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COMPANY LAWYER BRIEFING

Reforming corporate share-listing rules in China: Understanding the rationale and advantages of the registration-based IPO regime

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Chinese capital markets have undergone a series of market-oriented regulatory reforms in recent years. For example, the National People's Congress, which is the Chinese Parliament, passed the PRC Securities Law 2020 to overhaul the regulatory rules on multiple fronts including securities issuance, securities trading, information disclosures, and investor protection.[1] The underlying ideology of the reform is to remove unnecessary regulatory red tapes and let the market, instead of the government, play a primary role in share issuance and trading so as to achieve the most efficient allocation of capital and financial resources. Clearly, a well-functioning capital market needs a moderate level of regulation and control and it is likely to be destroyed by excessive regulation as Professor Barry Rider commented "regulatory overkill is just as real a threat to the financial services industry as regulatory ambivalence."[2]

Against this background, the article will introduce and analyse the most significant regulatory change of China's securities law, namely, the registration-based IPO regime, which has significantly limited the government's intervention in the process of share issuance and listing. In the future, the China Securities Regulatory Commission (CSRC) will no longer assess the substantial quality of issuing companies, providing that the issuers' investment bankers, accountants, and lawyers provide valid legal and financial documentations in compliance with securities regulations. There is no doubt that the registration-based IPO system is more cost-effective and time-efficient and it is likely to spur the further growth of China's stock markets. However, it needs more stringent post-listing financial supervision like adequate information disclosure requirements for issuers in order to safeguard the interests of domestic and international investors.

In December 2015, the standing committee of the National People's Congress (NPC), the Chinese parliament, gave a green light to the introduction of the registration-based IPO into Chinese capital markets.[3] This provides a solid legal foundation for the trial of registration-based IPOs in the latest star market (science and technology innovation board) of Shanghai Stock Exchange (SSE). In July 2019, the first group of 25 high-tech companies started trading at the start market and posed an average gain of 140% on their trading day, who have become the beneficiaries of the latest IPO system.[4] Afterwards, the recently amended PRC Securities Law 2020 has reiterated the adoption of registration-based IPO for Shanghai and Shenzhen stock exchanges, and its specific scope and implementation steps will be further defined by the State Council.[5] In June 2020, China started to expand the trial of its registration-based IPO system to the ChiNext board of Shenzhen Stock Exchanges (SZSE), which is the country's Nasdaq-style board that mainly hosts growth enterprises and innovative start-ups.[6] On 31 October 2020, China's Vice Premier Liu He chaired a special meeting of the Financial Stability and Development Committee of the State Council (China's cabinet) where he emphasised the need to strengthen the further reform and open-up of China's financial system, including the full implementation of the registration-based IPO system.[7] Accordingly, it is expected that the registration-based IPO regime will be soon adopted by

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[1] Wangwei Lin, Lihong Xing and Zhen Ye, "China Enforces New Securities Law in 2020" (2020) 41 *The Company Lawyer* 188, 188.

[2] Barry A.K. Rider, "Policing the International Financial Markets: An English Perspective" (1990) 16 *Brooklyn Journal of International Law* 179 at 220.

[3] CSRC, "CSRC Staff Answered Reporters' Questions on the Establishment of Shanghai Stock Exchange Science and Technology Innovation Board and the Pilot Registration-based IPO System", *http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201811/t20181105_346199.html* [Accessed 28 April 2021].

[4] Shuli Ren, "Chinese Investors Are Playing a Game of Hot Potato" *Bloomberg* (23 July 2019), *http://www.bloomberg.com/opinion/articles/2019-07-23/china-s-nasdaq-style-star-market-risks-burning-out-quickly* [Accessed 28 April 2021].

[5] PRC Securities Law 2020 art.9.

[6] Xinhua, "Registration-based IPO Reform of ChiNext a Boon for Innovative Enterprises" (17 June 2020), *http://www.xinhuanet.com/english/2020-06/17/c_139146066.htm* [Accessed 28 April 2021].

[7] *Global Times*, "IPOs to Enter Era of Full Registration, Delisting Process to be Normalized", Global Times (1 November 2020), *http://www.globaltimes.cn/content/1205330.shtml* [Accessed 28 April 2021].

all the market segments of Chinese capital markets, including the main boards of SSE and SZSE, in the upcoming years.

Since the launch of SSE and SZSE in the early 1990s, China has been operating the approval-based IPO system which allows the securities regulator to censor which companies are qualified for a public listing at SSE or SZSE. Chinese companies looking for the floatation of their shares are subject to strict financial assessment as per China's securities law and regulations, and has to obtain an administrative approval by the CSRC's Public Offering Review Committee. After 30-year development, China now has the second largest capital market in the world, which is just next to the United States, as it holds over 3,600 publicly listed companies, 156 million investors, and more than 130 securities companies or stockbrokers.[8] According to the UK's Centre for Economics and Business Research (CEBR), China is expected to overtake the US to become the world's largest economy by 2028.[9] In contrast to the rapid development of Chinese economy and its capital markets, the corresponding securities regulatory regime has been considered rudimentary and outdated as the law and regulatory framework seem to lag behind the market growth to a large extent.

Table 1 A comparison between approval-based and registration-based IPO systems[10]

	Approval-based IPO	Registration-based IPO
Institutional back-grounds	Capital markets are in the early stage of development.	Capital markets are becoming more developed and mature.
Listing standard/threshold	High. 1) provide public and accurate information; and 2) pass strict check of financial criteria in terms of revenue and profitability.	Low. 1) provide public and accurate information.
Who will assess the companies against the substantial listing standard?	1) Securities regulator; and 2) securities brokers or investment banks.	1) securities brokers or investment banks. *Securities regulator will only check the formalities of the applicants' materials.
Post-listing supervision from securities regulator	Weak. Securities regulation focuses on pre-listing substantial financial check.	Strong. Securities regulation focuses on post-listing information disclosure requirements.
Marketisation level	Low.	High.
IPO efficiency	Low.	High.

China's existing securities regulatory system pays most of its attentions to the pre-listing financial checks rather than post-listing information disclosure. The latter approach has been adopted by securities regulators in certain developed countries such as the US Securities and Exchange Commission (SEC). Under the current approval-based system, the CSRC is taking the primary responsibility of examining the substantial financial backgrounds of the issuing companies. In China, IPO applicants have to pass a lengthy application process which lasts for an average of 589 days and to go through at least three rounds of administrative reviews to secure a final regulatory approval from the CSRC.[11] Over the past, the ultra-long waiting time forced some high-quality companies, especially those tech start-ups needing a fast access to capital, to forego their listing plans in mainland China by turning to NASDAQ, New York Stock Exchange or Hong Kong Stock Exchange for a quicker and simpler listing. Moreover, the CSRC used to regularly pause new IPOs in order to reduce the supply of new shares to stabilise share prices and indexes in a bear market.[12] The interventionist approach has been criticised as driving away good companies as most of Chinese tech giants such as Alibaba, Tencent, JD.com, NetEase, and Baidu listed their shares in either New York of Hong Kong. Further, the inefficient and opaque approval-based IPO system creates a hotbed for money-power exchange. Mr Yao Gang, the former vice chairman of CSRC, was found guilty of corruption (who abused his power and received bribery of CNY 69.61 million) and insider dealing and was sentenced to 18 years in prison.[13] Apparently, under the approval-based IPO regime, the regulator has excessive power in determining the outcomes of IPO applications, which undermines the rule of law.

A market-oriented registration-based IPO system will create a more transparent, efficient, and healthy capital market system that is conducive to the long-term growth of the Chinese economy. It has significant advantages over the approval-based IPO system. For instance, under the approval-based regime, the securities regulator monopolises the power of share issuance, since companies need a de facto charter from the authority to float their shares and raise funds from the public. The system has distorted the market discipline by diverting financial resources to those companies which are closer to the power (in China's case, the state-owned enterprises) rather than giving capital to the businesses who really need it. The registration-based system will address this problem easily, as the securities regulator is no longer involved in deciding who will finally get a listing.

[8] Xinhua, "From zero start, China now has the second largest capital market in the world", *Xinhua Net* (8 October 2019)*http://www.xinhuanet.com/fortune/2019-10/08/c_1210303693.htm* [Accessed 28 April 2021].
[9] BBC, "Chinese economy to overtake US 'by 2028' due to Covid", *BBC News* (26 December 2020), *https://www.bbc.co.uk/news/world-asia-china-55454146* [Accessed 28 April 2021].
[10] The chart has been compiled by the author.
[11] *Xueqiu Finance*, "The Waiting Time for IPO Companies in the First Half of 2019", Xueqiu Finance (10 July 2019)*http://xueqiu.com/4200978411/129419178* [Accessed 28 April 2021].
[12] Nan Ma and Gabriel Wildau, "Beijing's Visible Hand Lies Heavy on China IPOs", *Financial Times*, 26 March 2015, p.18.
[13] *China Court*, "The Trial of CSRC Vice Chairman Yao Gang", China Court (28 September 2018)*http://www.chinacourt.org/article/detail/2018/09/id/3516496.shtml* [Accessed 28 April 2021].