

LEGAL DEVELOPMENT

Financial Legislation has achieved great progress In 2007, the legislative work focused on refining the financial legal system, formulating and amending regulations and guidelines on macroeconomic management, financial service enhancement, financial stability maintenance, and legal compliance in administration. The legislation has achieved great progress.

Full efforts were made to refine the financial legal system Firstly, the PBC assisted relevant authorities in drafting or amending financial laws, including the *Law on Commercial Papers* and the *Law on Futures*. It also worked to seek National Congress' interpretation of relevant articles of the *Law on Commercial Papers* as required in launching the Check Imaging System nationwide and took part in the discussions on its amendments. It participated in the amendments to the *Law on Futures* and the related assessment as a member of the drafting task force. It contributed advices on the *Law on Social Security*, the *Law on Employment Enhancement* and the *Law on Statistics*. Secondly, the PBC assisted relevant departments in facilitating the formulation or amendment of administrative regulations related to the central bank's mandates. To meet the demand arising from the reform of foreign exchange administration, the PBC submitted the *Regulations on Foreign Exchange Administration (for review)* to the State Council, actively supporting the Legislative Office of the State Council to amend the regulations. In support of the Legislative Office of the State Council's drafting of the *Regulations on Deposit Insurance*, the PBC conducted in-depth research and analysis on the nature, legal status and responsibilities of the deposit insurance institutions. In addition, efforts have been made to facilitate the formulation or amendment of financial regulations, including the *Administrative*

Regulations on Credit Information Collection, *Regulations on Bank Card*, *Administrative Regulations on RMB Cash*, etc.

Amending the regulations related to the central bank's mandates, providing legal basis for the PBC to function properly To improve the financial macro-management, regulate the development of the inter-bank market, a number of regulations and guidance notes were issued, including the *Rules on the Administration of Inter-bank Lending/Borrowing*, the *Administrative Rules on Market Makers in the National Inter-bank Bond Market*, the *Administrative Rules on Forward Interest Rate Agreement Business*. To enforce the *Law on Anti-money Laundering*, so as to fulfill the PBC's mandate of guiding and coordinating anti-money laundering in the financial sector, the PBC issued the *Rules for Reporting Suspicious Transactions for Terrorist Financing by Financial Institutions*, the *Administrative Rules for Financial Institutions on Customer Identity Verification and Record Keeping of Customer Identity and Transaction Information*, which are conducive to conducting anti-money laundering in the financial sector. By reviewing and publishing guidelines such as the *Rules on Nationwide Depositing and Cashing Business through the Small-value Payment System* and the *Processing Rules of RMB Bank Settlement Account Management System*, the PBC provided institutional basis for preventing payment risks, ensuring the secure, stable and efficient operation of the payment system. To implement relevant articles of the *Real Right Law*, the PBC clarified the rules of registering the receivables that are used as collaterals, joined the drafting and promulgating of the *Rules for Registration of the Pledge of Accounts Receivables* that defines the registration agencies, registering person and contents of the registration, protecting the legitimate interests of



people claiming on and offering the collaterals and other stake holders to facilitate the development of receivables-backed financing.

Intensified streamlining of existing financial administrative regulations and the PBC rules

According the State Council's *Notice on Streamlining the Administrative Rules and Regulations*, the PBC launched the work to streamline the existing financial administrative regulations and PBC rules, made recommendations to the State Council on streamlining administrative regulations that involves the PBC's mandates and functions. The results of this work was made public through PBC announcements.

Reinforcing theoretical research of financial laws, laying the foundation for financial reform and legislation

While engaging in the relevant legislative work, in response to the new issues and events arising from the financial sector, the PBC reinforced research on the fundamental issues of financial legislation based on the practical experiences, providing theoretical basis for financial reform and legislation. Issues explored including how to reconcile the netting of the final value, guarantee, and cross-default in OTC trading agreements of financial derivatives with relevant laws and regulations, namely the *Law on Bankruptcy*, the *Real Right Law* and so on. Efforts was made to communicate and coordinate with legislative and judicial institutions in this regard to further amend relevant laws and regulations. Studies were conducted on legal issues arising from the PBC's information collection and utilization in fulfilling its anti-money laundering mandates, RMB settlement account management and credit information collection, to promote the amendment to relevant laws and regulations. Besides, two key research projects were completed, namely the project on "legislation on deposit insurance in China" and the project on "the amendment of the Law on Commercial Papers".

Steady Progress in legal compliance in administration

To enforce the *Operational Guideline on enforcing legal compliance in administration*, steady progress was made with regard to the institutional building and the supervision of law execution. Firstly, relevant rules were worked out and improved, including formulating the *People's Bank of China's Rules on Inspection Procedures of Examination, Supervision and Anti-money Laundering Investigation*, modifying the *People's Bank of China's Rules on Procedures of Administrative Punishment* and the *People's Bank of China's Rules on Administrative Appeal*. Secondly, the appeal cases were handled with great care and responsibility. As a result, 41 appeal cases were handled in the whole year. Initial judgments were maintained for 30 cases and revoked for one case. For 6 cases, the appeals were withdrawn after mediation. The principle of "stop the dispute and settle the case" was concretely implemented.

Strengthen the education of laws and regulations and improve the PBC staff's knowledge of the legal system

In the context of nationwide education of laws and regulations, the PBC further reinforced its education and training efforts in this regard. Firstly, many forms have been explored to organize the publicity and education, particularly on the *Law on Anti-money Laundering* and the *Real Right Law*, the *Operational Guidelines of the Law on Administrative Appeal*, aiming at fostering conducive environment for the education and efficiently enhance the PBC staff's sense and knowledge of laws and regulations. Secondly, to improve legal service and efficiency of legal affairs processing, the PBC established a group of in-house lawyers. The *Pilot Scheme of the PBC's in-house lawyer* and the list of the first batch of selected in-house lawyers were published, which would facilitate the staff of legal department to exert their role as advisor, assistant and legal counsel.

Real Right Law of the People's Republic of China and the Reform of Secured Transaction System in China

Real Right Law of the People's Republic of China (Real Right Law) which came into effect on October 1, 2007, respectively regulates such real rights as ownership, usufructuary rights, real rights for security, possession, etc. and acts as the cardinal law which apply to civil relationship arising from the ownership and utilization of property. In the process of drafting and amending *Real Right Law*, the PBC and the World Bank Group launched joint researches such as "report on legal protection on creditor's rights in China", "research on China accounts receivable secured finance", "research on secured transactions system in China", and so on, and proposed the PBC's views and suggestions to the Drafting Group of *Real Right Law* on the construction of secured transactions system based on the pitfalls and problems of the existing secured transactions system in China. Most of the suggestions were adopted by the Drafting Group and embodied in the relevant articles of Part IV Real Rights for Security, which has made breakthrough progress in the secured transactions system reform in China.

Real Right Law enlarges the scope of collaterals for real rights for security *Real Right Law* constructs secured transactions system through giving play to the utilities of properties and protecting the real right of the right holders, and enlarges the scope of collaterals for real rights for security. According to the provisions of Article 180, Article 181 and Article 223 of *Real Right Law*, such properties that a guarantor owns as inventories (raw materials, semi-finished products and finished products), his/its existing and future properties (buildings, ships and aircraft under

construction as well as future production equipments, raw materials, semi-finished products and finished products), accounts receivables (including the right of collecting fees for use of roads and bridges) may be used as collaterals, and thus economic subjects can make the best use of the value of his/its assets as collaterals to obtain access to financing; at the same time a creditor may get more opportunities to make profits generated from the financing with as much security as possible.

Real Right Law adds variety of secured transactions through the introduction of floating security system The relevant provisions of *Real Right Law* have reflected the essence of "floating security" although the Law does not employ the term of "floating security" due to the legislative system and tradition in China. Article 180 and Article 181 of *Real Right Law* stipulate that a guarantor may mortgage the properties he/it owns, his/its existing and future properties together, that is, his/its collaterals could be floating; Article 196 of *Real Right Law* stipulates the circumstances that the mortgaged property shall be determined in case the mortgaged property includes existing or future ones, which is similar to "crystallization" in floating security.

Real Right Law simplifies the norms of the creation of real rights for security (i) Chattel mortgage registration is converted from registration effectiveness into registration antagonism. Article 188 and Article 189 of *Real Right Law* stipulate that right to chattel mortgage shall be created when the mortgage contract becomes effective, and if a party does not register



the mortgaged property, he may not defend against the claims of any bona fide third party. (ii) Freedom of contract and party autonomy get more respect, the content of chattel mortgage contract contains less statutory elements and more room of choices for parties concerned, and thus provides more freedom for the creation of real right for security. Article 185 and Article 210 of *Real Right Law* require only the related particulars that a contract shall include in general.

***Real Right Law* strengthens its legal protection on bona fide buyers in normal commercial transactions** The second paragraph of Article 189 of *Real Right Law* stipulates that if a party registers such mortgaged property as a guarantor's existing and future inventories, he may not defend against the claims of third party which has paid the consideration and obtained the mortgaged property in the ordinary course of business operations.

***Real Right Law* improves its registration of real rights for security** (i) It determines a uniform registration system over realties. The establishment of a uniform and sound real rights registration system is one of the pre-conditions of the foundation of modern real rights system for security. Article 10 of *Real Right Law* stipulates that the state applies a uniform registration system over realties. *Real Right Law* concurrently provides uniform stipulation on the general principles of registration over realties. For instance, Article 22 of *Real Right Law* stipulates that the registration of real property shall be charged according to the quantity and may not be charged according to the size, volume or price of the real property. (ii) It innovates in the selection principle of the chattel mortgage registration site. Compared with "location of chattel", "location of

mortgagor" is more stable and more operational. Article 189 of *Real Right Law* stipulates that "the place where the mortgagor resides" should be the selection criterion on chattel mortgage registration site. (iii) It specifies the registration institution of pledge of receivables. Article 228 of *Real Right Law* stipulates that the registration institution of pledge of receivables should be the credit information system organ and that the registration creates real rights for security, validity acting against a third party and the priority to gain compensation.

***Real Right Law* Provides clear priority rules** *Real Right Law* provides clear priority rules. Article 199 of *Real Right Law* stipulates that where the same property is mortgaged to two or more creditors, the proceeds from the auction or sale of the mortgaged property shall be used for liquidation according to the following provisions: where a mortgage contract takes effect with its registration, the liquidation shall be made in the order of the time of registration of the mortgaged property; if the registration is in the same order, the liquidation shall be made according to the respective proportions of the claims; the claim secured by registered mortgage shall be satisfied prior to the claim secured by unregistered mortgage; liquidation of unregistered mortgage shall be made according to the respective proportions of the claims.

***Real Right Law* further improves the realization system of real rights for security** The following reforms and improvements made in *Real Right Law* will contribute to the reduction of litigation burden of financial institutions and thus save costs of realization of real rights for security. (i) The parties concerned may freely stipulate circumstances for realizing real rights for security.

According to Article 170, Article 203 and Article 208 of Real Right Law, the parties concerned may freely stipulate circumstances for realizing real rights for security except for the circumstance that the debtor fails to pay due debts. (ii) The realization of real rights for security has further improvement. According to Article 195 of Real Right Law, the mortgagee and the mortgagor may, by concluding an agreement with the mortgagor, realize his/its real rights for security. In case the mortgagee and the mortgagor fail to conclude an agreement on the means of realizing the right to mortgage, the mortgagee may request the People's Court to auction or sell off the mortgaged property without lawsuit as long as his/its right status is adequately clear. (Iii) Real Right Law enhances

some binding provisions aiming at promoting a creditor to realize his/its real rights for security in a timely manner. Article 202 of Real Right Law stipulates that if the holder of security interest fails to act on the security interest upon the expiry of prescribed period for litigation, it shall not be protected by the People's Court.

The real rights system for security that Real Right Law has constructed makes progressive convergence with modern international secured transactions system and signifies the establishment of a scientific, uniform and perfect real rights system for security of China. It will promote the innovation and development of China financial market.