On 23 April 2019, China Securities Regulatory Commission (CSRC) announced the first administrative reconciliation case after four years’ trial implementation of the administrative reconciliation system in the securities and futures sector.

According to the CSRC, the administrative reconciliation system is an important institutional arrangement to adapt to the rapid development of the capital market, aiming to resolve the contradiction between limited administrative resources and the administrative efficiency in an efficient way, and to protect the legitimate rights and interests of investors.

I. Background and purpose of the introduction of the administrative reconciliation system for securities and futures

Since the cost (penalty) of illegal (criminal) acts involving securities and futures, as stipulated in current Securities Law, Criminal Law, etc., is far too low in China, for a long time, in the sector of securities and futures,
especially in the securities market, various violations of laws and regulations, such as false representation, insider trading, market manipulation and fraud on customers, have frequently occurred. At the same time, the regulatory agencies, due to limited means of investigation and scope of authority, often need a long time for investigation in individual cases. Such a lag in administrative punishment has greatly affected the deterrent effect of punishment and been detrimental to the stabilization of market expectations. For investigated enterprises, being investigated by regulatory agencies means a prolonged hinderance to normal operations. In addition, when securities and futures violations occur, the ultimate victims are often small and medium investors, for whom how to obtain more timely and effective protection has always been a problem. Albeit existing laws vest investors with the right to obtain compensation through civil litigation, the litigation per se, especially in term of civil compensation lawsuit concerning false statement in the securities market, often entails such problems as time-consuming, high-cost, complicated proof procedures and uncertain outcomes in procedures and proofs etc. All of the above have prompted the General Office of the State Council to issue the “Opinions on Further Strengthening the Protection of Small and Medium Investors' Legitimate Interests in the Capital Market” in 2013, proposing to “explore the establishment of an administrative reconciliation system for securities and futures, carry out administrative reconciliation on a pilot basis.”

It is against this background that the CSRC, aiming to “protect the interests of investors, resolve conflicts in a timely manner, and stabilize market expectations”, issued the “Implementing Measures for the Pilot Program for Administrative Reconciliation” on February 17, 2015 (hereinafter referred to as “the Pilot Measures”).

II. Key points of the administrative reconciliation system for securities and futures

1. Meaning of administrative reconciliation
Administrative reconciliation refers to the act that the CSRC, in the course of conducting the investigation and law enforcement for a violation of the laws, administrative regulations and the relevant regulatory provisions with regard to securities and futures in which a citizen, legal person or other organization (hereinafter referred to as the "administrative counterpart") is suspected of being involved, upon the application filed by the administrative counterpart, reaches an administrative reconciliation agreement with the administrative counterpart through consultation in respect of such matters as correcting the suspected violation of the laws, eliminating the adverse consequences of such violation, and making administrative reconciliation payment to compensate the losses of investors, and accordingly terminates the procedures for investigation and law enforcement.

2. Scope and prerequisites of administrative reconciliation

The administrative reconciliation parties are limited to the CSRC and the administrative counterpart, the latter being investigated by the CSRC due to such suspected behaviors as false representation, insider trading, market manipulation, fraud on customers and other violations of securities and futures regulations. It is worthwhile to pointed out that the regulatory department in administrative reconciliation is limited to the CSRC, and that the dispatched agency of the CSRC does not have the authority to carry out any administrative reconciliation. Where an administrative counterpart is suspected of being involved in false representation, insider trading, market manipulation, fraud on customers or other violations of the laws, administrative regulations or the relevant regulatory provisions regarding securities and futures, and the case meets all of the following circumstances, the administrative reconciliation procedures may apply:
(1) the CSRC has initiated the case formally and completed necessary investigation procedures, but it is difficult to completely ascertain the facts or legal relation of the case;
(2) the adoption of administrative reconciliation is beneficial to achieve regulatory purposes, reduce disputes, stabilize and define the market expectation, restore the market order and protect the lawful rights and
interests of investors;
(3) the administrative counterpart is willing to take effective measures to compensate investors for their losses resulting from a suspected violation of the laws by the administrative counterpart; and
(4) the case is closed by means of administrative reconciliation, which neither violates the prohibitive provisions of the laws or administrative regulations, nor damages the social public interests or the legitimate rights and interests of other people.

With regard to item (1) of the above, the "Pilot Measures", while keeping silent on the necessary investigation procedures which shall be undergone after the CSRC officially initiated the case, clearly stipulates that where the investigation lasts for less than three months, an application shall not be accepted except for special circumstances. Therefore, the CSRC can only accept an application for administrative reconciliation if the CSRC has consecutively investigated the case for at least three months and the facts or legal relationship of the case cannot be clarified.

Meanwhile, administrative reconciliation is excluded in the following circumstances:
(1) a violation of the laws of the administrative counterpart is of clear facts, sufficient evidence and explicit application of law, and the administrative punishment shall be imposed in accordance with the law;
(2) the administrative counterpart is suspected of being involved in a crime and the case shall be handed over to the judicial authority for handling in accordance with the law; and
(3) the CSRC deems it is inappropriate to conduct administrative reconciliation based on the principle of prudential regulation.

In addition, the administrative reconciliation procedure is not applicable to cases investigated by the CSRC dispatched agency during the pilot period.

3. Administrative reconciliation procedures
For ease of reading and understanding, the following procedures for administrative reconciliation are illustrated in both chart and text.

1. The Investigation Department of the case will not suspend the investigation following an application for settlement; but it will suspend the investigation after the settlement agreement is signed.

2. If the case has been transferred to the Case Hearing Department when applying for the settlement, the Case Hearing Department will suspend the hearing.

3. After the case is settled, the case investigation or hearing will be terminated.

4. If the settlement agreement is not fulfilled, the investigation procedure will be restarted, after which the settlement procedure will no longer apply.
(1) Application

The administrative counterpart is required to submit to the CSRC an application along with relevant materials to initiate the administrative reconciliation procedure.

(2) Acceptance

The Reconciliation Implementation Department of the CSRC shall seek the opinions of the Investigation Department of the CSRC in writing on whether the case falls within the scope and prerequisites stipulated in the “Pilot Measures”; if the case has been transferred to the Case Hearing Department of the CSRC, it shall seek the opinions of the Case Hearing Department of the CSRC in writing. If the administrative reconciliation is in compliance with the provisions of the “Pilot Measures”, the Reconciliation Implementation Department shall issue a notice of acceptance.

(3) Reconciliation Consultation

After the Reconciliation Implementation Department accepts the application, it may communicate and negotiate with the administrative counterpart.
counterpart in the form of face-to-face consultation on the matters stipulated in the “Pilot Measures”. During the consultation, there shall be no less than two staff members, who shall be strictly subject to the system of withdrawal. The time limit for administrative reconciliation consultation is three months, which may be extended upon the approval of the main responsible person of the CSRC.

(4) **Signing the settlement agreement and disclosing the main content of the agreement**

The settlement agreement shall include:

1) the reasons for administrative reconciliation;
2) the amount and method of administrative reconciliation payment made by the administrative counterpart;
3) other specific measures taken by the administrative counterpart to rectify a violation of the laws in which the administrative counterpart is suspected of being involved and eliminate or reduce the harmful consequences caused by such violation;
4) the time limit for performance of the administrative reconciliation agreement by the administrative counterpart; and
5) other matters that need to be stated.

The amount of the administrative reconciliation payment is one of the key elements of the administrative reconciliation agreement. The amount of administrative reconciliation payment shall be determined by considering the following factors:

1) the amount of a fine to be imposed or of illegal gains to be confiscated in accordance with the law for a confirmed violation of the laws in which an administrative counterpart is suspected of being involved;
2) the income obtained, or the loss avoided, by an administrative counterpart due to a violation of the laws in which the administrative counterpart is suspected of being involved; and
3) the losses incurred by others due to a violation of the laws involved in the case.
The management and use of the administrative reconciliation payment shall be performed by China Securities Investor Protection Fund Co., Ltd. in accordance with the “Interim Measures for the Management of Administrative Reconciliation Payments”. Investors can obtain compensation through the administrative reconciliation payment compensation procedure.

(5) Fulfillment of the administrative reconciliation agreement by the administrative counterpart

The Settlement Implementation Department supervises the administrative counterpart in fulfilling the obligations stipulated in the agreement within the time limit stipulated in the agreement.

(6) Settlement of the case

After the administrative counterpart performs all the obligations, the Reconciliation Implementing Department shall issue a notice on administrative reconciliation settlement to the administrative counterpart and copy the same to the Case Investigation Department, the Case Hearing Department and the administrative reconciliation payment management organization. The Case Investigation Department and the Case Hearing Department shall terminate the case investigation or hearing according to the provisions.

III. Conclusion

For the supervisory authority, administrative reconciliation is conducive to improving efficiency of investigation, promoting settlement of case, stabilizing market expectations, and, through settlement negotiation and implementation thereof, correcting irregular behavior of administrative counterpart; For administrative counterpart, administrative reconciliation is conducive to accelerating the resolution of dispute, reducing the negative social impacts due to involvement in investigation, and detecting/correcting irregular behavior in time to restore enterprise’s normal operation; while for damaged investor, administrative reconciliation enriches remedies which can provide protection in a timely
manner. Even though the first successful case of administrative reconciliation appeared only after four years of implementation of the “Pilot Measures”, it is still our hope that the legal system will play a more active role in the regulatory authority’s investigation and handling of violations in the securities and futures sector.

For more information, you may contact:

Huang Chen
Partner
Chen & Co. Law Firm
Phone: +8621 2228 8360
Email: huangc@chenandco.com

Arthur Chen
Partner
Chen & Co. Law Firm
Phone: +8610 5913 5451
Email: czj@chenandco.com

Coco Feng
Associate
Chen & Co. Law Firm
Phone: +8610 5815 4043
Email: keou.feng@chenandco.com