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# CSRC Tightens Regulation Of Backdoor Listings And Adopts Measures To Facilitate Asset Acquisitions By Way Of Share Issue

## Introduction

Amendments to the Administrative Measures for the Restructuring of Material Assets of Listed Companies (the **Measures**) (上市公司重大资产重组管理办法) have been announced by the China Securities Regulatory Commission (**CSRC**) and will come into force on 1 September 2011. The key changes introduced by the amendments are:

* new requirements raising the listing threshold for backdoor listings closer to that for IPOs; and
* improved regulation of listed companies’ asset acquisitions by way of share issue to facilitate such acquisitions.

This newsletter provides a summary of the amendments to the Measures. However, Charltons does not advise on PRC law and therefore takes no responsibility for the completeness and/or accuracy of the information in this newsletter. Specific legal advice should be sought from PRC lawyers in relation to any particular situation.

## Backdoor Listings

Backdoor listing refers to a method by which a privately held company becomes listed on a stock exchange via its acquisition of an already listed company, often one that is no longer profitable and which will serve as a shell company into which the private company’s assets can be injected. From the private company’s point of view, a backdoor listing (also called a reverse takeover or reverse merger) offers a number of advantages: speed, certainty of outcome, less dilution and thus greater control for the new owners of the listed company and the ability, in some jurisdictions, to circumvent onerous requirements for a new listing applicant.

Currently, backdoor listings in the PRC are subject to significantly less stringent regulation than IPOs, whereas in many developed securities markets the two face very similar regulatory treatment. A listed company will usually see a jump in its shares after a backdoor listing and this provides an opportunity for insiders to make a gain through insider trading. The CSRC has indicated that among the main aims of the new rules are closer supervision of poorly performing companies and reduced insider dealing and accounting fraud.

### Definition of backdoor listing

The Measures contain the first official definition of a backdoor listing. Under new Article 12 of the Measures, there will be a backdoor listing if the value of a private company’s total assets acquired by a listed company from a person or entity that has acquired control of the listed company, equals or exceeds the value of the listed company’s total assets, as shown in its audited consolidated financial statements at the end of the most recent fiscal year.

### New profit requirements

There is currently no profit requirement for a private company whose assets will be injected into a listed company to achieve a backdoor listing. New Article 12 now requires such a private company to have:

* a minimum trading record of 3 consecutive years;
* a positive net profit record for each of the last two fiscal years; and
* net profit of RMB 20 million in aggregate for the last two fiscal years.

The CSRC has stated that the backdoor listings of specific types of company, such as financial institutions and venture capital companies, will be subject to a different set of rules which will be released later.

### Extended period of continuous supervision and guidance by financial consultants

In an attempt to discourage accounting fraud, Article 35 of the Measures will be amended to increase the time period during which a listed company is required to receive continuous supervision and guidance from an independent financial consultant following CSRC approval of a major asset restructuring. In the case of a backdoor listing, the minimum required supervision period will be three fiscal years from the date the CSRC approves the material asset restructuring.

The minimum supervision period for listed companies having undergone material asset restructurings other than backdoor listings remains one fiscal year.

Furthermore, a new second part to Article 36 of the Measures will provide that the independent financial consultant to a listed company which has undergone a backdoor listing must, within 15 days after publication of the annual reports for the second and third fiscal years following the backdoor listing:

* provide continuous supervision opinions with respect to the matters set out below in relation to the material assets restructuring under the backdoor listing, based on the annual reports of the year of the backdoor listing and of the first three fiscal years after its completion; and
* report to the CSRC’s local agency and make a public announcement on the following matters:
  1. the performance status of the commitment of all interested parties in the transaction;
  2. realization of the profit forecast;
  3. the development status of the business mentioned in the management discussion and analysis section of the material assets restructuring report;
  4. corporate governance; and
  5. other matters that differ from the announced restructuring scheme.

However, although the new threshold for backdoor listings will prevent some companies from listing, the backdoor listing route may still offer advantages for those companies able to meet the new trading record and profit requirements. For example, there are no cash flow, net asset or share capital requirements for backdoor listings as there are for IPOs. In addition, a backdoor listing may be achieved more quickly than a traditional IPO.

## Improving The Regulation Of Asset Purchases By Way Of Share Issue

The CSRC has introduced clear requirements governing listed companies’ acquisitions of assets in return for shares issued to parties other than the listed company’s controlling shareholders, actual controllers of the listed company or other affiliated parties controlled by such controlling shareholders or actual controllers (**Independent Parties**). The purpose of the amendments is to make the regulatory regime governing asset acquisitions by way of share issues more comprehensive and to lower the costs of, and increase the efficiency of, asset restructuring.

Under a new second part to Article 41 of the Measures, a listed company will be allowed to purchase assets by issuing shares to Independent Parties, subject to the following requirements:

* the share issue must not result in a change in control of the listed company;
* the shares issued to the Independent Parties must comprise at least 5% of the listed company’s total issued share capital after the share issue; and
* if the shares issued to the Independent Parties are less than 5% of the total share capital following the share issue, the value of the assets to be purchased by the listed company must be at least RMB 100 million for a company listed on the Main Board or the SME Board, and at least RMB 50 million for a company listed on the Growth Enterprise Board.

## Supporting Listed Companies' Material Asset Restructuring And Supplementary Financing

To encourage listed companies to finance mergers and acquisitions by means of issues of shares, bonds or convertible bonds, the CSRC has introduced a new provision allowing a listed company which issues shares to purchase assets to raise supplementary finance at the same time (new Article 43 to the Measures). The existing rules require an asset purchase by way of share issue and any financing for the asset purchase to be conducted separately. This amendment also means that the approval for purchasing assets by was of a share issue and that for supplementary financing can be granted following a single application. The current regulatory system as set out in Article 6 of the **Detailed Implementation Rules for the Non-public Issuance of Stocks by Listed Companies** (《上市公司非公开发行股票实施细则》) requires two separate applications. Article 6 will be amended accordingly and promulgated later.

The amended Measures are available in [Chinese](http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201108/P020110805544514532166.doc) ([see archive](P020110805544514532166.doc)).

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