supervision, CSRC

October 17, 2008

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**Part I Introduction to Chinese Securities Dealers**

**Part II Risk Control Mechanism for Securities Dealers on Net Assets**

**Part III Classified Evaluation Mechanism for Securities Dealers Based on Risk Management Competence**

**Part IV Innovation Mechanism of Securities Dealers Based on Risk Control**

# Part I

## Introduction to Chinese Securities Dealers

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## Basic Information

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- By the end of June 2008, a total of 106 securities companies had been established. Among them, 8 are listed companies, 8 are foreign-shared and 10 set up securities agencies in Hong Kong.
- By the end of June 2008, RMB5.9951 trillion clients' assets had been under the management of securities companies. Among them, securities assets under custody were RMB4.7501 trillion, with trading settlement capital of RMB1.1666 trillion and entrusted capital in the asset management business of RMB78.4 billion.
- By the end of June 2008, the total assets of the securities industry had reached RMB1.6117 trillion, with net assets of RMB338.6 billion, net capital of RMB302 billion and paid-up capital of RMB152.3 billion.
- In the first half of 2008, the business income of the securities industry accumulated to RMB76 billion, with net profit of RMB32.3 billion.
- In 2008, among the 106 securities companies, 31 were labeled with A level (including 10 AA level and 21 A level). Meanwhile, 66 companies got B level (including 29 BBB level, 21 BB level and 16 B level), and 9 were graded C level (including 6 CCC level, 2 CC level and 1 C level), without D level companies.

## Part II

# Risk Control Mechanism for Securities Dealers on Net Capital

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## Basic Information

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- Based on the experience learning from securities firms' comprehensive governance and the mature markets, the CSRC established a system of risk control indicators focusing on net capital, by issuing the “Management Measures of Securities Companies' Risk Control Indicators” in 2006.
- In accord with the market growth level, the industry development trend and the “Accounting Standards for Enterprises”, the CSRC made amendment to the “Management Measures of Securities Companies' Risk Control Indicators” in June 2008, which will take effect as of December 1, 2008.

## About Net Capital

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- The “Management Measures of Securities Companies’ Risk Control Indicators” stipulates the absolute indicators, the relative indicators and the minimal standards for net capital, requiring the business scope and scale of a company to match its net capital capacity for prevention of over-expansion of a securities firm.
- The net capital is a comprehensive risk control indicator determined after risk adjustment to the assets and liabilities as well as relevant business based on the net capital according to the securities company’s business scope and the liquidity of its assets and liabilities. It mainly reflects the assets with high liquidity in the net assets.
- Net capital = net assets - risk adjustment to financial assets - risk adjustment to other assets - risk adjustment to contingent liabilities -/+ other adjustments identified or approved by the CSRC

## Absolute Indicators of Net Capital

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### Absolute Indicators for Different Businesses:

- The net capital shall not be less than RMB20 million for a securities company engaging in the stock brokerage.
- The net capital shall not be less than RMB50 million for a securities company engaging in any of such businesses as securities underwriting and sponsorship, self-dealing of securities, asset management and other securities business.
- The net capital shall not be less than RMB100 million for a securities company engaging in the stock brokerage business and simultaneously in any of such businesses as securities underwriting and sponsorship, self-dealing of securities, asset management and other securities business.
- The net capital shall not be lower than RMB200 million for a securities company engaging in two or more of such businesses as securities underwriting and sponsorship, self-dealing of securities, asset management and other securities business.

## Relative Indicators of Net Capital

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All companies shall conform to the relative indicators:

- The proportion of the net capital to the liabilities shall not be lower than 8%
- The proportion of the net capital to the net assets shall not be less than 40%;
- The proportion of the net assets to the liabilities shall not be lower than 20%;
- The proportion of the net capital to the risk capital reserve shall not be lower than 100%;

## Calculation of Risk Capital Reserve (I)

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● Risk capital reserve is calculated according to the business scale of each risk business. The sum of each risk capital reserve shall be less than the net capital, for the indirect control on the overall scale of each business. Meanwhile, direct scale control shall be conducted on high-risk business, including self-operation of securities. This aims to establish a new mechanism reflecting the interdependence of the securities company's each business scale and its net capital level.

● Securities companies engaging in securities brokerage business shall calculate risk capital reserve according to the total amount of clients' trading settlement capital under custody; securities companies engaging in businesses including securities self-operation, underwriting, asset management as well as margin trading and securities lending shall calculate the risk capital reserve according to business scales; securities companies establishing branches or securities business departments shall calculate risk capital reserve of these subsidiaries; securities companies shall calculate risk capital reserve for operation according to the total business costs of the previous year.

## Calculation of Risk Capital Reserve (II)

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- Securities companies graded with Level A, B, C and D shall be in accord with different calculation standards of risk capital reserve (i.e., 0.6 times, 0.8 times, 1 times and 2 times, respectively, of the calculation standards of risk capital reserve).
- By the end of June 2008, the risk capital reserve of the securities industry had reached RMB36.6 billion, with the net capital of RMB302 billion.  $\text{Net capital} / \text{risk capital reserve} = 825\%$ . This indicates the whole industry's sufficient capital supply as well as its high capacity of risk resistance.

## Part III

# Classified Regulation Mechanism for Securities Dealers Based on Risk Management Competence

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## Basic Information

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- In June 2007, the CSRC worked out the “Guidelines on Classified Supervision over Securities Companies (Trial)”, aiming to better regulate the securities firms, rationally allocate supervisory resources, enhance regulatory efficiency and promote the securities companies’ sustained development.
- In 2007 and 2008, the CSRC carried out securities firms’ classified evaluation, as required by the “Guidelines on Classified Supervision over Securities Companies (Trial)”.

## Evaluation Method (I)

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- By stipulating the benchmark score of 100 points for a securities firm in normal operation, the evaluation score of the securities company will be added or deducted correspondingly, with reference to its fulfillment of the specific standards as required by the securities companies' evaluation indicators while taking such factors as the securities firm's market share into consideration.
- Deduction will be given to the securities company during the evaluation period, if the securities firm has received any regulatory interview or rectification order imposed by the supervision measures or the administrative penalties, or if it has been under disciplinary penalty imposed by any securities industry's self-regulatory organizations. Specifically, points to be deducted depend on different punishment degrees of the disciplinary penalty, supervision measures and the administrative penalties.

## Evaluation Method (II)

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- Scores shall be added to a securities company if the firm's net capital is above certain standard and its risk control indicator reaches the criterion in successive years, or if supervision measures or administrative penalties have not been imposed on the company.
- To reflect a company's ability to control and afford potential risks, the company's risk management capacity will be appraised according to 69 evaluation indicators in 6 major kinds such as the firm's capital, protection of clients' rights and interests (including clients' assets safety, level of client service, stability and security of the information technology system as well as investors' education), compliance management, legal person governance (including moral integrity of the senior management), internal control and the firm's transparency.

## Formulate Classification (I)

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- The securities companies will be graded into 11 levels in 5 major kinds including Level A (AAA, AA and A), Level B (BBB, BB and B), Level C (CCC, CC and C), Level D and Level E.
- The securities company shall be directly classified as Level E if measures of risk disposal have been imposed on it, including business suspension for rectification by laws and rules, or take-over and custody by other agencies.
- With the benchmark of the middle value from the grading result of all the securities companies in normal operation, the securities companies will be classified, according to a certain score range, by 10 levels in 4 major kinds including Level A (AAA, AA and A), Level B (BBB, BB and B), Level C (CCC, CC and C) and Level D.

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## Part IV

# Innovation Mechanism of Securities Dealers Based on Risk Control

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## Urge Securities Dealers to Establish A Sound Innovation Mechanism Based on Risk Control (I)

● A securities company, when operating innovative business, shall not violate current laws, administrative regulations and the requirements of the CSRC. The risks in its innovative business should be predictable, controllable and affordable. The innovative business should be closely related to its current securities business. This will be conducive to making full use of the firm's existing business branches, clients' resources, business expertise and management experience. Besides, it will optimize services for clients and perfect the company's profit-making mode.

● The securities company shall, if operating innovative business, establish an internal evaluation and examination mechanism, to verify the compliance, feasibility and possible risks of the business, and work out business management rules stipulating operation process, risk control measures as well as measures of protecting investors' legal rights and interests.

## Urge Securities Dealers to Establish A Sound Innovation Mechanism Based on Risk Control (II)

- A securities company shall, when applying for innovative business, submit the business plan, the report on business feasibility and the compliance examination report on business plan issued by chief compliance officer.
- The securities company shall, when developing innovative business, be in line with the market acceptance and the investor affordability while prioritizing risk prevention.

## Intensify Risk Supervision over Securities Dealers' Innovative Business (I)

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- Priorities will be given to window guidance in terms of information transparency, risk disclosure, product adaptability, liquidity and risk control mechanism in innovative business.
- On-spot and off-spot examination over innovative business, especially the examination on risk leak and violations, will be conducted to prevent systematic risks.

## Intensify Risk Supervision over Securities Dealers' Innovative Business (II)

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- The CSRC will, through pilot projects and proper promotion, organize relevant experts to make appraisal and approve some securities firms to take initiatives, upon which the CSRC may decide whether to gradually expand the pilot project after working out relevant business rules, or to cease approvals for new applications.
- Efforts will be made in the research of new conditions and problems cropping up in the industry, to upgrade response capacity and supervisory efficiency.



# Thanks!

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