

Client Alert

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Pilot innovative companies can submit their Chinese Depository Receipts (CDR) listing applications now

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Current policy

On 6 June 2018, China Securities Regulatory Commission (CSRC) officially issued the Administrative Measures for the Issuance and Trading of Depository Receipts (for Trial Implementation) (《存托凭证发行与交易管理办法（试行）》) and a series of supporting rules (collectively the "**CDR Trial Rules**") to specify CDR's applicable laws and basic regulatory principles.

On 15 June 2018, the Shanghai Stock Exchange and the Shenzhen Stock Exchange issued their respective Implementing Measures for the Listing and Trading of Stock or Depository Receipts offered to Pilot Innovative Companies 《试点创新企业股票或存托凭证上市交易实施办法》 (collectively the "**CDR Implementing Measures**"). The CDR Implementing Measures specify the detailed arrangements for CDR's listing, trading, management and information disclosure systems. The implementation of the CDR details highlights the official launch of the pilot program for innovative companies to issue CDR in China. With immediate effect, pilot innovative companies can submit their CDR listing applications to CSRC.

Pilot innovative companies are the targets of CDR Trial Rules

1. What are the selection criteria of an eligible innovative company?

An eligible innovative company has to meet the following selection criteria:

- being a high-tech or strategic innovative company that aligns with China's national strategies and possesses core technologies with extensive market recognition;
- operating in high-tech industries or strategic emerging industries, such as internet, big data, cloud computing, artificial intelligence, software and integrated circuits, production of high-end equipment and biomedicine; and
- satisfies any one of the following standards:

Corporate nature	Specific standards
Red-chip companies that are listed on an overseas stock market	Market value should be at least RMB 200 billion

<p>Private companies that are not listed on an overseas stock market</p>	<ol style="list-style-type: none"> 1. the revenue of the principle business is at least RMB 3 billion in the most recently audited financial year and the company's market value is at least RMB 20 billion; or 2. leading high-tech companies that: <ul style="list-style-type: none"> ▪ own independently researched and developed intellectual properties (IP) or special technologies. Such IP or technology is internationally competitive and is capable of driving domestic development in important areas; ▪ possess distinctive technological advantages and have at least 30% R&D staff; ▪ have obtained at least 100 patents in relation to the principle business, or at least one new drug permission in relation to the principle business; or possess core technologies that are recognized by competent authorities as internationally leading; ▪ have relative competitive edge relying on technological innovation and intellectual property rights; ▪ own a major product with a top-three market share position; the compound growth rate of operating income should be at least 30% in the last three years; revenue of the principle business should be at least RMB 1 billion for the most recently audited financial year; R&D investment account for at least 10% of the total revenue of the principle business in the last three years; or 3. Companies that are crucial to China's innovation-driven development strategies, and have strong development potential and market prospects.
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2. Who have a say in selecting pilot innovative companies?

CSRC Science and Technology Innovation Advisory Panel under the CSRC provides advisory comments regarding the selection of pilot innovative companies.

What are the trading rules of CDR?

CDR trading rules include:

1. The pricing currency of CDR is Renminbi; CDR market price's minimum changeable unit is RMB 0.01;
2. CDR can be traded by auction, block trade or transfer agreement;
3. CDR has a 10% limit on its price change (increase or decrease), except for the first listing date; and

4. In principle, CDR and offshore underlying securities cannot be interchanged or pledged. In other words, the source of CDR's underlying securities can only be newly issued shares (i.e. new shares). Nevertheless, the CDR Trial Rules state that when previously issued securities serve as the basis of CDR, such CDR do not require underwriting by securities companies. Therefore, the future source of CDR's underlying securities may include existing issued securities (i.e. old shares).

What are the requirements for special companies?

1. Red-chip companies with variable interest entity (VIE) structures

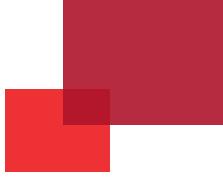
According to the CDR Trial Rules, offshore underlying securities issuers with VIE structures should disclose their specific arrangements and relevant risks of the VIE structures in the CDR prospectus, including but not limited to the following content:

- 1) basic information of the relevant players in the VIE structures and the core terms of the main contracts;
- 2) risks of punishing the offshore underlying securities issuers, adjustment of the relevant VIE structures, force majeure or substantially increased costs triggered by changes in domestic and foreign legal rules or regulatory environment;
- 3) risks of offshore underlying securities issuer's control arising from the reliance on the VIE structures instead of direct ownership of the operating entity;
- 4) risks of relevant party's default in the VIE structures;
- 5) risks of lost of control by the offshore underlying securities issuer in relation to the operating permits, business qualifications and control of the relevant assets under the VIE structures; and
- 6) risks of tax liabilities arising from the VIE structures or its relevant arrangements.

2. Red-chip companies with weighted voting rights (WVR) structures

According to the CDR Trial Rules, offshore underlying securities issuers with WVR structures or other similar different voting rights arrangements should disclose their specific arrangements and risks, including but not limited to the following content:

- 1) classes of shares, voting rights and upper limit of each share under the WVR structures or similar arrangements;
- 2) particular matters that are exempted from the special voting mechanism under the WVR structures or similar arrangements;



- 3) the restrictions and impact to CDR holders arising from the WVR structures or similar arrangements, such as the nomination and election of directors, participation in the company's decision making, etc;
- 4) the risks that WVR shareholders may jeopardize the legal rights and interests of other shareholders arising from conflict of interests;
- 5) protective measures for CDR holders' legal rights under WVR structures, such as varying the constitutional documents to restrict the transfer of WVR shares and the automatic conversion of WVR shares into ordinary shares when there is a change in control or retirement of the founder; and
- 6) the arrangement to maintain the proportion of WVR shares and their voting rights at a level not higher than that when the CDR were publicly issued in China, unless otherwise stipulated in the constitutional documents before the public issue of CDR.

3. Restrictions to special companies

Under the CDR Implementing Measures, WVR shareholders are subject to the following restrictions:

- 1) for Red-chip companies with WVR structures, the minimum number of shares held by WVR shareholders should not be less than 10% of the total number of voting shares; the voting power of each WVR share should not exceed 20 times of the voting power of each ordinary share;
- 2) ordinary shareholders should be entitled to cast not less than 10% of the total number of votes; ordinary shareholders holding at least 10% voting power can convene an extraordinary general meeting (EGM) and propose resolutions at the EGM; unless otherwise specified, the voting power of WVR shares cannot be increased after listing;
- 3) all WVR shares shall be converted into ordinary shares on a one to one ratio under certain specific circumstances; and
- 4) WVR shares and ordinary shares shall have the same voting power in resolving key corporate matters, such as:
 - changes to the company's constitutional documents;
 - variation of rights attached to WVR shares or ordinary shares;
 - merge, spin-off or winding up.

Who are eligible to invest in CDR?

Eligible CDR investors are subject to the same conditions as A-share investors. Other than that, the CDR Trial Rules and CDR Implementing Measures do not specify other restrictions on CDR investors' thresholds. Further, the CDR Trial Rules prescribe qualified foreign institutional investors and RMB Qualified Foreign Institutional Investors as eligible CDR investors.

Suspension or termination of listing of CDR

In principle, the circumstances and procedures leading to the suspension or termination of CDR follow the rules of A-shares, except for delisting indicators such as minimum public float and cumulative trading volume. If a CDR is delisted, the depository shall, as agreed in the depository agreement, sell the underlying securities and distribute the proceeds (after deducting tax) to the CDR holders in a timely manner. If a delisted CDR cannot be sold, the offshore underlying securities issuer should specify reasonable arrangements in the depository agreement to protect the legal interests of CDR holders.

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