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More Regulation of Securities Sponsors

By Christophe Han and Patrick Chen

The sponsorship system in the PRC was established in 2001 after the *Securities Law* was promulgated, and was developed when the *Interim Measures for the Administration of Sponsorship for Issuance and Trading of Securities* (Interim Measures) were promulgated in 2003. The sponsorship system under the Interim Measures imposed a positive impact on the PRC capital market and achieved a fair level of success. However, after the PRC capital market was developed further and sponsorship activities increased, the deficiencies of the sponsorship system under the Interim Measures have been exposed: some institutions that do not have enough capital or staff for recommending companies to be listed can be qualified as sponsor institutions; some sponsor representatives do not fully fulfil their responsibilities of supervision after the company they recommended is listed; and the internal management of some sponsor institutions is not well disciplined.

In order to make the sponsorship system work better, the *Measures for the Administration of Sponsorship for Issuance and Trading of Securities* (Measures) were promulgated on August 14 2008 and took effect on December 1. They replace the Interim Measures and the *Measures on the Guidance Work for the Initial Public Offering of Stocks*, and intend to amend and optimise the sponsorship system, mainly in the four areas described below.

Requiring sponsor institutions to establish sound internal control systems to control the quality and efficiency of sponsorship work

- Sound internal control system

  The Measures require the sponsor institutions to establish sound internal control systems for the sponsorship work. The persons responsible for sponsorship work, the persons responsible for internal checks, the person responsible for the sponsorship

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department, the sponsor representatives, the project assistants and other persons relevant to sponsorship work shall perform diligently and control strictly the risks in the sponsorship work so as to improve the quality of sponsorship work. The persons responsible for sponsorship work and the persons responsible for internal checks shall be liable for supervising the fulfilment of the internal control systems.

- Regulatory Measures

  The Measures also set out corresponding regulatory measures upon the sponsor institutions and the relevant persons. Where the sponsor institutions or the relevant persons do not fulfil the responsibilities specified under the Measures, the China Securities Regulatory Commission (CSRC) may suspend or revoke the qualification of the sponsor institutions or the sponsor representatives, take regulatory measures against them (such as regulatory talks, focused attention, ordering to re-study, written warnings, ordering to make clarification or recognising them as unsuitable for assuming relevant posts), or may order the sponsor institution to replace the relevant staff.

- Working manuscripts

  More detailed requirements are set out in the Measures. The sponsor institutions shall have sound systems requiring the sponsor representatives to prepare the working manuscripts for each project during their sponsorship work. Sponsor representatives shall prepare the due diligence investigation log for each project they are responsible for as part of the working manuscripts, and the sponsor institutions have the responsibility to review and inspect the due diligence investigation log. The working manuscripts shall be kept for at least 10 years.

- Higher threshold

  A higher threshold of conducting sponsorship work for sponsor institutions and sponsor representatives is also stipulated. A securities company planning to conduct sponsorship business shall employ at least four sponsor representatives, while the Interim Measures required only two; the registered capital of a sponsor institution shall not be less than Rmb100 million (US$14.6 million), and the net asset value shall not be less than Rmb50 million, while the Interim Measures had no relevant requirements; and the staff in the sponsorship department shall have no less than 35 qualified persons, at least 20 of whom shall have been engaged in the sponsorship business in the past three years.

Strengthening the administration on sponsor representatives

- Sponsorship professional ethics and disciplines

  Sponsor representatives shall strictly comply with professional ethics and disciplines, cherish their professional reputation, conduct their business with prudence and retain their professional capabilities; sponsor representatives shall protect the issuers' legitimate interests and keep confidential the issuers' information obtained during their sponsorship work; sponsor representatives shall perform their duties independently and keep their objective and fair angle of view and position rather than satisfy any improper or illegal requests from issuers; and sponsor representatives shall not solicit or assist the issuers or the securities intermediary institutions to conduct illegal or fraudulent activities.

- Sponsor institutions' administration on sponsor representatives

  Sponsor institutions shall annually assess and examine the professional capability of the sponsor representatives and provide the CSRC with annual reports regarding the sponsorship work and the sponsor representatives. The annual report shall include the practices of the sponsor institutions and the sponsor representatives in the past year, the fulfilment of the due diligence investigation log prepared by the sponsor representatives, and the result of the assessment and examination of the sponsor representatives.

- Sponsor representatives' regular training

  Sponsor representatives are required to attend the annual training held by the China Securities Association or any other institutions authorised by CSRC. The sponsorship qualification will be revoked where a sponsor representative fails to attend such regular training.

Strengthening supervision and regulatory measures on sponsor institutions and sponsor representatives

The Measures strengthen the regulatory measures on the sponsor institutions and the sponsor representatives and improve the regulatory effect to make the sponsorship system work well.

- On-site inspection

  The CSRC may carry out scheduled or unscheduled on-site inspections on the sponsorship work of sponsor institutions and sponsor representatives. The sponsor institutions and sponsor representatives shall cooperate with CSRC in its on-site inspections, and shall neither refuse, obstruct or evade the inspections, nor hide or destroy any evidence materials.

- More regulatory measures

  More regulatory measures are adopted in the Measures to supervise sponsor institutions, sponsor representatives, the persons responsible for sponsorship work and the persons responsible for internal checks, who do not fulfil their obligations diligently, or who act in violation of the Measures. For example, where the sponsor representatives do not conduct themselves diligently in supervising the issuer or participate in the due diligence investigation on the issuer, the CSRC may refuse to accept the recommendation by such sponsor representative or revoke his/her sponsorship qualification; where there are material falsities, misleading information or omissions in the sponsorship documents prepared by a sponsor representative, the CSRC may revoke the sponsor representative's sponsorship qualification or prohibit the sponsor representative to be engaged in the business of securities in future.

Endowing rights to sponsor institutions and sponsor representatives

While strengthening the supervision and administration on sponsor institutions and sponsor representatives, the Measures also endow sponsor institutions and sponsor representatives with rights to supervise the issuers.

More regulation of securities sponsors

- Rights to supervise the issuers

  Sponsor institutions and sponsor representatives have the rights to require an issuer to report its information timely in accordance with the Measures and the sponsorship agreement, to make scheduled or unscheduled visits to the issuer to check and review the materials required in the sponsorship work, to attend the shareholders' meetings, board meetings or supervisory board meetings, to check and review the documents relating to information disclosure and other documents to be submitted to the CSRC or the stock exchanges, to verify and examine the issues to which the relevant departments pay close attention, and to make a public clarification and statement on the matters violating laws or regulations by the issuer pursuant to the information disclosure rules.

- Right to suggest changing intermediary institutions

  Sponsor institutions and sponsor representatives are entitled to organise and coordinate the intermediary institutions and relevant signatory persons to participate in work relating to securities offering and listing. Where the sponsor institutions or sponsor representatives have full reason to believe that the accounting firms, law firms, asset valuation institutions or other intermediary institutions are incapable, the sponsor institutions or sponsor representatives may advise the issuers to change the relevant intermediary institutions.

Future impact

- Impact on sponsor institutions and sponsor representatives

  According to the higher requirements set out in the Measures, sponsor institutions should improve their internal control systems, including risk control, procedure control, staff training, optimisation of inspection and supervision systems and other systems, and the sponsor representatives should practise more diligently and prudently during their sponsorship work, including recording a due diligence log, attending issuers' meetings actively and improving their professional capabilities.

  Few sponsor institutions (apart from the intermediary institutions engaged by the issuers) engage other intermediary institutions to assist their sponsorship work under the Interim Measures. It seems that in order to control the risks and satisfy the requirements set out in the Measures more sponsor institutions will engage law firms or auditing firms to assist their sponsorship work.

  As a result, the higher requirements in the Measures will bring about a higher quality of sponsorship work.

- Impact on the securities market

  With the implementation of the Measures, the quality of sponsorship work will be improved. Under high-quality sponsorship work, the sponsor institutions and representatives will assist the issuers to satisfy the laws and regulations regarding securities offering and listing, to run in compliance with the current corporate governance rules, to make high-quality disclosure pursuant to the rules of the CSRC or the stock exchanges. Under the Measures, more high-quality issuers will be listed in the PRC capital market, which itself should come to be more prosperous.

- Impact on law firms

Law firms should strictly follow the requirements set out in the Measures to improve their legal services. Also, the Measures bring opportunities to law firms. As the responsibilities of the sponsor institutions and the sponsor representatives are greatly increased, high-quality sponsorship work is also required. Therefore, law firms may have opportunities to act as the sponsors' legal consultants to assist the sponsor institutions and the sponsor representatives to control the legal risks in their sponsorship work.

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