

The CSRC at 20: Power Centralization and Its Effects on Corporate Finance

(*title in Chinese: 《中国证监会二十年: 权力的聚集及对公司融资的影响》*)

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Abstract: From 1992 to 2012, the Chinese Securities Regulatory Commission (“CSRC”) has emerged from a weak regulatory body to a strong, powerful one, beating the local governments. Although the only two stock exchanges are respectively in the Shanghai and Shenzhen, yet which companies can qualify to go public, raise money from capital markets and list in the stock exchanges are all determined and approved solely and exclusively by the bureaucrats in the CSRC’s Beijing Headquarter. From historical and institutional change perspective, How did this happen? First factor was the SOEs reform and the abandonment of the IPO quota system. Second, the CSRC began to control the two exchanges in 1997. Third, from 2005, the corporatization of the SOEs and private firms need not be permitted by local governments. Fourth, from 2004 to 2007, the CSRC began to bail out the investment banks controlled by local governments and the central bodies controlled half of investment banks which otherwise were controlled by local governments. The centralization of IPO regulation makes the enterprises of different nature of ownership play in fair level; the competitions for IPO and listing among different provinces/regions more sincere and efficient; the CSRC increasing depend upon the investment banks (sponsors) to select which firms going public.

Key Words: CSRC; SEC; Power Centralization; Political Network; Securities Regulation; Corporate Finance

This paper reviews the history of the Chinese Securities Regulatory Commission (“CSRC”) from the perspective of power evolution and its effect on the corporate finance. After 8 • 17 event at Shenzhen City in 1992, the CSRC was immediately founded by the state in 1992. It’s at 20 and is about 60 years younger than the SEC in the US. It’s necessary to review the CSRC.

I. Beijing: the Power Center of Securities Regulation

Although the only two stock exchanges are respectively in Shanghai and Shenzhen, which companies can acquire the qualification to go public and list in the stock exchanges are determined and approved solely and exclusively by the bureaucrat in Beijing. The Beijing CSRC monopoly the power of IPO regulation, which does not share with local branches of the CSRC, the local governments or the exchanges.

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As a background, let me give you a full picture of the IPO process, so that we can judge which actors are more influential than other actors. First, an enterprise, especially the SOEs should transform to a corporation limited by stock, “corporatization”. A sponsor (securities companies/investment banks) is willing to warrant and recommendate the company. The local branches of the CSRC provide the tutoring and examining the applicant companies. After passing the tutoring (local branches of the CSRC submit the tutoring certification to the central CSRC), applicant companies with the help of the securities companies submit application materials to the central CSRC, the Division of Issuance or the Division of Growth Enterprise Board. The officials in the Division of Issuance or the Division of Growth Enterprise Board pre-review the IPO application materials and ask questions, demanding the applicant companies and sponsors to answer within the limited time. After a few rounds, if the officials agree preliminarily to the application, then the applicant companies enter next procedure, reviewed by a Panel/Committee of Securities Issuance Review (the Committee), members of the Committee coming from law firm, accounting firm, the CSRC, the State Assets Management Commission, and so on. The Committee would interview the president, CFO, CEO and sponsor representatives, and ask questions. The Committee approve or disapprove the application. After the approval from the Committee, the CSRC then approve the IPO.

A. Phase 1: the 1980s, freedom experiment

During the reforming era, the first piece of stock appeared in 1984. In 1983, the United Investment Company in Baoan County, Shenzhen City, was the first company that issued the stock certification. In July 1984, the first company limited by stock appeared in Beijing, TianqiaoBaihuo Stock Company. In November, 1984, Shanghai Feile Music Instrument Corporation that was started by Shanghai Diansheng General Factory was the first company that issued to public the stocks, raising RMB 400,000.

Restricted by the political ideology of capitalism and socialism, only small enterprises, collective owned enterprises had the encouragement to transform to corporation limited by stock and issue stocks. The medium and large SOEs seldom dared to try. The collective owned enterprises were the most likely to ownership reform. The so called “Red hat” enterprises that were private owned but in the name of the government for the protection from government were active because these enterprises wished to acquire the control of the “Red hat” enterprise by ownership reform.

In sum, the local governments dominated the procedure of securities issuance. The Committee of System Reform were responsible for approval of corporatization; the People’s Bank (the central bank) approved the securities issuance. Because the personnel of the local People’s Bank were determined by the local governments, local governments controlled

B. Phase 2: 1992-1997, the power of central government began to intervene, however, the central government was weak, the local governments were strong in the context of securities regulation.

In the 1980s, the central government let the local governments free to try and experiment in stock issuance. There was only one limitation imposed by the central

government upon the great experiment, that is, enterprises issued stock only to the people of the provinces where the enterprises located. The enterprises could not issue to the public that were outside the province where the enterprises belonged. Meanwhile, the stock only could trade within the provinces that approved the issuance of the stock. The purpose of the territory regulation was to prevent one province raising money from other provinces.

Although the central government had the ability to restrict the enterprises to go outside the local provinces, it did not have the ability to restrict the crazy investors move to other provinces to buy the stocks. The crowds outside the province could borrow the ID card from the people of this province, so qualified to buy the stocks in other provinces. The “stock fever” evolved into crowd event that threatened the social stability. The famous event was the “8 • 10 event”. The crowd that could not buy the certification of stock because the certifications of stock were scarce became rebels. The central government was shocked by the “8 • 10 event” and empowered to investigate the event.

In October 1992, The Securities Committee of State Council established as the highest securities regulatory agency, which was more like a coordinator. Zhu Rongji, also the associate prime minister, was the director of the Securities Committee. Associate directors of the Securities Committee were also part-time, 15 persons, the head of the 15 central governmental departments, including the head of the CSRC which was at the same time established as the enforcement agent of the Securities Committee. LIU Hongru, who was the president of the CSRC, recalled that “at the beginning of the CSRC, we did have no money, no persons, nor no offices.” Even the CSRC lacked of establishment money, “the Ministry of Finance promised to borrow money, but it delayed the grants. One of the student of LIU HongRu, ZHANG Zhiping borrowed RMB 2,000,000, using his relationship (GuanXi), and borrowed another RMB 2,000,000 from the Research Office of Union Securities (LianBan)”. At last, these persons rented a floor as offices. In a word, the establishment of the CSRC was very urgent and unprepared.

Correspondingly, local governments established the Office of Securities Management. For example, in Shanghai Municipality, head of the office of securities management was associate major. The Office comprised representatives from the Shanghai Branch of People’s Bank, Planning Committee, Committee of System Reform, Shanghai Branch of Ministry of Finance, Audit Bureau, Foreign Investment Bureau, Judicial Management Office, State Owned Assets Management Bureau (Shanghai Office), Shanghai Exchange. The functions of it were: stipulating the local regulation of securities and administrative management; regulating and authorizing the issuance and listing of local securities; regulating the local exchanges; regulating the disclosure of the local listing companies; stipulating the specific policies; Training local persons whose worked related to securities.

In sum, although the central government realized the seriousness of stock, established the central securities regulatory agency and began to exercise power and intervene, local governments decided in the process of IPO, seasoned offering, issuance of Share B, trading.

C. Phase 3: in 1998, the critical institutional reform of the state council

In November, 1997, national financial meeting convened by the central government which decided the reform of the system of national securities regulation, made clear the chaos of securities regulatory power, directly lead and control the local securities regulatory offices and agencies, and the people’s bank exited from the securities regulation, the central

securities regulatory body . In April, 1998, according to the institutional reform plan of the state council, the state council decided merge the Securities Committee and the CSRC into one agency, the CSRC and promoted the CSRC into a as high bureaucracies as other central governmental departments in order to be against the local provinces. In September, 1998, the state council stipulated the Provisions regarding the Functions, Institutional Design and Personnel of the CSRC (the SanDing Plan), further making it clear that the CSRC was directly led by the state council and was responsible for the regulation of the national securities and futures market. All the local Offices of Securities Management were transferred to the CSRC. Local exchanges except the Shanghai and Shenzhen Exchanges were closed. The Shanghai and Shenzhen exchanges were directly managed and controlled by the CSRC, following directly the orders from the CSRC. In a word, in 1998, the power centralization of national securities regulatory system was formed.

First, the local branches of the CSRC have little power about the approval of IPO. The CSRC established 36 branches in the 31 provinces and 5 special cities. These branches are responsible for tutoring and evaluating the listing company's candidates, however, form is over substance. The tutoring does not screen enterprises and reject application.

Second, local governments exited from the process of selecting which companies including private companies to go public with the abandonment of the quota system at the turn of the 20th century. During the 1990s, local governments or central departments determine which companies have the quota and can apply to the CSRC. Under the administrative approval system in the 21th century, both local governments and central governments exited from the reviewing process of IPO. The main role of the local governments is to provide for enterprises kinds of legitimate certification or documents the CSRC need that prove the company candidates under their jurisdiction did not violate the law or regulation, such as taxation, environment, labor and other issues that are regulated by local governments.

Third, the stock exchanges have no voice about the selective process. The stock exchanges have no power to decide which companies would or not list on them. Although the two securities exchanges in the mainland establish the listing committee after the Hongkong exchange, the things that the two securities exchanges want to do are only two, one is the arrangement of when the companies that have got the approval from the CSRC list in the exchanges; the other thing is giving a code of securities.

II. The Process of Power Centralization

The CSRC has emerged to a strong central securities regulators since 2001. From 1992-2000, the local governments was over the CSRC with respect of which firms had qualification to go public. The CSRC was weak. Since 2001, the CSRC has begun to monopoly all the power of securities regulation and grown to a strong, powerful agency. I am wondering how it happened.

First factor is the SOEs reform and the abandonment of the IPO quota system.

The state needs stock markets, however, the needs and strategy of the state may change.

The Chinese stock market was based upon the reform policy of the SOEs.

In the 1990s, the stock market served for the reform of SOEs. The IPO quota system was prevailing. The Securities Committee of State Council adopted the means of the planned economy, the Quota, to control the issuance of stock of the whole country every year. According to the notice of further enhance the macro regulation on the securities market by the state council and temporary provisions on the stock issuance and trading, the IPO quota system dominated the period, 1992-2001. Under the IPO quota system, local governments¹ and central governmental departments decided which firms go public. Every year the central government allocated IPO quota of next year among provinces and central governmental departments. ?

Things changed in 1999-2001. The foundation is the SOEs reform. In 1999, Prime Minister ZHU Rongji set the political task that the SOEs must become profitable within 3 years. In Jan. 10, 2001, the head of the State Committee of Economics and Trade announced officially at the news briefing of the News Office of the State Council that at the end of 2000, the China had complete successfully the 3-year goal of the SOEs reform, most of SOEs becoming profitable and getting rid of loss; meanwhile, most of the critical big and middle size's SOEs had established modern enterprises system preliminarily. ²

The announcement has profound implications, which means that the central government decided to abandon the responsibility to help those SOEs owned by local governments. The central governments were responsible for central SOEs and local governments were solely responsible for local governments. Hence, since then the capital market had stopped serving for the reform of local SOEs. In other words, when the SOEs reform was announced "successfully" in 2001, the story that capital markets served the SOEs reform was ended. It was a turning point of the history of Chinese securities law.

Accordingly, in 2001, the State council abandoned the IPO quota system, which was the means of the planned economy.

Second, the CSRC began to control the two exchanges in 1997. In the 1990s, the two exchanges had been controlled by the local governments, Shanghai City and Shenzhen City since these started. For example, the two local governments decided which listed companies qualified to issue securities to raise money.

Some events happened that touched the bottom line of the central government. The issue was the trading of the state stock (*guojiagu*) and state enterprise stock (*GuoYouFaRenGu*). The premise of the stock market in the 1990s which is the symbol of capitalism was freezing the state stock and state enterprise stock because the nature of these two kinds of stock was socialism and were forbidden to trade or sale through the stock market. However, exchanges easily let the frozen state stock and state enterprise stock trade or sell to public. JIANG Jiying, who was the associate manager of the listing department in the Shanghai exchange, recalled that: ?

In August, 1997, the central government decided to centralize the two exchanges and the CSRC controlled the two exchanges. Ever since, the securities offering by the listing companies must be approved by the CSRC. The CSRC would put the application of securities

¹ Chinese governments are divided into central government and local governments. Local governments include three level, *province, city and county*.

² Sen Peng and Li Chen, ed., *The Iconic Events of the Reform of the Chinese Economic System*, Vol.2, Beijing: Chinese Renmin University Press, 2008, p. 651.

issuance by listing companies to the Committee/panel of securities issuance (FaXingShenHeWeiYuanHui), established by the CSRC. The state council allocated the two exchanges to the CSRC. Meanwhile, it established the office of special agent of securities regulation.

Third, from 2005, the corporatization of the SOEs and private firms need not be permitted by local governments. Under the Chinese corporation law, the first step the firms going public need to do is corporatization, transforming the enterprises to the company limited by stock. Before 2005, under the old corporation law, the transformation of enterprise, not matter the SOEs or private firms must get the approval by the local governments. After 2005, with the enforcement of the new corporation law, the local government's power of approval of corporatization was abolished. In law, the local governments exited from the administrative review procedure of IPO.

Fourth, from 2004 to 2007, the CSRC began to bail out the investment banks controlled by local governments and the central bodies controlled half of investment banks which otherwise were controlled by local governments.

It is necessary for all the applicant companies going public to get the recommendation (under the Quota system from 1991-2001), opportunities (under the channel from 2001-2003) or sponsorship (under the approval system from 2004-today) from the securities companies. The sponsorship resources were scare. From 2001 to 2004, the CSRC allocated the channels to securities companies based upon their reputation, size and other factors. Securities companies decided which companies were priority of applying to the CSRC, however, the CSRC restricted the applicant numbers. Only after one applicant company went public successfully, could one channel be spared and securities companies submitted another applicant company's materials. From Feb. 1, 2004, the IPO regulation switched from the channels to sponsorship (meanwhile the channel as the transition). From Jan. 2005, the IPO regulation changed again, abandoning the channels restrictions and switching to sponsorship, i.e. enterprises need to get the sponsorship from securities companies.

From 2004-2007, the CSRC launched a movement to curb and bailout securities companies since securities companies stole money of their customers. The movement was called the "Comprehensive Governance of Securities Companies". Before the movement, local governments owned most of securities industry, which meant that local governments controlled most of the IPO opportunities and which companies could get the sponsorship.

During the movement, by bailing out securities companies, the CSRC let about half of securities companies out of the hand of local governments, and central bodies, like the central SOEs, national commercial banks, began to control half of securities industry. One typical example was that the CSRC itself directly controlled the AnXin Securities Corp, which the Chinese media called the "Son of the CSRC".

Additionally, when the CSRC restructured securities industry, the CSRC stipulated that persons who had right to sign to recommend applicant companies to the CSRC must pass the examination of entrance to sponsor representatives. The one who qualify to sign to recommend applicant companies to the CSRC were called the sponsor representatives, who were a new wealthy class, "Golden Collar". It was effective to enhance the power of the CSRC because old persons in securities industry cannot pass the examination which were very difficult and would take lots of time to prepare, yet the new persons who had time to

prepare can pass the examination and qualify to sign. It was difficult for the CSRC to control the old persons in the securities industry and yet easy for it to control the new persons most of which graduated from universities and were not influence by the bad atmosphere in securities industry.

III. The Effect upon the Chinese Corporate Finance in historical perspective

First, enterprises of different nature of ownership can play in fair level. Under the IPO quota system during the 1990s, almost only the SOEs can be selected by local governments or central governmental departments to go public or be privatized. Conversely, when the CSRC dominates the selective process, it is more neutral for firms with different ownerships. Please see the table 1 and 2, annex.

Second, the competitions among different provinces are sincere and efficient. Without the protection of IPO quota system, the developing provinces and governments cannot get the chance to the firms of their jurisdiction to go public. Please see table 3 and figure 1, 2.

Third, the CSRC increasing depends upon the investment banks (sponsors) to select which firms going public. In the 1990s, the CSRC depended upon the local governments or other central ministries to select screen and review the applicant companies.³

³ Katharina Pistor, Chenggang Xu, *Governing Stock Markets in Transition Economics: Lessons from China*, 7(1) American Law and Economics Review 184-210 (2005); Julian Du, Chenggang Xu, *Administrative Governance and Financial Development in China: Evidence from Regional Analysis*, Working Paper, Chinese University of Hong Kong, June 2005; Julian Du, Chenggang Xu, *Regional competition and regulatory decentralization: Case of China*, Working paper, Chinese University of Hong Kong and London School of Economics and Hong Kong University of Science and Technology, 2007; Julian Du et al., *Special Treatment (ST) Firms and Administrative Governance of Capital Markets in China*, in Thomas Eger et al. eds., *Economic Analysis of Law in China*, Edward Elgar, 2007; Julian Du, Chenggang Xu, *Which Firms went Public in China? A Study of Financial Market Regulation*, 7(4) World Development 812-824 (2009); Katharina Pistor, Chenggang Xu, *Governing Emerging Stock Markets: Legal vs Administrative Governance*, 13(1) Corporate Governance 5 (2005); Katharina Pistor, Chenggang Xu, *Beyond Law Enforcement Governing Financial Markets in China and Russia*, at www.colbud.hu/honesty-trust/pistor/PistorXu.doc, Last Visited April 21, 2011.

Annex:

Table1: # of the firms, reviewed by the CSRC committee of IPO Review (2006.5—2009)

Ownership	# (%)	pass (%)	rejected (%)	suspend (%)
Private	405 (73.1%)	319 (78.77%)	77 (19.01%)	9 (2.22%)
Town&Village	2 (0.4)	2 (100)	0	0
Local Governments	79 (14.3)	65 (82.28)	13 (16.46)	1 (1.27)
Central SOEs	68 (12.3)	58 (85.29)	10 (14.71)	0
total	554 (100%)	444 (80.14%)	100 (18.05)	10 (1.81%)

Source: data are collected manually by the Author; full sample.

Table 2: # of the local SOEs, reviewed by the CSRC Committee of IPO Review (2006.5—2009) ^a

Provinces	2006	07	08	09	Provinces	06	07	08	09
Anhui	0	2	0	2	Tianjin	0	2	0	2
Beijing	0	2	1	1	Hubei	0	1	0	0
Fujian	1	2	2	0	Hunan	2	2	0	1
Guangdong	1	4	3	1	Jiangsu	1	5	0	3
Zhejiang	1	1	0	2	Jiangxi	1	2	0	0
Guizhou	0	0	1	0	Liaoning	0	2	0	0
Hainan	0	0	0	1	Sichuang	0	0	1	1
Chongqing	0	1	0	1	Qinghai	0	1	0	0
Henan	2	0	0	1	Shandong	0	2	0	1
Xinjiang	1	2	0	2	Shanxi	0	0	1	0
Yunnan	2	0	1	0	Shangxi	1	1	2	0
Shanghai	1	0	1	1	合计 ^b	14/74	32/166	13/116	20/198
						18.90%	19.3	11.2	10.1

Source: data are collected manually by the Author; full sample.

Note a: 全国 31 个省区市中，西藏、河北、黑龙江、吉林、甘肃、广西、内蒙古等七省区市没有地方政府企业进入发审委。

Note b: 斜线后的数字为该年度所有进入发审委首发审核的企业数量，包括地方国企（省市县三级国企）、央企、民营企业（含外资、公私混合所有制企业）等。

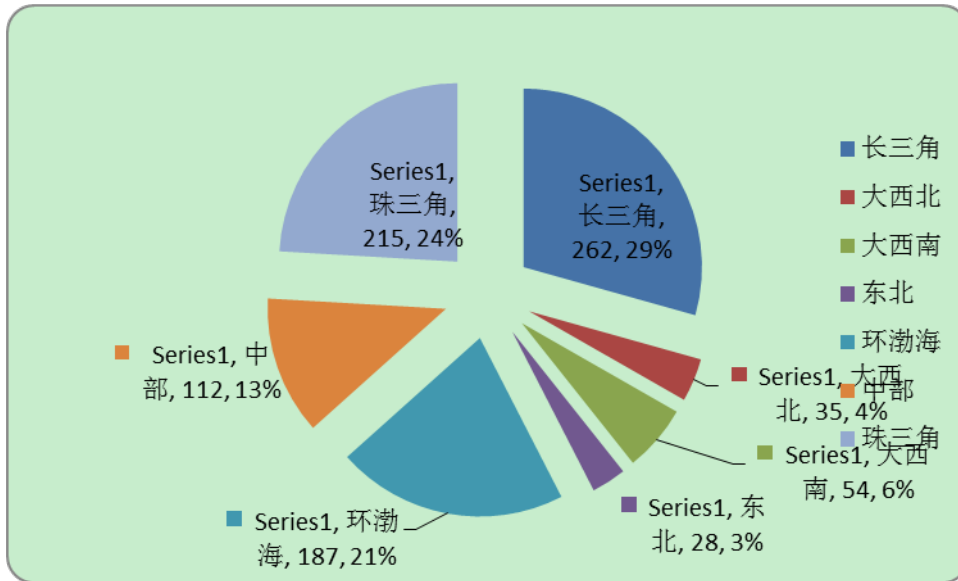
Table 3: # of firms from different provinces, reviewed by the CSRC Committee of IPO Review, 2006—2010.11

Provinces							(including: percentage of rejection in the private firms)			Total
	Cancellation	%	pass	%	rejection	%		suspension	%	
(I) West-Northern 大西北	0	0%	30	86%	5	14%		0	0	35
陕西省	0	0%	13	87%	2	13%	33.3%	0	0%	15
甘肃省	0	0%	4	80%	1	20%	0%	0	0%	5
青海省	0	0%	1	100%	0	0%	No private	0	0%	1

								firms			
内蒙古	0	0%	1	100%	0	0%	0	0	0%	1	
宁夏	0	0%	1	100%	0	0%	0	0	0%	1	
新疆	0	0%	10	83%	2	17%	25.0%	0	0%	12	
(II)											
West-southern 大西南	2	4	44	79%	10	18%		0	0	56	
广西	0	0%	4	67%	2	33%	20.0%	0	0%	6	
重庆	0	0%	6	86%	1	14%	0	0	0%	7	
云南省	1	11%	6	67%	2	22%	20.0%	0	0%	9	
四川省	1	3%	24	83%	4	14%	14.3%	0	0%	29	
贵州省	0	0%	3	75%	1	25%	0%	0	0%	4	
西藏	0	0%	1	100%	0	0%	0	0	0%	1	
(III) North-east 东北	1	3	23	79	5	17		0	0	29	
黑龙江	0	0%	3	100%	0	0%	0	0	0%	3	
辽宁省	1	6%	15	83%	2	11%	9.1%	0	0%	18	
吉林省	0	0%	5	63%	3	38%	40.0%	0	0%	8	
(IV) central areas 中部	2	2%	91	80%	21	18%		0	0%	114	
山西省	0	0%	3	60%	2	40%	33.3%	0	0%	5	
湖北省	0	0%	14	82%	3	18%	15.4%	0	0%	17	
安徽省	0	0%	21	81%	5	19%	21.1%	0	0%	26	
江西省	1	10%	7	70%	2	20%	14.3%	0	0%	10	
湖南省	1	4%	22	79%	5	18%	11.1%	0	0%	28	
河南省	0	0%	24	83%	5	17%	22.7%	0	0%	29	
(V)											
Circum-Bohai-Sea 环渤海	3	2%	149	78%	36	19%		2	1%	190	
天津	0	0%	11	85%	2	15%	14.3%	0	0%	13	
河北省	1	7%	12	80%	2	13%	14.3%	0	0%	15	
山东省	0	0%	48	76%	14	22%	20.4%	1	2%	63	
北京	2	2%	78	79%	18	18%	21.7%	1	1%	99	
(VI) Yangtze River Delta 长三角	4	2%	221	83%	39	15%		2	1%	266	
上海	0	0%	41	80%	10	20%	27.8%	0	0%	51	
江苏省	0	0%	84	82%	17	17%	16.7%	1	1%	102	
浙江省	4	4%	96	84%	13	11%	12.5%	1	1%	114	
(VII) Pearl River Delta 珠三角	2	1%	182	84%	31	14%		2	1%	217	
海南省	0	0%	2	67%	1	33%	0%	0	0%	3	
福建省	0	0%	32	86%	5	14%	19.2%	0	0%	37	
广东省	2	1%	148	85%	23	13%	13.4%	2	1%	175	

Source: data are collected manually by the Author; full sample.

Figure 1: # of firms from different provinces, reviewed by the CSRC Committee of IPO Review, 2006—2010.11



Source: data are collected manually by the Author; full sample.

Figure 2: # of listed companies in Chongqing, break down by year (1993—2009)



Source: YE Chunhe, ed., *The Past Decade of Capital Markets of Chongqing*, Jing Ji Ke Xue Press, p. 5.