

New Guidelines for the Issuance of Corporate Bonds

By Grant Chen and Zhengyi Zhang

Listed companies, including those listed in Shanghai, Shenzhen, or overseas, are now allowed to issue corporate bonds on a trial basis, according to the Measures for Pilot Projects for the Offering of Corporate Bonds (**New Rules**), which were promulgated by the China Securities Regulatory Commission (**CSRC**) on 14 August 2007. The Rules signal the official start of China's corporate bond issuance and are important in expanding enterprises' financing channels, providing a new outlet for excessive liquidity in the capital market, diversifying securities investment categories, and encouraging companies to improve management and performance.

Before the New Rules were introduced, corporate bonds were rare in China, and only a handful of large state-owned enterprises received approval from the National Development and Reform Commission (**NDRC**) to issue enterprise bonds. The price and amount of bonds to be issued were decided by the NDRC, and the NDRC also required the state commercial banks to underwrite the bonds. Since the New Rules have been published, the NDRC will still be in charge of approving sales of bonds by non-listed government-held enterprises, while the CSRC will be in charge of supervision of corporate bonds.

Conditions for Issuance

On the basis of being part of a "pilot" scheme, the corporate bonds will first be issued by listed companies. In the early stages, experimenting companies will be limited to those listed on Shanghai or Shenzhen Stock Exchanges, and domestic companies with foreign-invested stock listed abroad.

Requirements for corporate bond issuance are much looser than those for enterprise bonds and convertible bonds. The New Rules do not put additional restrictions on the conditions for issuance, other than those that have already been set in the Securities Law. According to the New Rules, potential issuers must have sound credit ratings, the average annual distributable profits of the company achieved in the last three

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fiscal years shall not be less than the one-year interest on the corporate bonds, and the cumulative corporate bond balance of the company after the present issuance shall not exceed 40% of the latest term-end net asset value, and the cumulative corporate bond balance of a company in the financial category shall be calculated according to relevant provisions.

Procedures for Issuance

To apply for the issuance of corporate bonds, the board of directors of a company shall formulate a plan, and the shareholders' meeting shall make a resolution on the number of bonds to be issued, arrangements on placement to shareholders of the company, the terms of bonds, purposes of funds to be raised, and other matters needing clarification.

According to the New Rules, the CSRC shall examine the application for the issuance of corporate bonds, after which an Issuance Review Committee would examine the application documents according to the special procedures set forth in the Provisions Concerning the Issuance Review Committee of China Securities Regulatory Commission.

The corporate bonds may be issued in installments upon one approval of an application for the issuance of corporate bonds. As of the date of the CSRC's approval of issuance, a company shall make an initial issuance within six months, and the issuance of remaining bonds shall be completed within 24 months. Where the issuance of corporate bonds fails to be made within the time limit specified in the approval document, the corporate bonds may be issued only after being approved again by the CSRC.

The guarantee is not required under the New Rules, and the use of raised capital is no longer limited to fixed assets. It may include the uses approved by a shareholders' meeting, such as repayment of loans and improving financial structure.

Protection of Rights and Interests of Bondholders

Protection of bondholders' rights and interests is enhanced under the New Rules in order to promote the healthy development of the bond market. A bond trustee system has been introduced in the New Rules, and it requires the bond trustee to act to maximize the interests of bondholders and shall not have a conflict of interest with bondholders. The New Rules also establish a bondholders' meeting system, which is to be convened under circumstances that are likely to have a material effect on any rights or interests of the bondholders, such as when the company is unable to pay the principal and interest as scheduled and change of the bond trustee is proposed.

In September 2007, having received approval from the CSRC, China Yangtze Power Co Ltd, the first listed company to issue corporate bonds after the CSRC released the New Rules, issued its first batch of 10-year bonds, amounting to Rmb4 billion yuan, and the bonds are carrying a coupon rate of 5.35 percent. Meanwhile, more than 10 listed companies, including Huaneng Power International and Guangdong Electric Power Development Co., Ltd, have announced their corporate bond issuance plans.

According to the officials, there are plans to issue a series of auxiliary measures covering issuance applications, prospectuses, bondholders' meetings, and custody agreements. Most recently, the Shenzhen Stock Exchange has released a set of detailed rules governing corporate bond issuance, and the Shanghai Stock Exchange has also revised its corporate bond trading rules.

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This article was first published in *China Law & Practice*, October 2007, Volume 21, Number 8.