

Legal Commentary

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Highlights of the Draft Revisions to the IPO System

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On February 1, 2023, the China Securities Regulatory Commission (“**CSRC**”), the Shanghai Stock Exchange (“**SSE**”), the Shenzhen Stock Exchange (“**SZSE**”), and the Beijing Stock Exchange (“**BSE**”) issued for public comments draft rules and regulations (the “**Draft Rules**”) related to the registration-based stock issuance system. The Draft Rules mark the official launch of the full implementation of stock issuance reforms in China.

With respect to the highlights of the registration-based stock issuance system, we have provided an overview in the previous article in this series, *A Brighter Future: Registration-based Share Offering Reform*.

This article further analyzes the main points of the Draft Rules, the current reform and their impact on initial public offering and listing (“**IPO**”) applicants.

Overview of the draft revisions to the IPO-related Draft Rules

In the current reform, the CSRC and the stock exchanges would systematically integrate or revise the IPO-related rules of all boards. In addition to making major adjustments to the IPO rules on the main boards in accordance with the registration-based system requirements, the regulators have mainly sought to optimize and adjust certain rules on the STAR Market and the ChiNext Market to form a clearer and more unified system of IPO rules. ([click here to download the foregoing draft rules and papers](#)).

I. Top priority: major adjustments to IPO-related main board rules to achieve the registration-based stock issuance system

The registration-based system would generally extend and apply to the main boards the review philosophy, procedures, methods, information disclosure requirements, and other provisions of the pilot registration-based system of the STAR Market and the ChiNext Market. The main boards would no longer require IPO applicants to be profitable for three consecutive years, to not have an undistributed deficit at the end of the last reporting period, or to be subject to a maximum amount of intangible assets among their net assets. Multiple sets of financial indicators would be available to choose from for domestic enterprises, red chip enterprises, and enterprises with differentiated voting rights arrangements. However, the Draft Rules also clarify the positioning requirements of the main boards, which would form a multi-tiered capital market pattern with coordinated development and

complementary functions with the STAR Market, the ChiNext Market, and the BSE.

II. Optimization and supporting adjustments for IPO rules for other boards

Based on the experience of the pilot registration-based system and market feedback, the SZSE supports eligible currently unprofitable enterprises to list on the ChiNext Market and would cancel the ChiNext Market listing requirement of a positive net profit for the latest year for red-chip enterprises and enterprises with differentiated voting rights arrangements. Rather than making substantive adjustments to the IPO criteria on the STAR Market and the BSE, the relevant rules of these boards would be appropriately unified and adjusted for the purpose of implementing the registration-based system.

Highlights and interpretation of the IPO system under the registration-based system

I. The main boards serve large-cap blue-chip enterprises and form a differentiated structure with other boards

The Draft Rules further clarify the positioning of the main boards, the STAR Market, and the ChiNext Market. Each board will present clearer multi-tiered and differentiated positioning to match enterprises of different development stages, business types, and industry characteristics. The details are as follows:

Matter	Main boards	STAR market	ChiNext market	BSE
Positioning	Highlight the features of the blue-chip market by prioritizing listing application support for enterprises with mature business models, stable performance, large scale and broad recognition.	Faces the frontiers of the world’s science and technology, the major battlefield of the economy and the major needs of the country. Prioritize enterprises that have core technologies, outstanding innovative capabilities, stable business models, and strong growth potential, and enjoy broad market recognition and good corporate images, which are also in	Focuses on the state innovation-driven development strategy, adapt to the trend of development relying more on innovation, creation, and creativity, mainly services growth-oriented innovative and start-up enterprises, and supports the integration of traditional industries with new technologies, new industries, the new economy and new models.	Mainly services innovation-oriented small and medium-sized enterprises, focuses on supporting enterprises in fields such as advanced manufacturing and modern service industries, promotes the transformation and upgrading of traditional industries, cultivates new driving forces for economic

Matter	Main boards	STAR market	ChiNext market	BSE
		line with national strategies and rely mainly on core technologies for production and operation.		development, and promotes high-quality economic development.
Industry requirements	/	<p>Supports new generation of information technology, high-end equipment, new materials, new energy, energy conservation and environmental protection, biomedicine, and other fields that are in line with the positioning of the STAR Market.</p> <p>The STAR Market restricts the listing of FinTech and business model innovation enterprises.</p> <p>The STAR Market prohibits real estate enterprises and enterprises mainly engaging in finance and investment businesses from offering and listing.</p>	<p>In principle, the following industries are not supported to apply for offering and listing on the ChiNext Market, except for innovative and start-up enterprises deeply integrated with new technologies, new industries, new business models such as the Internet, big data, cloud computing, automation, artificial intelligence and new energy: agriculture, forestry, animal husbandry and fishery; mining; alcohol, beverages and refined tea manufacturing; textile industry; ferrous metal smelting and rolling processing industry; production and supply of electricity, heating, gas and water; construction industry; transportation, warehousing and postal service industry; accommodation</p>	<p>Enterprises are not supported to apply for offering and listing in the financial and real estate industries, that engage in industries with overcapacity, industries subject to elimination as provided in the <i>Catalogue for Guiding Industry Restructuring</i>, and those engaged in pre-school education, academic tutoring, and other services.</p>

Matter	Main boards	STAR market	ChiNext market	BSE
			<p>and catering industry; financial industry; real estate industry; resident services, repair and other services.</p> <p>The ChiNext Market prohibits from offering and listing enterprises engaged in industries with overcapacity, industries subject to elimination under the <i>Catalogue for Guiding Industry Restructuring</i>, and those engaged in pre-school education, academic tutoring, or similar financial services.</p>	
<p>Detailed evaluation rules</p>	<p>/</p>	<p>The <i>Interim Provisions on Application and Recommendation for Issuance and Listing of Enterprises on SSE STAR Market</i> and other rules specify the science and technology innovation attributes of enterprises are clearly stipulated from indicators such as applicants' R&D investment, proportion of</p>	<p>The <i>Interim Provisions on the Declaration and Recommendation for the Stock Offering and Listing of ChiNext Enterprises</i> and other rules specify the evaluation indicators for growth-oriented innovative and start-up enterprises in terms of applicants' R&D investment, compound revenue growth rate/scale, and other aspects.</p>	<p>/</p>

Matter	Main boards	STAR market	ChiNext market	BSE
		researchers, number of relevant invention patents and compound revenue growth rate/scale as well the situations which can prove that enterprises have particularly outstanding science and technology innovation capabilities.		

We observe that the Draft Rules only provide principled provisions on the positioning of the main boards, and a further explanation has not been issued to describe the criteria of “mature business models, stable performance, large scale and broad recognition”. This is in contrast to the STAR Market, the ChiNext Market, and the BSE, which have relevant rules to determine the detailed criteria for their respective positioning (such as industry scope, quantitative evaluation index, etc.). Based on the rules and the previous listing review practice of the STAR Market and the ChiNext Market, whether an applicant complies with the positioning of the board is usually the key concern during an IPO review. Therefore, the criteria of the positioning requirements of the main boards will have a significant impact on the predictability of the main board IPO applications. It remains to be seen whether the securities regulators will in the future further specify the criteria by issuing relevant guidance.

II. Revising the main board IPO listing criteria enhances market inclusiveness

The registration-based stock issuance system would significantly adjust the offering and listing criteria for main board IPOs. Based on the review philosophy of the registration-based system, diversified offering, and listing criteria have been set up to increase the inclusiveness of different types of enterprises. This change would avoid excluding from the main boards high-quality enterprises whose short-term performance is affected by changes in industry cycles, external factors, or the political and economic environment, or that have accumulated a large undistributed deficit in previous periods. At the same time, the listing requirements for red-chip enterprises and enterprises with differentiated voting rights arrangements are also clarified as follows.

1. Set up multiple financial indicators, profitability for three consecutive years is not required

Compared with the current main board IPO-related rules, the Draft Rules mainly focus on the financial indicator listing criteria.

The current main board IPO rules require enterprises that apply for listing on a main board to have positive net profit in excess of RMB 30 million accumulatively in the last three fiscal years prior to the application (calculated based on the lower amount before and after deducting non-recurring profit and loss). The Draft Rules set up three financial indicators for domestic enterprises to choose from when applying for a main board IPO, among which: (1) the first set of criteria mainly assess the applicant's performance (profitability) and are similar to the current provisions, which require profitability for three consecutive years, set the threshold for the cumulative net profits for the past three years and the profit for the latest year, and raise the threshold for the amount of cumulative net cash flow or operating revenue for the last three years; (2) the second and third sets of criteria only require a positive net profit in the latest year. In addition to the requirements of profitability in the latest year, the second set of main board criteria require market value, revenue, and net cash flow to reach a certain threshold, which is similar to the third set of criteria of the STAR Market. However, the requirements for each indicator are higher, reflecting the mature businesses and larger scale of enterprises listed on the main boards. The third set of main board criteria requires the enterprise's market value and revenue to reach a certain threshold, which is similar to the fourth set of criteria of the STAR Market and the third set of criteria of the ChiNext Market, while it also requires higher market value and revenue indicators (and even higher than such requirements for the market capitalization and revenue of red chip enterprises that have not been listed on overseas stock exchanges to apply for domestic listing).

In addition, the Draft Rules would cancel existing main board requirements that include three consecutive years of profitability, no accumulated deficit at the end of the latest reporting period, and a maximum amount of intangible assets among net assets. Main board IPO applicants would no longer be affected by high accumulated deficits due to historical R&D investment or investments in market development.

2. Further improve the main board listing criteria for red-chip enterprises and enterprises with differentiated voting rights arrangements

In the Draft Rules, the exchanges integrate and add to the main board listing rules the relevant provisions on domestic listings of red chip enterprises, which further clarifies the specific criteria for the main board listing of red chip enterprises.

Moreover, for enterprises with differentiated voting rights arrangements, in addition to complying with relevant listing rules, the main board rules also draw on the relevant rules of the STAR Market and the ChiNext Market. The Draft Rules would raise the requirement of estimated market value/revenue, and add the requirement of positive net profit in the latest year, which fills in the blank in the existing rules that do not provide clear arrangements for the listing criteria of such enterprises.

After the above adjustments, red-chip enterprises and enterprises with differentiated voting rights will have a clearer path in terms of main board IPOs, which would be conducive to those enterprises to conform to the positioning of the main boards in applying for listing.

The following table shows a comparison of the revised main board listing criteria:

Criteria	Current rules	Draft rules
<p>Market value and financial indicators (domestic enterprises)</p>	<p>An issuer must meet the following financial indicators:</p> <ul style="list-style-type: none"> ■ Positive net profits in the each of the last three fiscal years, in excess of RMB 30 million accumulatively; ■ The cumulative net cash flow from operating activities in the last three fiscal years exceeds RMB 50 million, or cumulative operating revenue exceeds RMB 300 million; ■ No undistributed deficit at the end of the latest period. 	<p>An issuer must meet at least one of the following criteria: :</p> <ul style="list-style-type: none"> ■ The net profit in each of the last three fiscal years is positive and the cumulative net profit in the last three years is no less than RMB 150 million, net profit in the latest year is no less than RMB 60 million, the cumulative net cash flow generated by operating activities in the last three years is no less than RMB 100 million or the cumulative operating revenue is no less than RMB 1 billion; ■ The estimated market value is no less than RMB 5 billion and the net profit in the latest year is positive, the operating revenue in the last year is no less than RMB 600 million, and the cumulative net cash flow generated by operating activities in the last three years is no less than RMB 150 million; ■ The estimated market value is no less than RMB 8 billion and the net profit in the last year is positive, and the operating revenue in the last year is no less than RMB 800 million.
<p>Market value and financial indicators (red-chip enterprises not yet listed overseas)</p>	<p>An issuer must meet the following criteria:</p> <ul style="list-style-type: none"> ■ Its audited main business income in the latest year must be not less than RMB 3 billion, and the enterprise's valuation must be not less than RMB 20 billion; ■ It is be a high-tech enterprise that possesses intellectual property rights or know-how that have been independently researched and developed, enjoy internationally leading position and can obviously lead the development of important areas in China, and has obvious technological advantages; the proportion of 	<p>An issuer must meet at least one of the following criteria:</p> <ul style="list-style-type: none"> ■ The estimated market value is no less than RMB 20 billion, and the operating revenue in the latest year is not less than RMB 3 billion; ■ It has rapid operating revenue growth, independent research and development, internationally leading technology, in a relatively advantageous position in industry competition, and the estimated market value is not less than RMB 10 billion; ■ It has rapid operating revenue growth, independent research and development, and international leading technology, holds a relatively advantageous competitive position in the industry, and its estimated market value is not less

Criteria	Current rules	Draft rules
	<p>its research and development personnel exceeds 30%; it has obtained more than 100 invention patents relating to its main business or at least one new drug approval document relating to its main business, or possesses core technologies with internationally advanced and leading roles recognized by competent authorities. It relies on technological innovation and intellectual property rights to participate in market competition, with a comparative advantage in a competitive position, and the market share of its top product is within the top three. Its compound annual operating revenue growth rate is more than 30% in the last three years; its audited main operating revenue in the latest year is not less than RMB 1 billion, and its annual research and development investments account for more than 10% of the total income from its main business in the last three years. Exceptions may apply to an enterprise with important significance for national innovation-driven development strategies and strong development potential and market prospects.</p>	<p>than RMB 5 billion, and the operating revenue in the last year is not less than RMB 500 million.</p> <p>The “rapid growth of operating revenue” as specified in the preceding paragraph must meet one of the following criteria:</p> <ul style="list-style-type: none"> ■ If the operating revenue in the latest year is not less than RMB 500 million, the compound growth rate of the operating revenue in the last three years must be more than 10%; ■ If operating revenue in the latest year is less than RMB 500 million, the compound growth rate of the operating revenue in the last three years must be more than 20%; ■ Affected by cyclical fluctuations of the industry and other factors; if the industry as a whole is in a downward cycle, the compound growth rate of operating revenue of the issuer in the last three years must be higher than the average growth level of comparable companies in the same industry during the same period. <p>Red-chip enterprises in the research and development stage and those of great significance to the national innovation-driven development strategy are not subject to the above “rapid growth of operating revenue” requirement.</p>
<p>Market value and financial indicators (enterprises with differentiated voting rights arrangements)</p>	<p>The current main board listing rules do not specify the financial indicators for listing such companies</p>	<p>An issuer must meet at least one of the following criteria:</p> <ul style="list-style-type: none"> ■ Estimated market value of not less than RMB 20 billion, and the net profit in the latest year is positive; ■ Estimated market value of not less than RMB 10 billion, the net profit in the latest

Criteria	Current rules	Draft rules
		year is positive, and the operating revenue in the latest year is no less than RMB 1 billion.
Asset requirement	At the end of the last period, intangible assets account for no more than 20% of net assets (after deducting land use rights, surface aquaculture rights and mining rights, etc.).	Asset requirement removed.

III. Unify the review procedures to improve efficiency and transparency

In terms of review procedures, main board IPO applications will be subject to registration procedures, i.e., the exchange is responsible for accepting the application and conducting a comprehensive review of compliance with the issuance and listing criteria and information disclosure requirements, and will report to the CSRC for registration after the review.

Specifically, the main board review rules would generally follow the review rules of the STAR Market and ChiNext Market, which specify:

- Full implementation of the registration-based stock issuance system in issuance review, the exchange is fully responsible for the review of issuances, listing and information disclosures, and registration with the CSRC. The CSRC is mainly responsible for securities issuance registration, coordination, supervision, and management, and strengthening and gradually realizing the functional transformation of the CSRC;
- improve the mechanism for connecting the exchange review process and the CSRC registration process by specifying that the exchange’s review is under the supervision and inspection of the CSRC; when the exchange accepts an enterprise’s IPO application, it will review and determine whether the enterprise meets the offering conditions, listing conditions, and information disclosure requirements and immediately report to the CSRC for guidance any material sensitive matter, material unprecedented circumstance, major public opinions, and evidence of a major violation of law identified from the review (the “four major issues”);
- unify the application document standards of the main boards, the STAR Market, and ChiNext Market, simplify the application documents, and increase the requirements for application materials such as shareholder look-through verification documents and descriptions of compliance with board positioning;
- compared with the current approval system, the overall timeframe of the listing review is shortened, and important segments of the entire process are disclosed to the public; consultation and communication between enterprises, intermediaries, and review authorities are accepted from the pre-declaration to the post-review, strengthening the transparency of review and registration.

With the full implementation of registration-based stock issuance system, the functions of the

exchanges and the CSRC are further clarified, and the CSRC will gradually become a coordinator and regulator with a more open and transparent review process. According to the Draft Rules, in addition to general supervision and guidance, project sampling, and integrity supervision, the CSRC will focus on the “four major issues” and the issuers’ compliance with industrial policies and board positioning. The efficiency of listing reviews is expected to improve further with the transformation of the CSRC’s role.

IV. Other

1. Further loosen the listing criteria on the ChiNext Market for unprofitable enterprises

When the SZSE launched the ChiNext Market reform and piloted the registration-based system, although the IPO rules specified listing criteria for unprofitable enterprises, SZSE proposed a one-year transitional period arrangement for such criteria in its June 12, 2020 circular for the *SZSE Rules on Governing the Listing of Shares on the ChiNext Market*. The one-year transition period has now long expired, and the ChiNext Market has accepted no unprofitable enterprise’s IPO applications under this standard. In addition, the current rules require positive net profit in the latest year for red-chip enterprises and enterprises with a differentiated voting rights arrangements.

The Draft Rules would remove the positive net profit requirement for the latest year from the ChiNext Market financial indicators applicable to red-chip enterprises and enterprises with a differentiated voting rights arrangements, which is consistent with the current STAR Market rules. Moreover, the SZSE, in its comments to the press in relation to the Draft Rules, expressed that it would “support eligible unprofitable enterprises to list on the ChiNext Board”. We expect that after the reform is implemented, unprofitable enterprises will be able to list on the ChiNext Board, so that innovative and entrepreneurial enterprises that have not yet become profitable will have more options for listing domestically.

2. Accommodate the registration-based stock issuance system and further strengthen the information disclosure requirements and the duties of intermediaries

The registration-based system, with information disclosure at its core, imposes stricter requirements on the quality of information disclosures and the duties of intermediaries. The Draft Rules would further strengthen the information disclosure requirements and the duties of intermediaries, requiring the disclosure of information in filing documents to be concise and clear, easy to understand, relevant, effective, and readable. In addition, duties that previously arose after an application was accepted would now become duties undertaken at the time of application, reinforcing the responsibilities of intermediaries. In addition, the duties of intermediaries would be further clarified, and sponsors and other securities service providers, such as lawyers and auditors, would be guided to perform their respective duties and cooperate with each other. A clear and rational mechanism for the division of duties will be more conducive to the intermediaries to concentrate their efforts in their specialized fields and perform their role as gatekeepers.

In addition, The Draft Rules do not include intermediaries being investigated as a condition for rejecting or suspending a review, which would avoid the circumstance where an applicant is indirectly implicated

by the legal or compliance issues associated with other IPO projects.

3. Reform the issuance and underwriting system, optimize the main board trading rules

The current registration-based system reform would generally unify the main rules and trading system for securities issuance and underwriting on the SSE and SZSE, and sets up differentiated voting arrangements according to the positioning of each board. In terms of underwriting securities issuances, each board would uniformly apply the basic provisions for pricing, placement, issuance procedures, information disclosure, etc., fully implement the pricing mechanism based on market-oriented inquiries, supplemented by direct pricing, and an investment value research reporting system would be introduced on the main boards. After the implementation of market-oriented inquiries on the main boards, the invisible ceiling restrictions on the main board P/E ratios are expected to break and the main boards would no longer limit the price range within five trading days; the enterprise valuations will be left to the market.

Conclusion

Since the registration-based stock issuance system was first piloted on the STAR Market in 2019, relevant listing rules have undergone continuous adjustment and improvement. This current reform is not only an achievement of the pilot registration-based stock issuance system over the past four years, but also the starting point for entering the era of registration-based issuances and continuous improvement of the listing supervision system. We will remain focused on the introduction of the subsequent formal rules and look forward to improved financing platforms and new development opportunities for more high-quality enterprises.

Important Announcement

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