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China's new Regulation on Preferred Shares

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On 21 March 2014 the China Securities Regulatory Commission ("CSRC") released a Regulation on the Pilot Implementation of Preferred Shares ("Regulation") which came into effect on the same day. The adoption of this Regulation serves to implement the reform policy of the State Council which has adopted a Guideline on Executing the Pilot Program of Preferred Shares ("Guideline") on 30 November 2013 (see our *Update China Desk* 12/2013) to aim at facilitating the reform of the Chinese capital market.

Framework for Preferred Shares

The Regulation sets up a complete framework with 70 articles covering the general rules, the use of shareholder rights of preferred shares, the issuance of preferred shares by listed companies, the issuance of preferred shares by unlisted public companies, transfer of preferred shares and registration, information disclosure, repurchase and merger/restructuring, and authority supervising as well as legal liabilities. The highlights are in particular the following aspects:

Qualification of Issuers

Issuers of preferred shares are limited to listed companies and unlisted public companies. As already demonstrated in the Guideline, the reform policy of the State Council in the way of the preferred shares pilot program is to aim at providing more financing channels for Chinese listed and certain public companies, but far from facilitating non-public financing transactions. So far, private companies cannot benefit from this reform.

Listed Companies: Private Placement and Public Issuance

As regards issuance of preferred shares, listed companies generally may conduct private placement. However, only three types of them are entitled to issue preferred shares publicly. That are, at first, the listed companies whose common shares are included in the Shanghai Stock Exchange 50 index; secondly, the listed companies who use public issuance

of preferred shares as payment instrument to acquire other listed companies; thirdly, the listed companies who use public issuance of preferred shares as payment instrument to repurchase common shares with the purpose of capital reduction, or publicly issue preferred shares in the amount of no more than the capital reduction by repurchase after the repurchase has been completed. Even though, other limitations should not be overlooked. For instance, for public issuance of preferred shares a qualified listed company should have been continually profitable in the last three financial years.

Qualified Investors for Private Placement

As regards private placement, both listed companies and unlisted public companies may issue preferred shares only to certain qualified investors who are specified in the Regulation including, in particular, qualified financial institutions like commercial banks or insurance companies, private banking products of above qualified financial institutions, enterprises with legal personality with paid-up registered capital of no less than RMB 5 million, qualified foreign institutional investors (QFII), RMB QFIIs, partnerships and individual investors. However, among individual investors the issuers' directors, senior managers and their spouses should be excluded. Furthermore, for each issuance the total number of investors shall not exceed 200; and for the preferred shares issued under the same terms the aggregated number of investors shall not exceed 200.

Trading and Transfer

Among other highlights a significant aspect relates to the transfer of issued preferred shares which may be traded on a stock exchange market or the National Equities Exchange and Quotations ("NEEQ"). Noteworthy is, that the investors in the course of transfer at trading markets shall fulfill the qualification requirments specified in the Regulation as mentioned above.

Perspective

The Regulation provides the first legal basis for the introduction of preferred shares. Although the policy objective and legislative aim are relative narrow, the legal definition of preferred shares is finally established. An expansion of function and further possible legal reform of the Company Law could be expected.

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