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CSRC Further Deepens Reform of the System for Offering of New Shares

By James Weng and Patrick Chen

In order to resolve concerns over the "Three-High" phenomenon, namely "High Issuance Price, High Profit Ratio and High Over-Raised Capital", when new shares are offered in the current capital markets, the China Securities Regulatory Commission ("CSRC") released the *Guidance on Further Reform and Enhancement of the System for Offering of New Shares*. To further enhance the system, nearly one year later, the CSRC released the *Guiding Opinion on Intensifying Reform of the System for Offering of New Shares* ("Guiding Opinion") and the *Amendment to the Measures for the Administration of the Offering and Underwriting of Securities Decision* ("Amendment Decision") on 11 October 2010 after full consideration of opinions from the markets. The above two legal documents further regulate and perfect the processes related to the offering of new shares, such as price quotation and subscription, so as to stabilize the capital markets, restrain the "Three-High" phenomenon, and better protect the interests of small and medium-sized investors.

Four Main Measures in the Guiding Opinion

The Guiding Opinion mainly put forwards the following four reform measures:

- To further improve the constraint mechanism for price quotation, subscription and allotment

  In the IPOs launched by small and medium-sized companies, the issuers and their main underwriters shall reasonably determine the volume of each offline allotment on the basis of the scale of the share issuance and the market conditions. Afterwards, the issuers and their main underwriters may, based upon the volume for each allotment, determine the number of institutions to which the shares may be allotted, and then make allotments to those whose quotation matches or is above the issuing price. If the

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number of the candidate institutions exceeds expectations, it is possible to conduct a random selection and then make the allotments subject to the selection results. Increasing the volume of offline allotment of each institution in the new shares issuance of small and medium-sized companies is beneficial to strengthening the responsibility of the price-fixers and inducing them to quote more carefully and earnestly.

- To enhance the transparency of pricing information

  The issuers and their main underwriters must disclose the detailed prices quoted by potential investors who participated in the book-building. The main underwriters must also disclose their valuation conclusion on the issuers' shares, PE ratio of comparable listed companies and other related indices provided to the potential investors during the pre-marketing and road show stage. The tightened disclosure requirements can help to enhance the transparency of the pricing mechanism and induce brokers and institutions to quote more carefully and earnestly.

- To broaden the scope of book-building participants and expand offline institutional investors

  The main underwriters may recommend, at their own discretion, a certain number of institutional investors to participate in the offline book-building and allotments. The main underwriters shall set forth the principles and standards for the recommendation of institutional investors and establish a transparent recommendation mechanism. The recommendation standards, decision-making process and list of the finalized institutional investors shall be registered and filed with the Securities Association of China ("SAC").

- To improve the claw-back and suspension mechanisms

  If the online subscription is insufficient, an offline claw-back is allowed to enable offline institutional investors to subscribe to the shares. If the subscription is still insufficient, the underwriting syndicate may recommend other investors to participate in the offline subscription. Where the valid subscription by offline institutional investors is insufficient against the established ratio for offline allotment, it is not permitted to make any online claw-back. Instead, a suspension of the issuance is permissible. The suspension may also be triggered under several other scenarios. A suspended IPO may be restarted within the valid period of the approval document after application has been filed with the CSRC. The above mechanisms can help to promote the issuers and their main underwriters to design the underwriting process reasonably, and reach a balance between protecting investors' interests on the one hand and managing the underwriting risks on the other.

In order to carry out the reform measures for offering of new shares provided in the above-mentioned Guiding Opinion, the *Measures for the Administration of the Offering and Underwriting of Securities* has been revised accordingly. The Amendment Decision and the Guiding Opinion provide a powerful assurance for the implementation of the above reform measures.

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