LLINKS Law Offices 通力律师事务所

Shanghai
19F, ONE LUJIAZUI
68 Yin Cheng Road Middle
Shanghai 200120 P.R.China
Tel: (86 21) 3135 8666
Fax: (86 21) 3135 8600

Beijing
Units 902-903
Winland International Finance Centre
No.7 Finance Street, Xicheng District
Beijing 100140 P.R.China
Tel: (86 10) 6655 5050
Fax: (86 10) 6655 5060

上海
上海市银城中路68号
时代金融中心19楼
邮政编码: 200120
电话: (86 21) 3135 8666
传真: (86 21) 3135 8600

北京
北京市西城区金融大街7号
英蓝国际金融中心9楼02-03单元
邮政编码: 100140
电话: (86 10) 6655 5050
传真: (86 10) 6655 5060

www.llinkslaw.com
master@llinkslaw.com

Llinks Corporate Finance Bulletin
June 2009

Growth Enterprise Market: New Start for Multiple-Tier Capital Markets

By Christophe Han and Grant Chen

After nearly one-year opinion solicitations since the China Securities Regulatory Commission's ("CSRC") promulgation of *the Measures for the Administration of Initial Public Offerings of Shares and Listing on the Growth Enterprise Market* (Draft for Opinion-Solicitations) on 21 March 2008, ultimately CSRC officially released the *Interim Measures for the Administration of Initial Public Offerings of Shares and Listing on the Growth Enterprise Market* ("GEM Measures") on 31 March 2009. The issue of the Measures is more than ten years later than the "Hi-tech Board" initially proposed by CSRC.

As two aspects of a multiple-tier capital market, the main board market and the growth enterprise market ("GEM") differ in terms of their positions and functions. The *Measures for the Administration of Initial Public Offerings of Shares and Listing* ("Main Board Measures"), rules followed by offerings at the main board, and the GEM Measures, listing rules for the GEM, reflect such differences from legal perspective.

Offering Requirements

The essence of the Main Board Measures and the GEM Measures is that they both set out the requirements for offerings of shares on the main board or the GEM. The two measures basically share similar requirements for qualification of issuers, independence, regulatory compliance and ongoing operability. However, given that enterprises that are listed on the GEM are "enterprises with independent innovations and other growing venture enterprises" are not comparable with those enterprises listed on the main board in terms of the sizes of assets and operation and profitability, there exist distinguished different requirements in the two measures in respect of issuers' total shares, net asset value, revenue, net profit and cashflow. The GEM Measures lowers down the requirements for an issuer's size indicators and shortens the profitability term while enhancing the requirements for growth indicators.

如果您需要本出版物的中文本，请与下列人员联系：

韩东红: (86 21) 3135 8709
Publication@llinkslaw.com

If you would like other Llinks publications, please contact:

Lily Han: (86 21) 3135 8709
Publication@llinkslaw.com

Llinks Law Offices
www.llinkslaw.com

Accordingly, lawmakers have taken into account the different characteristics of independent innovation enterprises versus ordinary main board enterprises. For example: 1) intangible assets (such as patents and copyrights) account for a higher proportion of the asset portfolio; 2) independent innovation enterprises are not typically capital-intensive; 3) independent innovation enterprises are usually smaller in size and 4) independent innovation enterprises usually have a high growth speed. However, compared with overseas GEM, China's GEM still attaches great importance to the profitability of an enterprise and follows the principle of "first making a profit, then getting listed". This is primarily because China's capital market is still at an early stage of development and in lack of mature qualified investors. It also reflects the regulatory body's prudential attitude.

The market has all the time been concerned about whether the GEM Measures will specify the sectors in which listed enterprises engage businesses and whether it will clearly define "independent innovation enterprises and other growing venture enterprises". The GEM Measures does not specify or limit the sectors in which listed enterprises engage businesses, but only emphasizes on the growth of enterprises. Obviously, the regulatory body is more concerned about the growth speed of enterprises without specifying the scope of venture enterprises that may lead to controversies in the market. However, it will be tested by the growth board practice whether it will accept an enterprise that have a good growth prospect but engage in a traditional sector, which might lead to further controversies.

The Main Board Measures and the GEM Measures both require listed enterprises to have a clear use of the funds raised. This requirement may cause difficulties to the listing of venture enterprises. Because the sectors in which venture enterprises engage businesses are different from the traditional sectors, relatively speaking, they will face a market environment with more changes. Accordingly, it may be inappropriate to impose strict requirements on the use of the funds raised by venture enterprises at the time of listing. Whether flexibility will be given when reviewing the listings on the GEM remains to be seen.

Except for the growth and profitability requirements different from the main board, the other offering requirements set forth in the GEM Measures maintain the requirements in every other aspect in the Main Board Measures. To some extent, the GEM is somewhat more akin to a "mini board" with thresholds lower than those applicable to the "SME Board". Under this scenario, it remains to be seen whether the enterprises in emerging sectors (such as the internet sector) that have failed to obtain listings on the main board can get listed on GEM.

Stricter Requirements for Insiders

From the GEM Measures, because independent innovation enterprises are usually comparatively small in size with a high fluctuation and the ownership and operational rights are more likely to be merged together, it imposes stricter requirements on the internal staff of a company such as directors, senior officers, controlling shareholders and de facto controllers.

Pursuant to the relevant provisions of the GEM Measures, directors, supervisors and senior officers of an issuer have faith and diligence obligations. Moreover, an issuer and its controlling shareholders and de facto controllers must not have committed any serious unlawful act detrimental to the lawful rights and interests of the investors or the public interests over the most recent three years. Controlling shareholders and de facto controllers of an issuer are required to issue confirmatory opinions on any prospectus by signing and sealing the same.

These provisions are aimed at offering more protection to public investors by establishing a system of corporate governance and internal controls which is much stricter than that required under the Main Board Measures. Therefore, it will be a must for innovative enterprises aiming to get listed on the GEM to establish a strict corporate governance and internal control system.

Heavier Responsibilities for Sponsors and Intermediary Institutions

On one hand, lawmakers hope to regulate corporate operations through an improved corporate governance and internal control system, while on the other hand, they encourage sponsors and other securities service institutions to carry out due diligence exercises to test whether issuers have satisfied the offering requirements set forth in the GEM Measures. Therefore, while it follows the relevant provisions concerning the legal liabilities of sponsors and securities service institutions set forth in the Main Board Measures, the GEM Measures imposes heavier responsibilities on intermediary institutions, and especially on sponsors.

According to the GEM Measures, when sponsoring an issuer’s share offering and listing on the GEM, the sponsor is required to carry out a due diligence on and undertake a prudent assessment of the issuer’s growth, and issue an opinion. If the issuer is an independent innovation enterprise, the issuer’s ability to make independent innovations must be addressed in the opinion. In addition, the sponsor is obliged to supervise and guide the issuer on an ongoing basis.

According to the explanations by a CSRC spokesman, in respect of its ongoing supervision and guidance obligations for the companies listed on the GEM, a sponsor is required to supervise an issuer to ensure it is operated lawfully, discloses information on a genuine, accurate, complete and timely basis, and fulfills each of its undertakings on an ongoing basis. A sponsor is also required to compile tracking reports on regular announcements published by an issuer. In addition, the sponsorship period for a GEM listed company is appropriately extended compared with the period applicable to a main board company.

Furthermore, the GEM Measures reiterates that if a securities service institution fails to act with due diligence, resulting in a false or misleading statement being made in or material omissions from the documents it prepares and issues, CSRC will either refuse to accept specific documents for the securities offerings issued by such institution for a period of 12 months, or refuse to accept specific documents for the securities offerings issued by the relevant signatories for a period of 36 months. CSRC will also impose penalties in accordance with the Securities Law and relevant laws, administrative regulations and rules.

Investor Cultivation

It is provided in the general provisions of the GEM Measures that the growth enterprise market shall establish an investor access system which is appropriate to investors’ capacity to bear risk and fully disclose the investment risks to investors. It is further provided in Article 40 of the GEM Measures that an issuer shall make relevant risk disclosures to investors in its prospectus. Meanwhile, the stock exchanges will also gradually establish market risk alert systems and continuous investor cultivation systems which accord with the GEM’s characteristics. These provisions show that investor protection and cultivation will be one of the major tasks of the growth enterprise market regulatory bodies in the future.

Delisting and Transformation Mechanisms

Because the relevant supporting rules for the GEM have not been released so far, the GEM Measures keeps silent on the delisting mechanism applicable to the GEM listed companies. It merely provides that the stock exchanges shall establish listing, trading and delisting systems which accord with the GEM's characteristics. It is necessary for the Shenzhen Stock Exchange to clarify the above issues in its relevant operating rules, such as the "GEM Listing Rules" and the "Special Provisions on Stock Trading on the GEM".

In light of high risk profile, small size and unstable performance of the GEM listed enterprises, we are of the view that the delisting mechanism for the GEM listed enterprises will be stricter than that applicable to the main board listed companies, in order to avoid the occurrence of more investor losses by ensuring that a listed company is promptly de-listed once it fails to meet listing requirements. To achieve fairness in the market, listed companies found to be involved in making misrepresentations, unlawfully disclosing information or insider trading will be strictly and decisively dealt with and de-listed. Furthermore, due to the characteristics of the sectors in which the GEM listed companies engage businesses, asset reorganizations and shell purchase of the GEM listed companies will also be strictly limited to avoid having no growth enterprises listed on the GEM.

The GEM Measures does not specify the requirements and methods under which a GEM listed enterprise can be transformed onto the main board. Currently, the SME board of the main board also lacks a transformation mechanism. Given that enterprises listed on the SME board are growing gradually, all this will lessen the distinguishing features of the SME board. In future, the GEM will also need to consider how to establish a transformation mechanism without prejudicing the stability of listed companies, all the while maintaining the characteristics of venture enterprises.

The official release of the GEM Measures is a milestone. However, the relevant detailed rules, provisions and guidelines still need to be promulgated to improve the legislation and its implementation. Although the Main Board Measures differ from the GEM Measures in many respects, we believe that the relevant provisions of the Main Board Measures and their supporting rules will have great reference value for the development of the GEM.

LLINKS Law Offices 通力律师事务所

Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual Llinks contact.

Shanghai	**Beijing**
Christophe Han Tel: (86 21) 3135 8778 Christophe.Han@llinkslaw.com	**Wayne Chen** Tel: (86 10) 6655 5050 - 1022 Way.Chen@llinkslaw.com
Grant Chen Tel: (86 21) 3135 8699 Grant.Chen@llinkslaw.com	
Calista Huang Tel: (86 21) 3135 8788 Calista.Huang@llinkslaw.com	
James Weng Tel: (86 21) 3135 8660 James.Weng@llinkslaw.com	

This article was first published in *China Legal Review, April 2009.*