

Risk Disposal of Chinese Securities Companies

Review and Reflection

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- Major problems and risks of securities companies prior to the comprehensive governance
- Major risk disposal practice of securities companies
- Lessons learned from the risk disposal of securities companies

Major problems and risks prior to the comprehensive governance (1)

- Misappropriating clients' capital and impairing clients' interests

The deficit of clients' securities trading settlement capital in the whole industry exceeded RMB60 billion, with the appropriated clients' bonds exceeding RMB13 billion.

- Illegal entrusted wealth management and OTC bonds issuance -- illegal financing

Securities companies conducted illegal financing by illegal asset management or OTC bonds issuance, with the total amount exceeding RMB180 billion and 200,000 individual investors involved.

Major Problems and Risks prior to the comprehensive governance (2)

- Dishonest accounts and sheets as well as business operation with concealed accounts

Securities companies are plagued by the dishonest accounts and sheets as well as the business operation with concealed accounts which totals over RMB100 billion.

- Holding over-proportion stocks and manipulating stock prices

31 punished securities companies held over 50 stocks of listed companies. For instance, China Southern Securities Co., Ltd. once held over 90% of floating shares of Hafei Motor Co., Ltd. and Harbin Pharmaceutical Group Holding Co., Ltd. in the name of Huade Assets Management Co., Ltd. and T&F Investment Consulting Co., Ltd. under its control.

Major Problems and Risks prior to the comprehensive governance (3)

- The whole industry is suffering from critical financial situation, and securities companies facing eruptive risks.
 - The whole industry has been under deficit for three years in a row; a batch of clients of securities companies have difficulty in withdrawing cash, transaction clearing of securities is breached and the capital chain may fracture at any moment. Some high-risk companies have their problems exposed, motivating creditors to apply for closing down and freezing accounts of securities companies or even clients' assets. Individual creditors appeal to the higher authorities for help in groups, and such incidents as appellants strike operation network of securities companies and regulators happen frequently.
 - As the market being constantly on the downturn and structural adjustment, a chain of securities companies such as China Southern Securities Co., Ltd. and Xinjiang D'Long (Group) Co., Ltd. have their scandals uncovered from the end of 2003 to the first half of 2004, thus years of cumulative risks in the industry are on the verge of flooding. Risks facing securities companies paralyze the capital market and destabilize the society. All in all, we are in the life and death situation.

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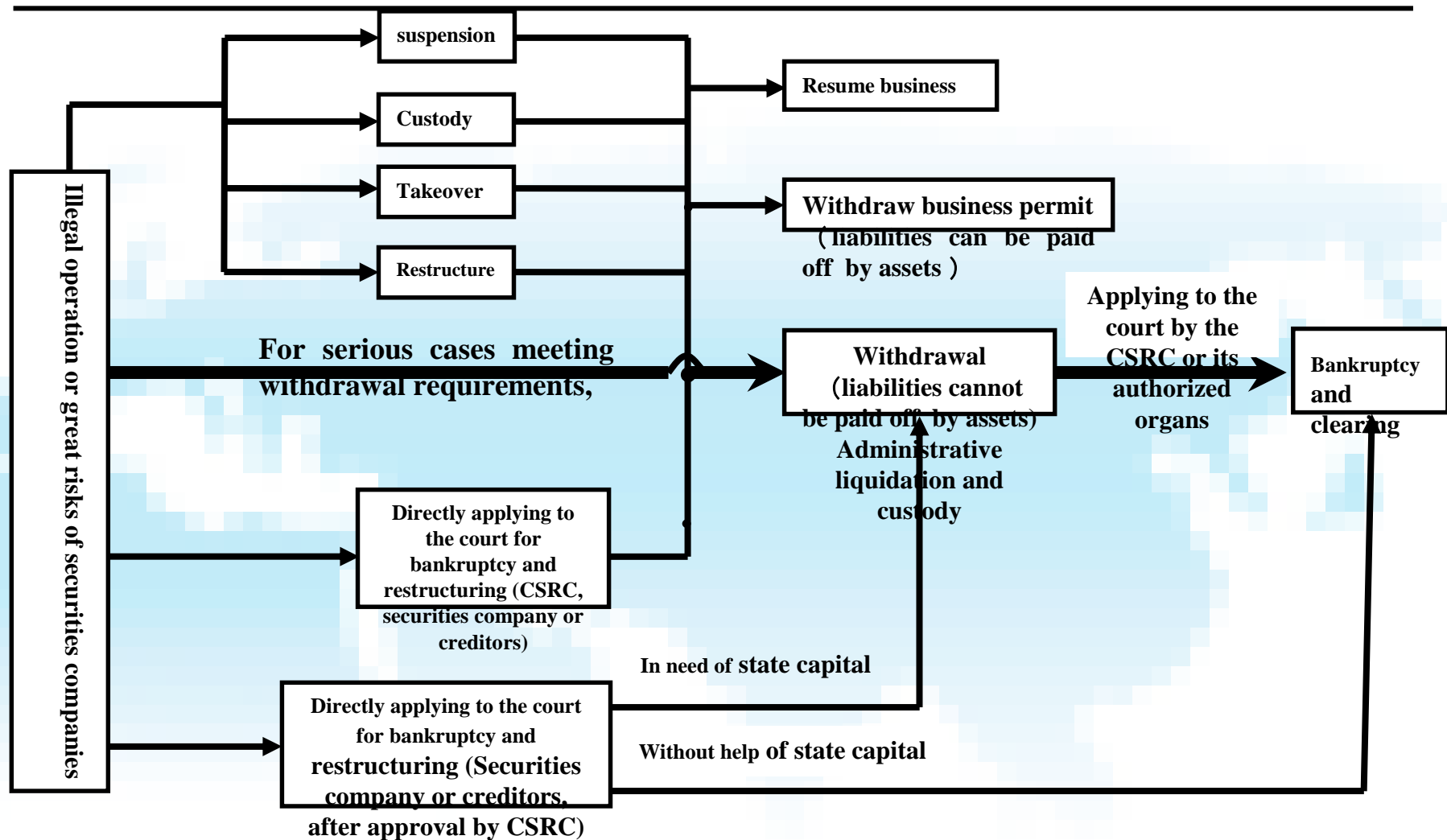
Major Risk Disposal Practice of Securities Companies (1)

- To adopt efficient measures to defuse the risks in securities

Since 2004, the CSRC has taken 3-year overall governance on securities companies, centered on the high-risk companies,.

- To make all-round risk assessment of securities companies and supervise their rectification;
- To dispose the high-risk companies timely and steadily;
- To encourage the relevant parties to restructure the risky companies in line with the laws and rules as well as supervisory regulations;
- To regulate the securities companies according to different classifications and establish a new mechanism associating the company's business scope and scale with its net asset movement;
- To inspire the optimized companies to make innovations and provide supports for their further development;
- To reform and improve the related fundamental systems, laws and regulations.

Major Risk Disposal Practice of Securities Companies (II)



#. Note: during the current period of comprehensive governance, the main mode of risk disposal is illustrated as the Black Line in the middle part, i.e., direct withdrawal will be imposed on the company together with administrative liquidation and custody of brokerage business.

Major Risk Disposal Practice of Securities Companies (3)

- **to establish an efficient risk disposal mechanism**
 - The CSRC is working with the relevant departments, the local people's governments and the judicial authorities under the State Council's uniform deployment.
 - The respective duties of the Risk and Commissioner offices are defined, while the agencies actively participate in.
 - The on-the-spot work group, custody group, administrative liquidating group, investigation group and special group are established.
 - Work standards and procedures are regularized, and high-quality securities dealers and eligible intermediaries are engaged in the risk disposal in a market-oriented way;
 - Securities investor protection fund companies are established.

Major Risk Disposal Practice of Securities Companies (4)

- Safeguarding social stability

During the governance period, the CSRC, together with all the custody groups and liquidating groups, has accumulatively dealt with more than 14,000 cases of complaint visits and interviewed more than 180,000 visitors for complaint, safeguarding the normal trading of the disposed company's clients and furthest preventing significant group accidents and other malignant incidents.

- Cracking down on violation of laws and rules

Criminal cases have been put on file to more than 170 persons while administrative penalties or market entry-ban have been imposed on more than 100 person-times.

Major Risk Disposal Practice of Securities Companies (5)

● Major achievements

- Having smoothly disposed of 31 high-risk companies, with 28 disposed of by the administrative means including custody, take-over and revoking business licenses, 2 by market-oriented way, and 1 by bankruptcy and restructuring;
- Having guided the restructuring of about 20 high-risk companies;
- Having dissolved all the risks left over by history, solved the problems of liquidity gap and fully cleared the business operations with concealed accounts or recorded them in accounts by centralized measures such as the risk disposal.

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Lessons learned from risk disposal of securities companies (1)

- A sound policies-and-rules system is the basis

In light of the recent years' practice, it is the policies-and-rules system based on practice and exploration that turns from a passive risk disposal to an active one, from a single one to an integral one and from a groping one to a regularized one. Thus, the investors and creditors' interests and rights are protected at maximum.

- An efficient and fair work coordination mechanism is the key

The risk disposal is complicated when dealing with the contradictions of the customers, creditors, shareholders and employees. Thus, establishing a coordination mechanism, introduction of professional intermediaries and guarantee for fairness and efficiency lay a solid foundation for the success in the risk disposal.

Lessons learned from risk disposal of securities companies (2)

- Securities market and social stability is the prerequisite

In the risk disposal, securities companies' risks should be separated from market and social risks and overall consideration to control the risk infection, while the disposal externality should be reduced for the market's sound operation and social stability. In recent years, the securities companies' risk disposal has always given priority to stability of the securities market and the society, which is an important prerequisite to success.

- Severe punishment for violation is the guarantee

Each violation should be punished once discovered, while criminal responsibility should be charged by cooperating with public security authorities. Powerful regulatory and deterrent forces should be maintained by strict law enforcement, disciplinary actions and accountability. In addition, the management of self-regulation organizations should be reinforced.

Lesson learned from risk disposal of securities companies (3)

- Securities companies' self-conscious compliance operation and effective risk control is the essential

The sound corporate governance and internal control of securities companies should be supervised and guided to improve their risk management competence. Besides, the management with compliance, good faith and stability should be encouraged for regularized development and higher competence.

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