



October 25, 2012

Capital Market Law

CSRC Released New Measures to Supervise Unlisted Public Companies

Yang CHEN

On October 11, 2012, the China Securities Regulatory Commission (the “CSRC”) issued the *Administrative Measures for Supervision over Unlisted Public Companies* (the “Measures”), which will take effect on January 1, 2013. The Measures set the scope of unlisted public companies, raise the basic requirements for corporate governance and information disclosure, and clarify the application procedures for public transfer, share transfer and private offering. In particular, unlisted public companies that have more than 200 shareholders are included within the scope of CSRC supervision.

The issuance of the Measures will optimize the supervision over unlisted public companies in the following ways, a) it shall loosen the limitation on object scope and number of private offerings, encouraging innovative enterprises to set up their own equity incentive mechanism; b) it shall loosen the standards on exemption of rapid financing, making the directional finance more convenient; c) it shall explicitly require the unlisted public companies to conduct their public transfer in legally established stock exchanges, reserving some space for “transfer listings.” The 63-article on the Measures has 8 chapters, i.e., general provisions, corporate governance, information disclosure, stock transfer, private offering, supervision and management, legal liabilities, and supplementary provisions. The main contents of the Measures are as follows:

Unlisted Public Companies Under Supervision

The unlisted public companies refer to joint stock companies that are under any of the following circumstances and whose shares are not listed or traded on stock exchanges:

- a) Issuing or transferring shares to specific investors to produce over 200 shareholders; or
- b) Transferring shares publicly to the general public.

In current practice, the first situation mainly refers to a) companies that have over 200 shareholders after issuance or transfer on the purpose of executing an equity incentive plan or introducing strategic (financial) investors, while the second situation mainly refers to b) companies which transfer their shares on legally established stock exchanges, including property right exchanges (equity exchanges) and the small and medium-sized enterprise share transfer system (the new third board).

According to the *Company Law of the People's Republic of China* and other the relevant provisions of laws and regulations in force, the number of shareholders of a joint stock company shall be not less than two but not more than two hundred. Where a joint stock company that has more than 200 shareholders is to issue shares, it shall meet the conditions as prescribed by the laws and regulations and submit an application to the securities regulatory authority under the State Council for examination and approval. Shares shall be issued in public manners to non-specific persons. Shares shall be transferred on lawfully established stock exchanges or such other ways as may be so prescribed by the State Council. The Measures get rid of the traditional 200 limit of the number of shareholders, allowing the unlisted public company to publicly issue and transfer shares, and the participants are not limited to directors, supervisors, senior managers and key employees. Instead, those who qualify for the relevant regulations, namely natural person investors, corporate investors and other economic organizations, are regarded as eligible participants, thus allowing private investors to participate in the transfer and issuance of unlisted public company shares.

Companies that meet the following conditions are subject to the regulations for unlisted public companies under the Measures:

- a) Joint stock companies whose shares are not listed or traded on stock exchanges and that issue specific investors or transfer shares to specific investors to produce over 200 shareholders, or transfer shares publicly to the public; and
- b) Having a clear shareholding structure, conducting legal and standard operations, having established corporate governance mechanisms and performing the obligation of information disclosure.

In addition, the shares of the unlisted public company shall be registered with and deposited in China Securities Depository and Clearing Corporation Limited.

Joint stock companies that have more than 200 shareholders before the enforcement of the Measures, regulated in accordance with the relevant laws and regulations, after confirmation by the CSRC, may submit an application for examination and approval in accordance with the Measures to be included within the scope of the Measures. This process allows the Measures to regulate the companies that have more than 200 shareholders.

In practice, even during the pilot of the "The new third board," the number of shareholders is

strictly maintained at 200, which limits the development of the company and any potential investment opportunities. The Measures get rid of the limitation, which is helpful for the innovative unlisted public companies in conducting an equity incentive plan to retain key employees and for developing unlisted public companies to finance and expand their scale.

Intensifying the Ability of Corporate Self-governance, Bringing into Play the Role of Intermediaries and Enhancing Investors' Risk Awareness

The Measures intensify the ability of corporate self-governance based on three aspects: firstly, considering the characteristics of unlisted public companies and actual needs for regulation, the CSRC set forth principled regulations on unlisted public company governance to guide them to improve corporate governance mechanisms; secondly, focusing on the safeguard of shareholders' legitimate rights and interests, to require the Boards of Directors to discuss and evaluate whether or not corporate governance mechanisms will ensure that all shareholders enjoy full and equal rights, and require companies to set forth the system of voting right exclusion in articles of association as appropriate; thirdly, promoting companies to conduct "self-governance" legally, to require companies to set forth the mechanism of conflict and dispute settlement among shareholders in articles of association, and support shareholders in claiming their legitimate rights and interests in judicial ways including arbitration, mediation and civil litigation.

The Measures bring into play the roles of securities service agencies including securities companies, accounting firms and law firms, which are all regulated by the CSRC. Securities companies, law firms, accounting firms and other securities service agencies that issue special documents to companies shall be diligent, responsible, honest and trustworthy, carefully perform the obligation of prudential examination, offer professional opinions in accordance with legally formulated business rules, industrial practice standards and code of ethics, ensure the authenticity, accuracy and integrity of issued documents, and accept the supervision of the CSRC. When having doubts about the authenticity, accuracy and integrity of documents issued by securities companies and securities service agencies, the CSRC may require relevant institutions to make explanations or supplements, and review their working papers. Companies shall assist securities service agencies that provide service to them and provide required materials in accordance with the requirements. Financial accounting reports in annual reports that are planned to be disclosed shall be audited by accounting firms with business qualifications for securities and futures. Recommendation reports issued by securities companies, documents issued by law firms, accounting firms and other securities service agencies, and other relevant important documents shall be disclosed as documents for reference.

Law firms that issue special documents to companies shall be diligent, responsible, honest and

trustworthy, carefully perform the obligation of prudential examination, offer professional opinions in accordance with legally formulated business rules, industrial practice standards and code of ethics, ensure the authenticity, accuracy and integrity of issued documents. Documents issued by law firms and other relevant important documents shall be disclosed as documents for reference. (The Measures provide that specific content and formats of information disclosure documents, rules of formulation and disclosure requirements shall be prepared separately by the CSRC.) Where the unlisted public company is able to conduct any business with respect to merger, acquisition or corporate restructuring, apply for publicly transferring their shares to the general public or targeted issuance (including two circumstances, i.e., issuing shares to specific investors to produce over 200 shareholders and public companies that have more than 200 shareholders issuing shares to specific investors), law firms shall issue relevant legal opinions. Such documents shall be regarded as important parts of the application documents when unlisted public companies apply for CSRC approval.

The Measures establish the system of investor eligibility, require participants to have corresponding capabilities of risk awareness and tolerance, further enhance investors' concept of "risks are born by buyers" and practically reduce systematic risks. The regulations on investor eligibility management shall be formulated separately by the CSRC.

Information Disclosure Obligations

The Measures provide that unlisted public companies and other obligators of information disclosure shall, authentically, accurately, completely and duly disclose information, and the information disclosure documents include regular reports, public transfer instructions, private share transfer instructions, etc. The specific content and formats, rules of formulation and disclosure requirements shall be formulated by other CSRC documents.

Except for announcements issued by the Boards of Supervisors, the information disclosed by companies shall be released in the form of announcements issued by the Boards of Directors and announced on information disclosure platforms assigned by the CSRC. Companies that transfer shares to specific investors to produce over 200 shareholders may set up other ways of information disclosure in articles of association.

The Measures simplify the information disclosure process of unlisted public companies by stressing several key points, including 1) regular reports that shall be disclosed only to include annual and semiannual reports rather than quarterly reports 2) the information shall be disclosed through information disclosure platforms assigned by the CSRC rather than on newspapers and magazines, which is conducive to the establishment of a unified electronic disclosure platform.

Merger, Acquisition, Reorganization and Takeover

1) Merger, Acquisition and Reorganization

Where an unlisted public company conducts merger, acquisition and reorganization, it shall fulfill the relevant decision-making procedures and hire securities companies and other relevant securities service agencies to provide professional opinions.

2) Takeover

The Measures require either the purchaser or its actual controllers to have sound corporate governance mechanisms and good credit records.

The Measures require a 12-month lock-up period for the shares of unlisted public companies acquired by the purchaser in the purchase of public companies.

Regarding the process of merger, acquisition, reorganization and purchase activities, the Measures introduce intermediaries to provide services, such as ensuring that the ownership of the assets involved in the major asset reorganization shall be clear and the price of assets involved shall be fair. Also, a sound corporate governance mechanism shall be formed after reorganization in order to safeguard unlisted public companies and shareholders' legitimate rights and interests.

Requirements of Share Transfer

1) Share Transfer by Agreement in a Non-public Way

Shares shall be transferred to specific investors by agreement in a non-public way. Companies that transfer shares to specific investors that produce over 200 shareholders shall, within three months from the date of occurrence of the above-mentioned behavior, fill out application documents in accordance with relevant regulations of the CSRC, and submit application documents to the CSRC for approval.

The Measures set no threshold for companies that transfer shares to specific investors to produce over 200 shareholders, and such companies may apply to the CSRC for examining or reducing the number of shareholders within three months after the occurrence of the above-mentioned circumstances. If the number of shareholders drops to less than 200 within the three months, companies do not need to file applications. At the same time, in order to prevent supervision arbitrage, shares shall not be transferred publicly but be transferred to specific investors by agreement in a non-public way. If planning to transfer shares publicly or issue shares to specific investors, such companies shall apply for examination and approval in accordance with the following regulations.

2) Public Transfer

For companies that apply for publicly transferring their shares to the general public, the

Boards of Directors shall make resolutions on specific plans for the public share transfer in accordance with the law, submit resolutions to general meetings of shareholders for approval, such resolutions of general meetings of shareholders must be adopted by the attending shareholders with two thirds or more vote. Companies shall make application documents for the public transfer in accordance with the relevant regulations of the CSRC, and submit application documents to the CSRC for approval.

For companies that apply to publicly transfer their shares to the general public, the Measures loosen administrative regulation and simplify permit procedures, mainly requiring sound governance mechanisms and standard information disclosure. No financial targets are set and no profiting requirements are raised for companies that apply for public transfer of shares. At the same time, the Measures require that securities companies shall issue recommendation reports, law firms shall issue legal opinions, accounting firms with business qualifications for securities and futures shall issue audit reports, and stock exchanges shall issue examination opinions on approving or disapproving the listing.

Requirements of Private Offering

1) Private Offering Refers to the Issuance to Specific Investors, Including the Following Two Conditions:

- (1) Issuing shares to specific investors to produce over 200 shareholders; or
- (2) Unlisted public companies that have more than 200 shareholders issuing shares to specific investors.

The scope of specific investors includes:

- i. The issuer's shareholders;
- ii. The issuer's directors, supervisors, senior managers and key employees; and
- iii. Natural person investors, corporate investors and other economic organizations that conform to the regulations on investor eligibility management.

In practice, technological or innovative enterprises often need to retain internal employees, especially key employees by setting up the appropriate incentive and restraint mechanisms. The Measures include key employees into its issuance of investors. To identify key employees, the company shall: 1) nominate key employees by the Board of Directors; 2) publicize to all employees and gather their opinion; 3) apply for approval from the Board of Supervisors; 4) submit to a general meeting of shareholders for approval.

The Measures also set a limit to the number of private offering investors, that is, including key employees except shareholders, the total number of issuance to a specific investor will not exceed 35 people, which controls equity incentive within a fixed range.

2) Adopting Shelf Offering as an Issuance Method for Private offering

The system of shelf offering, which comes from the United States, is a special process for public companies refinancing behavior, more specifically, a refinance system of one-time approval, multiple-time issuance. Compared to the traditional security issuance regulation of “one application for one issuance,” shelf offering is a regulation pattern that continuously regulates the pre-stage, current-stage, and post-stage of securities issuance process for a package of projects. Companies shall make an initial issuance within three months from the dates of approval by the CSRC and issue the rest within 12 months. The initial issuance volume shall be not less than 50 percent of the total issuance volume, the volume of future issuance shall be determined by the companies, and the companies shall report issuance information to the CSRC for record filing within five working days after each issuance.

3) Exemption of Approval

The Measures establish the system of exemption for the rapid financing of unlisted public companies. Unlisted public companies whose shareholder number do not exceed 200 after the private offering, or whose accumulative financing amount of share issuance within 12 months is less than 10 million Yuan, such companies may be exempted from applying to the CSRC for approval, and may issue shares on their own. The company shall report issuance information to the CSRC for record filing within five working days after each issuance and disclose such information.

Compared to the draft for comments, the Measures change the standard of small-amount financing from “10 million Yuan exemption” to a relative standard, that is the accumulative financing amount of share issuance within 12 months is less than 20 percent of the companies’ net assets, which is seen as a better way to promote the development of innovative enterprises.

Such regulations apply to unlisted public companies issuing shares to specific investor to purchase assets.

The CSRC practices simple approval procedures for access by unlisted public companies, which differs vastly for companies that publicly issue shares and are listed in terms of access conditions and procedures. On the one hand, no financial targets shall be set in terms of access conditions, and companies shall be required to preferentially define primary businesses, enhance governance mechanisms, improve the quality of information disclosure and disclose relevant information authentically, accurately, completely and duly in accordance with rules of information disclosure. On the other hand, in terms of access procedures, no organizations similar to the Public Offering Review Committee shall be established, no sponsor system shall be practiced, and approval procedures shall be greatly simplified.

Trading Places

Shares of unlisted public companies shall be registered and deposited in China Securities Depository and Clearing Corporation Limited. However, public transfer and private share transfer shall be traded in different exchanges where different rules shall be applied.

1) Public Transfer

Public transfer of unlisted public companies must be conducted in legally established stock exchanges, that is, the National Small and Medium-sized Enterprises Share Transfer System, also called “the new third board”.

2) Non-public Transfer

Those unlisted public companies that are involved in non-public transfer may not list on “the new third board”, but their shares shall be registered and deposited in the China Securities Depository and Clearing Corporation Limited. Shareholders may transfer by contract or transfer directionally in accordance with the relevant regulations.

3) Public Issuance and Listing

Unlisted public companies that issue shares to non-specific investors publicly shall comply with the *Securities Law* and relevant provisions of the CSRC, and shall apply for CSRC approval.

Those unlisted public companies that apply for a stock exchange listing shall comply with relevant provisions of the CSRC and stock exchange. The Measures explicitly require the unlisted public companies to apply for a stock exchange listing in accordance with relevant regulations, reserving some space for these companies to be listed, once they meet listing requirements, they could perform a “transfer listing.”

In addition, according to the *Decision of the State Council on Straightening out and Rectifying Various Types of Trading Venues to Effectively Prevent Financial Risks* (Guo Fa [2011] No. 38), other local market places are not allowed to engage in any standardized transaction and centralized auction. Only shares of non-public companies that have less than 200 shareholders are allowed to be traded in such market places. However, it is beyond the scope of the trading places regulated by the Measures where unlisted public companies are allowed to conduct trading.

Authority Division between the China Securities Regulatory Commission and the Securities Association of China

The Measures provide that the CSRC and its subordinate institutions shall, in accordance with the law, perform their responsibilities for supervising companies' share transfer, private offering and information disclosure. The CSRC has the right to take supervisory measures in

accordance with the law, which includes conducting on-the-spot inspection, ordering relevant companies to make corrections, arranging supervisory talks, ordering them to make explanations, and issuing written warnings.

The Securities Association of China (the “**SAC**”) shall bring into play the role of self-regulation and administration to supervise securities companies engaged in corporate share transfer and private offering. When finding securities companies in violation of the laws, administrative regulations and relevant regulations of the CSRC, the association shall report those violations to the CSRC and take self-regulatory and administrative measures.

In practice, although the CSRC takes on the lead supervisory role during the pilot of “the new third board”, the SAC performs its management duty. The Measures require the CSRC to manage the issuance, listing and trading of unlisted public companies shares, reassuring the supervision rights of the CSRC from a legal level.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact any of the following Han Kun lawyers:



Contact Us

Beijing Office

Tel.: +86-10-8525 5500
Suite 906, Office Tower C1, Oriental Plaza
No. 1 East Chang An Ave.
Beijing 100738, P. R. China

Estella CHEN Attorney-at-law

Tel.: +86-10-8525 5541
Email: estella.chen@hankunlaw.com

Shanghai Office

Tel.: +86-21-6080 0909
Suite 5709, Tower 1, Plaza 66, 1266 Nanjing
West Road,
Shanghai 200040, P. R. China

Yinshi CAO Attorney-at-law

Tel.: +86-21-6080 0980
Email: yinshi.cao@hankunlaw.com

Shenzhen Office

Tel.: +86-755-3680 6500
Suite 4709, Excellence Times Plaza, 4068
Yitian Road, Futian District,
Shenzhen 518048, P. R. China

Jason WANG Attorney-at-law

Tel.: +86-755-3680 6518
Email: jason.wang@hankunlaw.com