

client alert

IPO | CHINA |

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CHINESE SECURITIES REGULATOR RELEASES AMENDED DRAFT IPO RULES FOR PUBLIC COMMENT

BACKGROUND

On November 6, 2015, the Chinese Securities Regulatory Commission (“CSRC”) released draft amendments to its initial public offering and stock listing measures for the main boards and Growth Enterprise Markets to seek public comments.

The two laws under consideration for amendment are the:

- Administrative Measures for Initial Public Offering and Listing of Stocks (“Main Board IPO Measures”); and
- Administrative Measures for Initial Public Offering and Listing on the Growth Enterprise Market (“GEM Board IPO Measures”).

This Client Alert highlights the main changes made and their potential impact on foreign investors. As the draft amendments are still in the public comment stage, none of the changes discussed herein have been implemented or are in effect.

ANALYSIS

Main changes

The draft amendments remove the condition of independence from listing conditions, which means that the issuers no longer need to pass the CSRC’s review of their independence (including non-competition and transactions with related parties issues).

Independence no longer required as listing condition

Under the Main Board and GEM Board IPO Measures, the issuer must have an integral business structure and the ability to operate in the market “independently” – that is, it must have intact assets, independent personnel, financial independence, organisational independence, and business independence. These requirements have been removed in the draft amendments, and thus the CSRC will no longer verify an issuer’s independence.

However, issuers seeking listing on the Main Board must still disclose in their prospectus the following information: separation of assets, personnel, financing, organisation, and business with their controlling shareholder, de facto controller, and entities under the issuer's control. They must also explain whether they have an integral business structure and the capacity to operate in the market independently. Issuers seeking listing on the GEM Board are not required to disclose such information in their prospectus.

Non-competition and related-party transactions no longer required as listing conditions

Under the Main Board and GEM Board IPO Measures, the issuer may not have any competing business or "obviously unfair" related-party transaction with its controlling shareholders, de facto controller, or entities under the issuer's control. This requirement has also been removed in the draft amendments. The CSRC will no longer verify the non-competition and related-party transaction issues of an issuer.

However, issuers must still disclose details about any competition between them and their controlling shareholder, de facto controller, and entities under their control, as well as any related-party transaction issues, in their prospectus. They must also disclose measures to deal with such matters.

Impact on foreign investor's investment in China

While the draft amendments remove independence, non-competition and related-party requirements from listing conditions, it does not mean that issuers no longer need to clear its competition or related-party transaction issues before IPO if such issues may harm the interests of the listing company or minority shareholders.

To supervise the independence of listing companies, the CSRC intends to reinforce disclosure requirements instead of carrying out a substance review. It also remains to be seen to what extent the independence requirement will actually be relaxed in follow-up implementing rules issued by the CSRC or Chinese stock exchanges.

Once these changes are implemented, foreign investors may be impacted in several ways:

IPOs of foreign-invested enterprises ("FIEs") in China

The strict prohibition of non-competition between an issuer and its controlling shareholder effectively bars many foreign-controlled FIEs (e.g. a multinational company's affiliate in China) from launching an IPO in China. The shareholder of a FIE which (or the shareholder's subsidiaries in other countries) which has the same or similar business in other parts of the world that may compete with the FIE's business in China would first need to restructure its business globally to ensure no competition between them before its IPO. Such restructuring is costly and time-consuming, and may not even be feasible for a multinational company. After the independence requirement is removed from listing conditions, multinationals may have the option of listing part of their businesses in China.*

Acquisition of domestic companies in China

Foreign investors, when acquiring a domestic company that intends to launch an IPO in the future, are often requested to undertake to exit from the company before the IPO if they or their subsidiaries have the same or similar business that will compete with the company's business. Some foreign investors may even be forced to abandon their acquisition project because of the undertaking requirement. The removal of the independence requirement from listing conditions may ease foreign investors' acquisitions of pre-IPO domestic companies.*

* Subject to the filing requirements and position on non-compete issues of the stock exchanges if IPO registration system is implemented in China

Acquisition of shares in a listed company in China

Under the Administrative Measures for the Takeover of Listed Companies, when a foreign investor intends to purchase more than 20% of the issued shares in a listed company (or if less than 20%, in case the foreign investor will become the largest shareholder or actual controller of the listed company), the foreign investor must disclose whether there is any competition between it and the listed company. If there is, it must also disclose whether arrangements have been made to avoid competition and maintain the independence of the listed company. While the draft amendments of the Main Board and GEM Board IPO Measures concern only IPOs, if independence is removed from mandatory listing requirements, the requirements for foreign acquisition of Chinese listed companies may also be released to a similar extent.

COMMENTS

The draft amendments to the Main Board and GEM Board IPO Measures constitute an important step in the PRC for encouraging companies to list. The contemplated changes further indicate that Chinese authorities intend to reform the IPO system from regulatory verification to simple registration. All parties are now waiting for more detailed implementing rules to see how much impact the draft amendments may have in practice.

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