

New Rules Regulating the Use of Funds Raised by Listed Companies

By Calista Huang and Vanessa Wang

China Securities Regulatory Commission (“CSRC”) recently issued “Guidelines for the Administration over Listed Companies No.2” (“Guidelines”), amending several rules regarding the use of funds raised by listed companies under current laws and regulations. Shenzhen Stock Exchange then revised the “Memorandum No.29 of Small and Medium Enterprise Board on Information Disclosure” (“Memorandum”) in February 2013, and Shanghai Stock Exchange revised the “Measures for Administration of Funds Raised by Companies Listed on the Shanghai Stock Exchange (2013)” (“Measures”) in April 2013. This article summarizes several substantive changes in rules regarding the use of raised funds based on the aforementioned regulations.

Idle Raised Funds Allowed for Cash Management

Comparing to existing rules, a major change in the Guidelines is that it relaxed restrictions on the use of raised funds that are temporarily idle. Listed companies are allowed to use such funds to do cash management. The products invested with idle raised funds shall meet the following two conditions: (i) highly secured, satisfy the capital preservation requirements and the issuer of the products shall be able to provide the capital preservation guarantee; and (ii) highly liquid and shall not affect the normal operation of the investment plan of the raised funds. Investments to be made with idle raised funds shall be reviewed and approved by the board of directors of the owner listed company and information of the investment products, including quotas, terms, return allocation mechanism, investment scope and etc., shall be publicly disclosed within 2 days after the board meeting. Besides, the listed company shall disclose every 6 months, information such as the return of the investment products for the then-current reporting period and the investment amount at the end of the period, as well as signatories, names and terms of the investment products.

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In accordance with the Guidelines, both the Memorandum and the Measures specified that idle raised funds may be allowed for cash management. It is worth noting that the Memorandum requires the investment term of the products purchased with temporarily idle funds to not exceed 12 months, and if the purchased investment products are issued by financial institutions other than commercial banks, the review and approval of the shareholders meeting will be needed.

Idle Raised Funds Used for Temporarily Replenishing Working Capital

The Guidelines also relaxed the time limit for using idle raised funds to temporarily replenish working capital. A single replenishment of working capital shall not exceed 12 months, instead of 6 months in previous regulations. The working capital that are temporarily replenished shall only be used for production and operation related to core business, and shall not be directly or indirectly used for placing and subscription of new shares or used for trading of shares, derivatives and convertible corporate bonds, etc..

Further, the Measures revised the amount limit and approval process requirements in existing rules of Shanghai Stock Exchange regarding the use of idle raised funds to temporarily replenish working capital. Provisions such as “a single supplement of current capital may not exceed 50% of the net amount of the raised funds, and supplement of current capital with idle raised funds that account for more than 10% of the amount of the current fund raising shall be approved by the general meeting of shareholders” are removed from the Measures. The Memorandum requires that Small and Medium Enterprise Board companies who intend to temporarily replenish working capital with idle raised funds shall have not conducted any venture investment in the past 12 months and shall undertake not to conduct venture investment during the replenishing period.

Over-raised Funds Used for Permanent Replenishment of Working Capital

Over-raised funds (the particular amount of funds raised by a listed company that exceeds the amount planned) may be used for permanent replenishment of working capital and repayment of bank loans. The Guidelines set the maximum accumulative replenishment amount in every 12 months at 30% of the total amount of over-raised funds. The use of over-raised funds for permanent replenishment of working capital and repayment of bank loans shall be reviewed and approved by shareholders meeting of the listed company. The listed company shall also undertake not to make any high-risk investment or provide financial aid to others within 12 months after the replenishment of working capital.

The Memorandum further provided detailed rules regarding the use of over-raised funds by companies listed on Small and Medium Enterprise Board. Over-raised funds shall be used in priority to replenish the funding gap of projects invested with raised funds, to support new projects and projects under construction, and to repay bank loans. Where over-raised funds are used for cash management or temporary replenishment of working capital, rules regulating the use of idle raised funds shall apply. In addition, over-raised funds shall not be used for permanent replenishment of working capital and repayment of bank loans if the company listed on Small and Medium Enterprise Board has conducted high-risk investment such as securities investment in the past 12 months.

Generally, the Guidelines, the Memorandum and the Measures are practical and work their purpose. The promulgation of these rules help increase the efficiency of using idle raised funds, and is significant in optimizing the allotment of capital market resources.

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