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An Interpretation of the SAIC's Measures on Pledged Shares Registration

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Pursuant to Article 226 of the Property Law of the People's Republic of China (the "Property Law"),[1] the administrative bureau for industry and commerce is responsible for the registration of pledged shares unregistered with the securities depository and clearing institution. Nevertheless, the State Administration for Industry and Commerce (the "SAIC") failed to introduce relevant measures on pledged shares registration upon the implementation of the Property Law and, therefore, there was no uniform legal basis for proceeding with pledged shares registration. Almost a year later, the long-awaited Measures of the SAIC on Pledged Shares Registration (the "Measures") were finally promulgated by the SAIC on 4 September 2008 with effect from 1 October 2008.

Application scope of the Measures

Pursuant to Article 2, the Measures are applicable to the registration of pledged shares in limited liability companies and joint stock-limited companies at the administrative bureau for industry and commerce. Meanwhile, the Measures expressly exclude the pledge of shares in joint stock-limited companies registered with securities depository and clearing institutions (Companies whose shares shall be registered with securities depository and clearing institutions by law include listed companies, public offering companies and non-public offering stock-limited companies which have more than 200 (including 200) shareholders). Hence, the Measures are applicable only where a shareholder intends to pledge shares in a limited liability company or non-public offering stock-limited company which has less than 200 (excluding 200) shareholders.

According to Article 5 of the Measures, registration of a pledge over shares in a foreign investment enterprise is subject to the prior approval of the original approval authority for the establishment of the enterprise. Apparently, limited liability companies referred to in the Measures should include foreign investment enterprises. According to Article 23 of the Implementation Rules on the Foreign Enterprises Law (the "Implementation Rules"), a foreign enterprise shall also obtain the approval authority's approval and file with the administrative bureau for industry and commerce the foreign mortgage of shares in the foreign enterprise.[2] The term "foreign mortgage" means the case of a foreign enterprise creating a mortgage over its assets or interests in favour of financial institutions (including branches established in the PRC), companies, enterprises or other economic organizations outside the PRC.[3] In addition, the Rules for the Change of Shares of Investors in Foreign Investment Enterprises (the "Rules for Change of Shares") state that the pledge over shares in a foreign investment enterprise necessitates the approval of the approval authority for the establishment of the enterprise and filing with the company registration authority. Compared with the Implementation Rules, the Rules for Change of Shares do not make any distinction between foreign and domestic pledge. We understand that, prior to the introduction of the Measures, the pledge over shares in the foreign investment enterprises necessitated both the approval from the relevant approval authority and filing with the company registration authority, regardless of whether it was a domestic or foreign pledge. Hence the provision of the Measures that the pledge over shares in a foreign investment enterprise necessitates "the prior approval of the approval authority for the establishment of the enterprise" is to reaffirm the Implementation Rules and the Rules for Change of Shares.

Registration review

Article 3 of the Measures states that the administrative bureau for industry and commerce with which the company concerned is registered is responsible for pledged shares registration. The purpose of the pledged shares registration is not to review the legality and validity of the pledged shares, but to enhance the effectiveness of public notification and improve the level of social credit. Hence the registration authority shall review the format of the application documents submitted for pledged shares only. As for the authenticity, validity and legality of the application documents, the pledgor and pledgee shall assume the legal responsibilities jointly. An outcome of the application only depends upon whether the pledgor and pledgee have submitted all the application documents set forth in the Measures.

Registration requirements

The pledgor and pledgee shall jointly submit all the application documents required by the Measures to the registration authority in relation to the establishment, modification and cancellation of the pledged shares. Pursuant to Article 7 of the Measures, the following documents should be filed with the registration authority in respect of the application for the establishment of pledged shares registration:

- Application for the Establishment of Pledged Shares signed or sealed by the applicant;
- Duplicate of the register of shareholders of the limited liability company, which records the name and amount of capital contribution of the pledgor or the duplicate of shares held by the pledgor in the joint stock-limited company (affixed with corporate seals);
- Pledge contract and duplicate of either legal person status certification or natural person identity certificate of the pledgor and pledgee (the duplicate needs to be either signed if the pledgor or pledgee is a natural person or affixed with corporate seals if the pledgor or pledgee is a legal person).

Where there is any modification to the amount of pledged shares, the name of the pledgor or pledgee, or the name of the company in which the shares are pledged, the pledgor and pledgee shall make an application for registration modification. Article 9 of the Measures sets out all the documents that need to be submitted for registration modification. Pursuant to Articles 10 and 12, the pledgor and pledgee shall submit an application for registration cancellation where any of the following events occur (1) the principal indebtedness is paid off; (2) the rights of pledge are realized; (3) the pledgee waives its rights of pledge; or (4) other situations as prescribed in law resulting in the loss of the rights of pledge. Where the pledge contract is held invalid or revoked by law, either the pledgor or the pledgee is entitled to submit an application for registration revocation. The registration authority shall process the registration application on the spot and issue the notice of registration if the application is successful. The notice of registration should be affixed by the registration authority with the special seal for pledged shares registration.

Furthermore, it is worth emphasizing that shares to be submitted for the pledge registration must be transferable and capable of being pledged. Article 5 of the Measures states where the shares are frozen by a people's court, before having the shares unfrozen, the pledgor and pledgor cannot apply for pledged shares registration.

To support the implementation of the Measures, the SAIC released sample documents for the registration of pledged shares on 1 September 2008. In the application form for the establishment or modification of pledged shares registration, the SAIC makes it clear that a company limited by shares is not allowed to accept its own shares as the object of the pledge (PRC Company Law, Article 143).

In conclusion, the promulgation and implementation of the Measures have provided a legal basis for the specific operation in the registration of pledged shares in limited liability companies and joint stock-limited companies, and standardized the practice of local administrative bureaus for industry and commerce in proceeding with pledged shares registration. Meanwhile, the Measures have also achieved the legislative purpose as provided in Article 226 of the Property Law, which is to enhance the effectiveness of public notification and improve the level of social credit through pledged shares registration.

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1 The Property Law came into force on 1 October 2007.
2 Prior to the Security Law, the term "mortgage" included "mortgage" and "pledge".
3 See the Reply of the Ministry of Foreign Trade and Economic Cooperation on the Issue Concerning the Foreign Mortgage of Assets or Interests in Foreign Enterprises. Wai Jing Mao Fa Han Zi No. 66[1996].