PANORAMIC

CORPORATE GOVERNANCE

China

LEXOLOGY

Corporate Governance

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Sidley Austin LLP

Generated on: March 21, 2025

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The main pieces of legislation that regulate corporate governance in China are as follows:

- the Company Law (newly revised and effective from 1 July 2024) and judicial interpretations, which apply to both private and listed companies;
- the Minutes of the National Courts' Civil and Commercial Trial Work Conference, although not considered law, are often referred to by the courts at all levels;
- the Foreign Investment Law(effective since 1 January 2020), which applies to foreign-invested companies and replaces the Wholly Foreign-Owned Enterprise Law, the Sino-foreign Equity Joint Venture Law and the Sino-foreign Cooperative Joint Venture Law, along with their respective implementation rules;
- the Securities Law, specific to the corporate governance of listed companies;
- the Code of Corporate Governance for Listed Companies and related administrative measures, guidelines, rules and explanatorynotes issued by the China Securities Regulatory Commission (CSRC);
- the listing rules issued by Chinese stock exchanges (ie, Shanghai Stock Exchange, Beijing Stock Exchange and Shenzhen Stock Exchange) and other designated trading venues; and
- the rules and guidelines respectively issued by the National Financial Regulatory Administration (NFRA) (incorporated by China Banking and Insurance Regulatory Commission in 2023) and CSRC, which apply to companies in the sectors of banking, insurance and securities.

China adopts a 'comply or explain' approach to enforcing corporate governance norms for listed companies.

Law stated - 1 May 2024

Responsible entities

What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The National People's Congress and its Standing Committee serve as the primary legislative bodies for the Company Law, the Foreign Investment Law, and the Securities Law. These laws are primarily enforced by the State Administration for Market Regulation (SAMR), the Ministry of Commerce, and the China Securities Regulatory Commission (CSRC).

The State Council is responsible for establishing administrative regulations concerning the admission, supervision, and risk control of security companies, banks, and insurance companies. The enforcement of these regulations is mainly carried out by the CSRC and the NFRA.

In terms of rules applicable to listed companies, the CSRC, the Shanghai Stock Exchange and the Shenzhen Stock Exchange play dual roles as legislators and enforcers.

Additionally, the NFRA and the CSRC respectively enact and enforce other relevant rules pertaining to the banking, insurance, and securities sectors.

Currently, there are no well-known shareholder groups or proxy advisory firms that exert material influence on corporate governance-related issues of companies.

Law stated - 1 May 2024

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

There are two types of companies with limited liability in China: limited liability companies (LLCs) (all LLCs are private companies); and companies limited by shares (CLS) (CLS includes both private and public companies).

Limited Liability Companies

In LLCs, shareholders have the legal right to appoint and remove directors according to the procedures specified in the articles of association.

The board of directors is responsible for implementing the resolutions made by the shareholders. Resolutions related to regular business operations require the approval of shareholders representing a majority of the voting rights. Resolutions regarding amendments to the articles of association, changes in registered capital, mergers, demergers, dissolution or changes in the company's structure require the approval of shareholders representing more than two-thirds of the voting rights.

However, in wholly state-owned LLCs, an employee representative who serves as a director on the board of directors is elected by the meeting of employees.

Companies Limited by Shares

The election of directors and supervisors in CLS may adopt a cumulative voting system as specified in the company's articles of association or resolutions passed by the meeting of shareholders.

Similar to LLCs, the board of directors is responsible for implementing the resolutions made by the shareholders. Resolutions at the meeting of shareholders are adopted when more than half of the voting rights held by the attending shareholders vote in favour. Resolutions related to amendments to the company's articles of association, changes in registered capital, mergers, divisions, dissolution or changes in corporate form require the approval of shareholders representing more than two-thirds of the voting rights held by the attending shareholders.

Law stated - 1 May 2024

Shareholder decisions

What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The newly revisedCompany Law reserves to the shareholders in both LLCs and CLS on:

- electing and replacing directors and supervisors, as well as determining their remuneration;
- deliberating on and approving the reports presented by the board of directors;
- deliberating on and approving the reports presented by the board of supervisors;
- deliberating on and approving the plans for profit distribution and the allocation of losses within the company;
- making resolutions concerning the increase or decrease of the company's registered capital;
- making resolutions regarding the issuance of corporate bonds or authorise the board of directors to make such resolutions;
- making resolutions pertaining to the merger, split-up, dissolution, liquidation or change of the company's corporate form;
- amending the articles of association; and
- exercising any other functions and powers as stipulated in the articles of association.

In addition, a company is required to obtain a resolution from the shareholders' meeting for the following actions:

- providing a guaranty to any shareholder or actual controller;
- when a listed company's major asset purchases, sales or guarantees within one year exceed 30 per cent of its total assets;
- issuing new stocks and making decisions such as regarding the class and amount of the new stocks, issuing price, issuance dates and allocation of new stocks to original shareholders;
- purchasing its own shares due to a reduction in registered capital or as part of a merger with another company holding its shares; and
- setting aside discretionary reserve from after-tax profits after accruing statutory reserve.

At present, there is no legal concept or practice about non-binding shareholding votes in China.

Law stated - 1 May 2024

Disproportionate voting rights

To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

LLCs offer shareholders the flexibility to determine voting rights based on their preferences through provisions in the articles of association. If no specific provisions are outlined, the default rule is that voting rights are determined by the shareholders' ratio of capital contribution.

For CLS, the structure allows for disproportionate voting rights through different classes of shares and specific voting procedures for electing the board of directors and the board of supervisors.

CLS are permitted to issue classified shares, which may have varying voting rights compared to ordinary shares. This includes preference shares and A/B shares, which represent Weighted Voting Rights.

Preference shares limit voting rights to specific matters, such as the issuance of new preference shares, amendments to the articles of association concerning preference shares, significant reductions in the company's registered capital exceeding ten percent and actions related to merger, division, liquidation or changes in corporate form.

The arrangement of Weighted Voting Rights involves dividing a company's shares into two groups with different voting rights, typically referred to as A shares and B shares. A shares grant holders up to ten votes per share but have restrictions on transferability and must waive their voting privileges if converted to ordinary voting shares. These shares are typically held by the company's founding team. B shares carry a single vote per share and can be freely traded in the market.

In addition, CLS's article of association may incorporate a cumulative voting system for the election of the board of directors and supervisors. Under this system, each share carries a number of voting rights equal to the number of directors or supervisors to be elected, enabling shareholders to concentrate their voting power. Alternatively, a fundamental principle of 'one share, one vote' is often adopted in other instances.

Law stated - 1 May 2024

Shareholders' meetings and voting

Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Shareholders who are legally registered in the shareholders' register are generally allowed to participate in general meetings of shareholders. However, in the case of a general meeting that deals with matters concerning providing securities to a shareholder or the actual controlling party of the company, such shareholders or the shareholders controlled by the actual controlling party are not permitted to participate in the general meeting of shareholders. Additionally, in CLS with preference shareholders, participation in the general shareholders' meeting and the right to vote is typically restricted to specific circumstances.

In the case of LLCs, shareholders have the ability to pass a resolution in writing without convening a shareholders' meeting, provided that the resolution is unanimously approved and is signed and sealed by all shareholders.

Shareholders' meetings can be conducted through telecommunication means, unless the articles of association specify otherwise.

Law stated - 1 May 2024

Shareholders and the board

Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Shareholders' meetings are classified into regular shareholders' meetings and interim shareholders' meetings. In LLCs, regular shareholders' meetings are governed by the articles of association, while interim shareholders' meetings can be convened upon the proposal of shareholders representing more than one-tenth of the voting rights. In CLS, shareholders holding individually or collectively more than 10 per cent of the company's shares have the right to request the convening of an interim shareholders' meeting, which must take place within two months.

Although the current Company Law does not specifically address whether shareholders are able to vote for the resolutions and director nominations against the wishes of the board, since the shareholders' meeting holds the highest authority, it is customary for a shareholder to propose matters that may go against the wishes of the board. The board of directors, in turn, aims to implement the resolutions approved by the shareholders.

The requirement for the board to circulate statements by dissident shareholders falls within the scope of discretion governed by the articles of association, since the Company Law does not provide explicit provisions.

Law stated - 1 May 2024

Controlling shareholders’ duties

Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Affected parties have the right to sue the controlling shareholder for compensation if a controlling shareholder abuses their rights and causes significant harm to the company or other shareholders. According to Chinese law, the abuse of the rights by a controlling shareholder is considered a tort. In addition, under the newly revised Company Law, in cases of abuse by the controlling shareholder, other shareholders have the right to request the company to acquire their shares at a fair price. Furthermore, if a resolution passed at a shareholders' meeting violates any laws, administrative regulations or the company's articles of association, the resolution will be deemed null and void. Non-controlling shareholders have the right to request a court to confirm the invalidity of such a resolution.

The Code of Governance for Listed Companies specifically states that controlling shareholders of a listed company have an obligation to act in good faith towards other shareholders. A controlling shareholder is prohibited from exploiting their position, rights and pre-existing relationship with the company to the detriment of the company's interests and the interests of non-controlling shareholders.

Law stated - 1 May 2024

Shareholder responsibility

Can shareholders ever be held responsible for the acts or omissions of the company?

In general, shareholders of a company in China are not personally held responsible for the acts or omissions of the company. However, any shareholder who abuses their rights and causes loss to the company or other shareholders is liable for compensation. Additionally, veil-piercing also applies when a shareholder abuses the limited liability to evade debts.

Law stated - 1 May 2024

Employees

What role do employees have in corporate governance?

In China, employees can actively participate in corporate governance through the Employee's Representative Congress (ERC). When a company is making significant decisions related to business operations, such as restructuring, dissolution, bankruptcy application or formulating important regulations, the company is required to seek the opinions of the ERC. The ERC serves as a platform for employees to voice their opinions and concerns in decision-making processes.

Furthermore, an employee's representative can hold positions as a member of the board of directors and supervisors within the company. In addition, an employee serving on the board of directors can also become a member of the audit committee. In wholly state-owned companies, it is mandatory for the board of directors to include employee representatives.

Law stated - 1 May 2024

CORPORATE CONTROL

Anti-takeover devices

Are anti-takeover devices permitted?

In China, the use of anti-takeover devices is generally permitted, as there is no explicit prohibition in the laws and regulations. However, while there is no clear definition of 'anti-takeover' in Chinese laws, certain provisions exist that either create obstacles or exclude the use of such measures.

For instance, Article 151 of the newly revised Company Law sets requirements for the issuance of new shares, including the type, amount, price, commencement and termination dates and allocation to existing shareholders. This provision poses a significant obstacle to implementing 'poison pill' strategies.

The Measures for the Administration of Takeover of Listed Companies also include provisions to prohibit controlling shareholders or the shareholders' meeting from harming the interests of the acquired company, making major purchases or sales of assets and major investments, and disposing of the company's assets at will except for the continuation of normal business activities.Article 7prohibits controlling shareholders or de facto controllers from abusing shareholder rights to jeopardise the acquired company's legitimate interests. Article 33 states that, without shareholder approval, the board of directors of the acquired company cannot undertake actions that significantly impact the company's assets, liabilities, equity or operating results, except for normal business activities or resolutions approved by the shareholders' general meeting. Additionally, Article 52 prohibits the acquired company from issuing shares publicly to raise funds, conducting major asset transactions or investments or engaging in connected transactions with the acquirer and its related parties, except in cases where the acquirer is rescuing a listed company in crisis or facing severe financial difficulties.

Law stated - 1 May 2024

Issuance of new shares

May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

According to the newly revisedCompany Law, the authority to adopt resolutions on the increase of registered capital or the issuance of new shares rests solely with the shareholders' meeting. In the case of a listed company, the company is required to submit an application and relevant documents, including the resolution of the shareholders' meeting, to the CSRC for approval before issuing new shares.

The existence of pre-emptive rights for shareholders to acquire newly issued shares depends on the specific terms outlined in the company's articles of association. By default, shareholders in an LLC have pre-emptive rights to it. However, in the case of a CLS, shareholders do not have default pre-emptive rights unless it is specifically provided for in the articles of association.

Law stated - 1 May 2024

Restrictions on the transfer of fully paid shares

Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

In China, restrictions on the transfer of shares are permitted, regardless of whether the shares are fully paid or not. Companies have the authority to adopt such restrictions by including them in their articles of association.

The Company Law also establishes specific restrictions on share transfers, as follows.

1. Restruction for LLCs: in the case of share transfers in LLCs, the shareholder intending to transfer their shares is required to provide a written notice to other shareholders, specifying the transfer amount, price, payment method and time period. This is to ensure that other shareholders have the opportunity to exercise their pre-emptive rights.
2. Restriction for public companies: for public companies, shares that were issued prior to the public offering are generally subject to a restriction on transfer for a period of one year from the date of listing and trading of the company's shares on the stock exchange.
3. Restrictions for directors, supervisors, and senior management: directors, supervisors and senior management of a company are obligated to declare their holdings of the company's shares and any changes therein. They are generally restricted from transferring more than 25 per cent of the total number of shares held by them during each year of their term of office. Additionally, the shares held by these individuals may not be transferred within one year from the date of listing and trading of the company's shares. Furthermore, there is an additional restriction that the shares held by these individuals may not be transferred within six months after their departure from office.

Law stated - 1 May 2024

Compulsory repurchase rules

Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Share repurchases in China can be classified into two categories: statutory repurchases and contractual repurchases.

Statutory repurchases are governed by the Company Law and provide specific circumstances in which a shareholder can request the company to repurchase their shares at a reasonable price. These circumstances include:

- the company has not distributed any profits to shareholders for five consecutive years, despite having made profits and meeting the requirements for profit distribution;
- the company undergoes a merger, split-up or transfer of significant assets; and

- the term of business operation specified in the articles of association expires or any other dissolution event specified in the articles of association occurs. Unless the shareholders' meeting adopts a resolution to amend the articles of association and allow the company to continue existing.

In addition, a shareholder has the right to request the company to repurchase their shares at a reasonable price if the controlling shareholder abuses their power in a manner that severely harms the company or the interests of other shareholders.

On the other hand, contractual repurchases are voluntary agreements between shareholders and the company. The terms triggering the repurchase are typically outlined in the agreement and may include performance benchmarks, infringement of shareholders' rights by the company, shareholder withdrawal, changes in corporate structure and other mutually agreed-upon circumstances. Contractual repurchases are valid as long as they do not violate mandatory legal provisions. However, the actual implementation of such agreements can still be subject to dispute and examination in the judicial system.

Law stated - 1 May 2024

Dissenters' rights
Do shareholders have appraisal rights?

Appraisal rights for dissenting shareholders in an LLC provide a mechanism for shareholders who vote against a resolution passed at a shareholders' meeting to request the company to repurchase their shares at a reasonable price. The circumstances under which shareholders can exercise appraisal rights in an LLC include the following:

- the company has not distributed profits to shareholders for five consecutive years, even though it has been profitable during that period and meets the legal requirements for profit distribution;
- there has been a merger, division, or transfer of the company's main assets; and
- the business term specified in the articles of association has expired or the company is dissolved for reasons specified in the articles of association and a shareholders' meeting passes a resolution to amend the articles of association to allow the company to continue its existence.

If shareholders fail to reach an agreement with the company for the acquisition of their equity interests within 60 days from the date of the shareholders' meeting resolution, they have the right to file a lawsuit with a people's court within 90 days from the date of the resolution.

In the case of dissenting shareholders in a CLS, the Company Law imposes further limitations on appraisal rights. The conditions for exercising appraisal rights in a CLS are the same as those in an LLC, with the exception that dissenting shareholders cannot request the company to repurchase their shares due to their objection of a merger or division resolution.

Law stated - 1 May 2024

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The newly revised Company Law in China introduces a single-tier governance structure, departing from the previous two-tier structure. This change grants companies the flexibility to determine their governance arrangements through their articles of association.

For listed companies, Article 121 of the Company Law specifies that CLS have the option to establish an audit committee within its board of directors. The audit committee is entrusted with the powers and functions previously assigned to the board of supervisors under the previous law. Consequently, there is no longer a requirement for board of supervisors or supervisors in listed companies.

Law stated - 1 May 2024

Board's legal responsibilities

What are the board's primary legal responsibilities?

Under the newly revised Company Law, the board of supervisors and the audit committee have the following functions and powers:

- to examine the financial affairs of the company;
- to supervise the actions of the directors and senior executives in the performance of their duties – they can propose the removal of directors and senior executives who have violated laws, administrative regulations, the articles of association or resolutions of the shareholders' meeting;
- to request directors and senior executives to rectify their actions if they harm the company's interests;
- to propose the convening of interim shareholders' meetings and presiding over the shareholders' meeting in cases where the board of directors fails to fulfil its duties to convene and preside over the shareholders' meeting as prescribed by the law;
- to present proposals to shareholders' meetings;
- to initiate lawsuits against directors and senior executives who have breached their duty of loyalty and duty of care; and
- to exercise other functions and powers as provided for in the articles of association.

Law stated - 1 May 2024

Board obligees

Whom does the board represent and to whom do directors owe legal duties?

In China, the board of supervisors and the board of directors represent the interests of the company and its shareholders.

Indeed, the newly revisedCompany Law has introduced explicit provisions regarding the duty of loyalty and duty of care for the board of supervisors, directors and senior executives.

According to the law, supervisors, directors and senior executives have an obligation of loyalty to the company. They are required to act in the best interests of the company and must take measures to avoid any conflicts of interest between their personal interests and those of the company. It is prohibited for them to seek improper benefits by exploiting their positions of power.

Additionally, these individuals have a duty of diligence towards the company. When performing their duties, they are expected to exercise reasonable care, which aligns with the level of care that a competent manager would exercise in similar circumstances. This duty of care ensures that supervisors, directors and senior executives act prudently and responsibly, considering the best interests of the company.

Law stated - 1 May 2024

Enforcement action against directors

Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgement rule?

Under the provisions of the Company Law, if a supervisor, director or senior executive violates any law, administrative regulation or the articles of association while performing their duties, resulting in a loss to the company, they can be held liable for compensation. Shareholders who individually or collectively hold 1 per cent or more of the total shares for a continuous period of 180 days or longer have the right to request the board of supervisors (in the case of a supervisor's violation) or the board of directors (in the case of a director's violation) to initiate a lawsuit in the people's court. If the board of supervisors or the board of directors refuses to initiate a lawsuit after receiving a written request from the shareholders or fails to file a lawsuit within 30 days of receiving the request, the shareholders have the right to directly initiate a lawsuit in the people's court on behalf of the company.

Currently, Chinese law does not include the business judgment rule. Instead, the judicial practice in China focuses on the tort relationship and its elements to determine the liability of these individuals for breaching their duty of care. This involves analysing factors such as negligence, damage and causation to attribute liability.

Law stated - 1 May 2024

Care and prudence

Do the duties of directors include a care or prudence element?

Under the newly revised Company Law, supervisors, directors and senior executives have a duty of diligence towards the company. They must exercise reasonable care, commensurate with the standard expected of a manager, while performing their duties in the best interests of the company. Besides, they should be liable for damages caused to the company if they

perform their duties in violation of laws, administrative regulations or the company's articles of association.

Law stated - 1 May 2024

Board member duties

To what extent do the duties of individual members of the board differ?

In general, individual board members in China have similar duties regardless of their varying skills or experience. Most companies in China adhere to the duties outlined in the Company Law and the articles of association, which are applicable to all directors. However, if board members also hold positions overseeing specific aspects of company management, their duties may differ in that particular capacity.

For listed companies, the Guidelines on Governance of Listed Companies require a reasonable professional structure for the board of supervisors. Board members are expected to possess the necessary knowledge, skills and qualifications to fulfil their duties effectively.

Law stated - 1 May 2024

Delegation of board responsibilities

To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The newly revised Company Law does not explicitly outline the delegation of responsibilities from supervisors to management. Instead, it provides flexibility for companies to address this issue in their articles of association. However, it is important to note that having a board of supervisors in a company is not mandatory. The role of supervisor can be fulfilled by an audit committee formed from the board of directors.

Law stated - 1 May 2024

Non-executive and independent directors

Is there a minimum number of ‘non-executive’ or ‘independent’ directors required by law, regulation or listing requirement? If so, what is the definition of ‘non-executive’ and ‘independent’ directors and how do their responsibilities differ from executive directors?

Under the newly revised Company law, there are non-executive directors for non-listed companies and independent directors for listed companies. For CLS, if the company adopts a one-tier governance model without a board of supervisors, the directors will be entitled to form an audit committee of more than three members in which at least half of them should not be in any connection with the CLS that may affect the independent and objective judgement or be appointed for other positions within the CLS. In solely state-owned enterprises, at least half of the directors should be external directors. External directors refer

to those who are not employed by the solely state-owned enterprises, which may also include independent directors in the state-owned listed companies.

The Company Law expressly requires that a listed company must establish an independent director system and at least a third of board members must be independent directors, including at least one accounting professional.

Independent director is defined as a director who does not hold any position in the listed company other than director and who has no relationship, directly or indirectly, with the listed company and its principal shareholders, or the de facto controller that could hinder independent and objective judgements of the directors.

In accordance withthe Administrative Measures of Independent Directors in Listed Companies (the Measures) implemented in September 2023, the responsibilities of independent directors generally include:

- participating in the decision-making of the board of directors and expressing clarified opinions on the matters in discussion;
- supervising the matters where there are potential major interest conflicts between the listed company and its controlling shareholder, de facto controller, director and senior management so as to ensure the decision made by the board of directors is consistent with general interests of the listed company and protect minority shareholders' interests; and
- providing professional and objective suggestions regarding the operation and development and improving the ability of decision-making of the board of directors.

Apart from the above responsibilities, independent directors are distinguished from executive directors in the respect of statutory special powers comprising:

- engaging independently with intermediaries for audit, consultation or verification on specific matters;
- requesting to be entrusted by the shareholders to attend shareholders' meetings and be given executive shareholders' rights such as proposing and voting; and
- expressing independent opinions on matters that may impair the interests of the listed company and minority holders.

The Measures also introduce new regimes that obligate the independent directors to strengthen their independence and encourage them to be more frequently involved regarding corporate governance. For example, it is compulsory that the company host meetings attended by independence directors regularly or irregularly.

Law stated - 1 May 2024

Board size and composition

How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created

directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

Under the newly revisedCompany Law, an LLC should have a board of directors of more than three people unless the LLC is small-scaled or owned by relatively few shareholders in which case a single director will suffice. No maximum number is currently decreed for directors. For an LLC with more than three hundred employees, except where the board of supervisors is established with representatives of employees, the board of directors should be equipped with representatives of employees after democratic elections. A CLS is also subject to the rules hereof.

It is stipulated that the board of supervisors in an LLC should be comprised of at least three members. LLCs owned by relatively fewer shareholders or with a relatively smaller scale may appoint one or two supervisors instead of establishing a board. Besides, there is an alternative for LLCs to constitute an audit committee instead of a board of supervisors pursuant to the newly revised Company Law. Same pattern applies to CLSs. In addition, supervisors or a supervisory board is not necessary in solely state-owned companies.

The composition of directors or supervisors should be subject to the articles of association. Filling vacancies on the board or among newly created directors or supervisors should be decided by the shareholders' meeting, which formally entails the amendment to the articles of association.

Except for independent directors who are subject to particular regulations, the law does not set out any unified criteria a director or a supervisor should meet; however, it provides a negative list and any person that falls under this list cannot be a director or a supervisor:

- a person who has no civil capacity (under the age of 18 or unable to account for their own conduct) or limited civil capacity (under the age of 18 or unable to fully account for their own conduct);
- a person who has been convicted for corruption, bribery, conversion of property or disruption to the order of socialist market economy and a five-year period has not elapsed since the expiry of the execution period or a person who has been stripped of political rights for being convicted of a crime and a five-year period has not elapsed since the expiry of the execution period;
- a person who acted as a director, factory manager, manager in a company that has been declared bankrupt or liquidated and who is personally accountable for the bankruptcy or liquidation of the company and a three-year period has not elapsed since the completion of bankruptcy or liquidation of this company;
- a person who has acted as a legal representative of a company that has had its business licence revoked or has been ordered to close down for a breach of law and who is personally accountable and a three-year period has not elapsed since the revocation of the business licence of such company; and
- a person who is unable to repay a relatively large amount of personal debts.

At the incorporation of a company, the information of the identities of each member of the board of directors and supervisors must be registered with the commercial registry and any changes regarding the board members must also be registered with the commercial

registry. The names of board members of a company can be found in the nationwide company registration search system, namely the National Enterprise Credit Information Publicity System. Listed companies are obligated to disclose to the investors regarding the position of directors, their shareholding and annual renumeration.

Law stated - 1 May 2024

Board leadership

Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

The Company Law does not directly specify the role of CEO. In China, CEO is more of a commercial role that is legally covered by the general manager and directors as specified in the Company Law regarding their powers and functions. The Company Law does not mandate the separation of functions between a board's chair and the CEO. For LLCs, especially relatively small ones, it is common that a person performs the dual roles of the board chair and CEO. For a CLS, the separation of the board chair and CEO roles is widely deemed as a more reasonable and modern approach to avoid conflicts of interest. Even so, the dual role of being both CEO and board chair is not rare.

Law stated - 1 May 2024

Board committees

What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Pursuant to the Guidelines on Governance of Listed Companies, the board of directors of a listed company must set up an audit committee and may establish the relevant specialised committees, such as a strategic committee, nomination committee and a remuneration and appraisal committee, as required. The audit committee should supervise and evaluate external and internal audit work and internal control, propose the appointment or replacement of external audit firms, examine the company's financial information and disclosure this information. The key duties of the strategic committee are to study the company's long-term development strategies and major investment decisions and make recommendations thereto. The key duties of the nomination committee should include studying the selection standards and procedures for directors and senior management personnel and making recommendation thereto, shortlisting qualified candidates and reviewing candidates for the aforesaid positions. The remuneration and appraisal committee should study the appraisal standards for directors and senior management personnel, conduct appraisal and make recommendations thereto and study and examine remuneration policies and schemes for directors and senior management personnel. Members of the special committees should be composed of directors. Moreover, independent directors should constitute the majority of the members of the audit committee, the nomination committee and the remuneration and appraisal committee and act as the convener. The convener of the audit committee must be an accounting professional.

Law stated - 1 May 2024

Board meetings

Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no minimum requirement on the number of meetings an LLC's board of directors must hold each year, but its board of supervisors must convene at least one meeting per year.The Company Law requires a CLS to convene at least two meetings of its board of directors every year and at least one meeting of its board of supervisors every six months. The Guidelines on Governance of Listed Companies, which apply to listed companies, only states that a board of directors must convene meetings on a regular basis, whilethe Guidelines for Articles of Association of Listed Companies states that the board of directors should hold meetings no less than twice a year, which is consistent with the Company Law.

Law stated - 1 May 2024

Board practices

Is disclosure of board practices required by law, regulation or listing requirement?

The board practices of an LLC and a CLS are mainly set out inthe Company Law and the articles of association. Companies are only allowed to set up their own rules of board practices in the articles of association when the Company Law does not stipulate otherwise. Article 73 of the Company Law**s**tates that board minutes should be made for each board meeting, which should be signed by all the directors present at the meeting. The meeting should only be held when more than half of all the directors are present. Resolutions should be made with more than half of all the directors voting for passing, with each director having one vote. Nevertheless, disclosing the articles of association to the public is not obligatory for an LLC. Authorised natural persons or qualified lawyers may retrieve LLCs' files from local counterparts of the State Administration for Market Regulation from which the articles of association could be acquired.

Listed companies, however, are subject to more rigorous regulations, including listing rules and special regulations on disclosure. Listed companies should disclose regularly through publishing their regular reports (ie, annual reports, semi-annual reports and quarterly reports). An annual report should include, among other things, the reports of the board of directors, the committee structures and the number of board meetings where resolutions and attendance would be covered. In addition, listed companies should also formulate a system to manage information disclosure. The Measures of Disclosure provide a wide range of the items that this system should embrace. These include, inter alia, the duties of reporting, deliberating and disclosing for the directors, the board of directors, the supervisors, the board of supervisors and senior managers. With regard to the board of directors' procedural rules, article 29 of theGuidelines on Governance of Listed Companies specifies that the rules of procedure for the board should be formulated and be incorporated into a company's

articles of association. Board meetings should be conducted strictly according to the rules of procedure.

Law stated - 1 May 2024

Board and director evaluations

Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

There is no mandatory requirement or practice that requires the evaluation of the board in LLCs or CLSs. They may implement their own evaluation mechanism in the articles of association. In listed companies,the Guidelines on Governance of Listed Companies require fair and transparent standards and procedures to be implemented in assessing the performance and fulfilment of the duties of the directors, supervisors and senior executives. Performance assessment should be organised by the board of directors or the remuneration and appraisal committee or, alternatively, other independent (external) firms. Self-assessment, mutual assessment or other methods are introduced inthe Guidelines to assess the fulfilment of duties. Each assessment result and remuneration should be reported to the shareholders' general meeting and be disclosed.

Law stated - 1 May 2024

REMUNERATION

Remuneration of directors

How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

Article 59 of the Company Law specifies the powers of the shareholders' meeting, which are inherent and cannot be derogated or circumvented by the articles of association or shareholders' agreements. One of these powers is to appoint and remove directors, as well as to decide their salaries and compensation. Article 70 of the Company Law provides certain autonomy to companies when it comes to the tenure of directors, requiring the tenure to be set forth in the articles of association, but subject to a three-year maximum. Upon re-election or reappointment, they may continue to serve as directors in the company. For listed companies, a contract should be executed between the company and the director specifying their rights and obligations, the tenure of the director, the liabilities when the statutory or contractual obligations are breached and the compensation when the contract is terminated prematurely. The principle of fairness should be applied when considering the amount of compensation, while keeping the company's lawful interests unharmed and any behaviour amounting to the transmission of interests barred. According to the Guidelines on Governance of Listed Companies, the remuneration of directors should be

decided by shareholders' meetings. Board committees, such as remuneration and appraisal committees, may also be set up to study and review directors' remuneration schemes. It is, however, not mandatory under the Guidelines to have such a committee in place. The board of directors should report the directors' performance, the assessment results and remuneration to shareholders' meetings, which should eventually be disclosed by the company. The Company Law used to strictly prohibit providing loans to directors, either directly or indirectly through subsidiaries. Now, the stipulation has been deleted and it is subject to the governance rules made by board of directors or shareholders' meeting.

Law stated - 1 May 2024

Remuneration of senior management

How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

In LLCs or CLS, the board of directors is in charge of hiring or dismissing the manager, the vice-manager and the finance manager, as well as deciding their salaries and compensation. Usually, the articles of association will provide further details regarding the factors that may affect the remuneration of senior managers.

Providing loans to senior managers either directly, or indirectly through subsidiaries was prohibited. However, the revision of the Company Law changes the practice and leaves it to the discretion of the company.

The picture is rather different when listed companies are involved. Regulations on managers' remuneration parallel those for directors:

- the remuneration and appraisal committee, if set up, would be responsible for studying and reviewing senior managers' remuneration;
- the principle of fairness to be applied when considering the amount of compensation, without prejudice to the company's lawful interests; and
- a comprehensive evaluation mechanism for performance and remuneration must be in place, based on which performance appraisal could be conducted when determining senior managers' remuneration and other bonuses.

Upon being approved by the board of directors, the remuneration distribution plan for senior managers must then be explained in a shareholders' general meeting and be disclosed sufficiently in accordance with the Guidelines.

Law stated - 1 May 2024

Say-on-pay

Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

One of the statutory powers of the shareholders' meetings is to elect and change the directors and supervisors, as well as to decide their salaries and compensation. The shareholders' meeting could be a regular or an interim one. Regular meetings should be held in a timely fashion according to the articles of association. Where an interim meeting is proposed by shareholders representing 10 per cent of the voting rights or more, by directors representing a third of the voting rights or more or by the board of supervisors or supervisors (when no board of supervisors is in place), an interim meeting should be held. In a listed company, the remuneration of directors and supervisors would be decided at the general meeting of shareholders. A general meeting of shareholders is hosted annually. An interim general meeting should be convened in the case of any statutory circumstances.

Law stated - 1 May 2024

DIRECTOR PROTECTIONS

D&O liability insurance

Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance was first brought to China in 2002 following the promulgation of the Guidelines on Governance of Listed Companies. Article 24 of the Guidelines on Governance of Listed Companies allows listed companies to purchase liability insurance for directors on the premise that the shareholders' general meeting gives prior approval. The coverage of this liability insurance should be set out in the contract of employment or services, excluding the liabilities arising out of a breach of laws, regulations or the articles of association. The Company Law revised in 2023 added a provision that the company may insure the directors for D&O liability insurance during their tenure against liabilities incurred for discharging their duties. The company may pay the premium and the board of directors should report to the shareholders' meeting in respect of the insured amount, the insured range and premium rate. It is quite common for listed companies to insure for their directors and officers in China.

Law stated - 1 May 2024

Indemnification of directors and officers

Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Under the current legal framework in China, no specific law or regulation has directly touched upon constraints on the company indemnifying directors and officers. It is stipulated in article 191 of the Company Law that the liability incurred during discharging the duties by directors or senior managers should be borne by the company. The directors and senior managers may be held liable to the extent of intention and gross negligence.

Nonetheless, according to the Company Law, the director, executive director or general manager of a company may also be the legal representative of the company. When a

company's legal representative engages in civil activities in conformity with the law and the articles of association for and on behalf of the company, all the legal consequences arising therefrom should be borne by the company. If, while performing their duties, the legal representative causes harm or damage to third parties, the company should assume the liability. After the company indemnifies the third parties, it may seek to recoup from the legal representative who has caused or contributed to this harm or damage.

Law stated - 1 May 2024

Advancement of expenses to directors and officers

To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

This is not applicable.

Law stated - 1 May 2024

Exculpation of directors and officers

To what extent may companies or shareholders preclude or limit the liability of directors and officers?

The Company Law greatly limits the circumstances in which directors' and officers' obligations might be precluded or limited. In non-listed companies, the director should be responsible for resolutions of the board of directors. When any of these resolutions is in violation of laws, regulations, the articles of association or resolutions made by shareholders' general meetings, causing serious damage to the company, the directors taking part in the resolutions should be held liable for the company's damages. The liability may only be exempted if the directors raised objections to these resolutions at the board meeting and these objections were recorded in the minutes. The same provision is laid down in article 23 of the Guidelines on Governance of Listed Companies, governing directors' liabilities and exculpation in listed companies.

Law stated - 1 May 2024

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

Are the corporate charter and by-laws of companies publicly available? If so, where?

In China, the articles of association embody the functions and features of the corporate charter and by-laws in combination. Parts of the company information that have been registered with a local branch of the State Administration for Market Regulation (SAMR) are publicly available. However, the articles of association, in their entirety, are generally not available to the public. Qualified Chinese lawyers may acquire the articles of association

through a local branch of the SAMR if certain conditions are met (eg, when they are authorised by the company itself, or in the course of a civil proceeding, by exercising their statutory power of inquiry to retrieve all the company's files, including articles of association, from the local branch of the SAMR).

Investors are able to check articles of association through the websites of the China Securities Regulatory Commission, Shanghai Stock Exchange, Shenzhen Stock Exchange and third-party providers such as Juchao Information Network.

Law stated - 1 May 2024

Company information

What information must companies publicly disclose? How often must disclosure be made?

The following information must be disclosed constantly by SAMR and other government departments to the public regarding non-listed companies according to the administrative regulations:

- the company's registered general information;
- the registered movable assets;
- the pledges on equity;
- the administrative punishments;
- the information on granting, altering or renewing administrative permits; and
- other information that must be disclosed in accordance with the law.

In addition, companies must submit their annual reports for the previous year to the online credit disclosure system which will be disclosed to the public. This submitted information must include:

- the company's postal address, postcode, telephone number and email;
- the company's commencement, discontinuation or liquidation;
- the company's investments in other enterprises;
- the amounts, time and forms of capital contributions, subscribed and paid-up, where the enterprise is a limited liability company or a company limited by shares;
- the shareholders' equity transfer;
- the company's website and the name, website and other information on online shops engaging in online business; and
- the number of employees, total assets, total liabilities, guarantees provided externally, total owners' equities, gross operating income, prime operating income, total profits, net margin and total tax payment.

All of the above items should be disclosed to the public with the exception of the last item, which companies may opt to disclose to the public. For listed companies, the Measures of

Disclosureset forth the main documents that should be disclosed: stock prospectuses, bond prospectuses, the listing memorandum, periodic reports (annual reports, half-yearly reports and quarterly reports) and interim reports. In summary, any information that would affect investors' decisions must be disclosed. Effective from 2019, the Securities Lawexpanded the scope of significant events that should be disclosed in the reports. For stock listed companies, major events now include significant changes in a company's assets, significant guarantees or related transactions and the inability of the chairperson or manager to perform their duties. Article 81stipulates that a bond-listed company should make interim reports on significant matters affecting the trading price of bonds. In particular, the second paragraph lists 10 specific matters, including significant changes in the company's shareholding structure or production and operation status and changes in the bonds' credit ratings.

Law stated - 1 May 2024

HOT TOPICS

Shareholder-nominated directors

Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

In accordance with the Guidelines on Governance of Listed Companies, the nomination and selection of directors should be stipulated formally and clearly in the articles of associations, to ensure transparency, fairness and justice. In addition, as the shareholders' meeting is in charge of appointing directors, details of directors should be disclosed to it in advance in order to provide sufficient information of the candidates. The procedure of nominating of directors or independent directors by shareholders is usually clarified in the articles of association in a listed company. As for proxy access, Article 90 of the Securities Law regulates proxy access in general, but detailed manipulation rules have not been formulated, especially for directors nominated for proxy access.

Law stated - 1 May 2024

Shareholder engagement

Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

There is a significant number of small and medium-sized private investors in China, making up a large proportion of total investors. Listed companies' engagement with these private investors and shareholders is mainly led by companies' investor relations teams. China Securities Regulatory Commission (CSRC) posted guidance in 2022, expanding contents disclosed to the investors and setting up all kinds of channels to facilitate communication. Generally, the obligations of the listed companies with respect to engagement with the investors involve not only the company and its senior management (directors, supervisors and senior managers), but also the secretary of the board. The guidance does not stipulate specifically when to engage with the investors, leaving it to the discretion of both parties, but

the company should actively engage with the investors in accordance with the principles set in the guidance.

On 4 August 2023, the Shenzhen Stock Exchange revised the Listing Rules of Stocks in Shenzhen Stock Exchange, elaborating on the administration of engagement with the investors. It commands that engagement with investors should be given importance to. The secretary of the board of directors should be held responsible for detailed work while the board of supervisors should supervise. The Rules further stipulate the basic rules to follow when administrating engagement with investors, which include transparency, fairness and justice. Unauthorised disclosure of significant information or misleading the investors via excessive propaganda is strictly forbidden. In summary, listed companies should develop companies' investors relations management mechanisms through which the investors can engage with the company effectively and be well-informed.

Law stated - 1 May 2024

Sustainability disclosure

Are companies required to provide disclosure with respect to corporate social responsibility matters?

Generally, the methodology towards disclosing environment-related information is to combine mandatory disclosure with voluntary disclosure. The 2018 Company Law stipulated expressly that companies should bear social responsibility, but it did not mention requirement of disclosure, nor did it clarify social responsibility. In the newly revised Company Law, social responsibility covers the rights of employees, the rights of consumers and environment protection. In addition, companies are encouraged to release report on fulfilling social responsibility.

According to the Environment Protection Law and other environmentally related laws, companies that discharge pollutants must disclose to the public the names of their major pollutants, discharge methods, discharge concentration and total volume of discharged pollutants and any discharge beyond the approved quota, as well as information relating to construction and operation of pollution-preventing facilities. Listed companies are subject to more demands of the disclosure of performing environmental protection duties. Apart from the environmental information (including the information of serious pollution in the course of major asset transactions), a listed company should also disclose information pertaining to poverty alleviation and other social responsibilities in accordance with the Guidelines on Governance of Listed Companies, which since its implementation in 2018, has established the basic framework for information disclosure of ESG (Environment, Social, Governance). Further requirements are established in documents released by China Securities Regulatory Commission (CSRC) and listing rules of Shanghai Stock Exchange and Shenzhen Stock Exchange.

In addition to compulsory disclosures, the voluntary disclosure includes but is not limited to:

- the purpose and philosophy of the company in fulfilling its social responsibility;
- the protection of the rights and interests of shareholders and creditors;
- the protection of the rights and interests of employees;
- the protection of the rights and interests of suppliers, customers and consumers;

- the environmental protection and sustainable development the company is involved in; and
- the public relations and social public welfare the company is engaged in.

What is distinct under Chinese law is that the efforts to revive the rural areas and reduce poverty is encouraged to be disclosed.

Law stated - 1 May 2024

CEO pay ratio disclosure

Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

This is not applicable.

Law stated - 1 May 2024

Gender pay gap disclosure

Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

This is not applicable.

Law stated - 1 May 2024

UPDATE AND TRENDS

Recent developments

Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Company Law 2024

The major development in corporate governance over the past year is the promulgation of the newly revised Company Law (Company Law 2024), which after three reviews in the National People's Congress, is ultimately adopted and expected to be formally implemented on 1 July 2024. The revision refashions Chinese company law in multiple respects, particularly in corporate governance.

Company Law 2024 enriches the model for corporate governance by bringing in one-tier governance. It is optional for the company to decide whether to set up board of supervisors or not. An audit committee compromising of directors will suffice instead of supervisors or a board of supervisors. It is the first time that audit committees should not only be for listed

companies for supervision, but also for LLCs. The discretion now rests with the articles of association of the company. Besides, LLCs with a relatively small size of fewer shareholders need not necessarily establish a board of directors or a board of supervisors. The position of supervisors may be cancelled at the decision of all the shareholders for such companies.

Company Law 2024 strengthens the liability of the controlling shareholders and de facto controller. It is stipulated that the controlling shareholders and de facto controller should be held jointly and severally liable with the directors and senior managers for instructing them to damage the interests of shareholders or the company. Both the controlling shareholder and de facto controller should owe fiduciary duty to the company. The new approach is expected to provide more protection for the minority shareholders.

To sum up, companies have been the basic units in the national economy. Company Law 2024 is the most influential reform of the legal practice of companies since 2013. Some alterations in this reform are to react to the effect of the former revisions. It is generally believed that Company Law 2024 will improve governance by giving more autonomy to the company and protect rights of creditors and minority shareholders by tightening the responsibility of the shareholders.

Implementation of registration-based IPO System

On 17 February 2023, the China Securities Regulatory Commission (CSRC) issued corresponding rules regarding the comprehensive implementation of a registration-based initial public offering (IPO) system, replacing the previous approval-based system.

The alteration covers many respects, notably strengthening the responsibility of intermediaries. The Administration Measures on Law Firms Engaging in Securities Business, which came into effect on 1 December 2023, stipulates the range of business that law firms are approved to do, which is broadened compared to before. Law firms are encouraged to verify the information that may substantially affect the decision of investors as they draft prospectuses. Stricter demand on building comprehensive risk management systems is suggested. The Measures are to better enhance the role of law firms in capital market as the 'gatekeepers'.

In addition, protection of the interests of the investors are given greater importance. The Administration Measures on Independent Directors in Listed Companies, which came into effect on 4 September 2023, aims to improve the functions of independent directors and increase their capabilities as they play an integral role in protecting the interests of investors.

The year 2023 was also a crucial for the establishment of Beijing Stock Exchange (BSE). On 31 August 2023, the China Securities Regulatory Commission (CSRC) issued Opinions on Building Beijing Stock Exchange with High Quality, suggesting a bunch of methods for the construction of BSE, facilitating the finance for small- and medium-sized enterprises that specialise in a segmentation of an industry.

Even though the registration-based IPO system has been launched, the quality of listed companies is now the priority of regulation. On 15 March 2024, CSRC released Opinions on Strengthening Regulations on Listed Companies, targeting misconducts of listed companies such as financial fakery and illegal share reduction.

To summarise, despite drastic fluctuations in the capital markets recently, the last year witnessed the development of the reform on a registration-based IPO system. We are still observing the direction of this reform and how it will eventually reshape Chinese capital market.

Law stated - 1 May 2024