

Regulatory Enforcement of Public Disclosure and Connected Investors in Corporate Bond Issuance*

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Abstract

Using a hand-collected dataset of CLs issued by China's bond market regulator before the bond issuance, we find that the regulator's concerns about issuers' public disclosures negatively affect the completion of the issuance. However, among the bonds that are issued successfully, we find that connected investors—financial institutions with prior business relationship with the issuers—increase their bond purchase to mitigate CLs' negative effect on the bond issuance. Further analyses show that the connected investors' increase in bond purchase is motivated by a quid pro quo relationship with the CL-recipients and not by their superior private information about the CL-recipients.

Keywords: Comment Letters, New Issues, Corporate Bond, Chinese Market

JEL Classifications: G12, G18, G24

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1. Introduction

Regulators use comment letters (CLs) to monitor and enhance firms' public disclosure (Cunningham and Leidner, 2022). The regulatory concerns in the CLs heighten arm's length investors' attention to the information asymmetry with the firms because, without access to private information, these investors rely heavily on firms' public disclosures for information. Li and Liu (2017) and Lowry, Michaely, and Volkova (2020) find that firms that receive comment letters before the issuance of equity experience a lower IPO price. However, unlike arm's length investors, non-arm's length (i.e., connected) investors are likely to be less affected by the CLs because they can seek either private information or private compensation from the issuers through their relationships, thereby mitigating the information risks raised by the regulator.¹ Thus, it is unclear whether and how CLs on firms' public disclosure will affect their investment decisions.

In this study, we use China's corporate bond market to examine how CLs affect bond issuance and connected investors' bond purchase decisions. In China's bond market, a significant portion of investors are financial institutions, which are connected to the bond issuers through their prior lending relationship with them (24% in our sample are connected). We expect that this business relationship has a strong effect on the connected investors because prior research has found that business and social relationships play an important role in transferring private information and

¹ Non-arm's length investors could be connected to the firms through prior business or social ties. These are not firms' insiders, as studied in Dechow, Lawrence and Ryans (2016). For our study, we treat financial institutions that have prior business relationship with the issuing firms as connected investors. The past business relationships provide a private communication channel for financial institutions to obtain information about borrowers (Diamond, 1984, 1991; Bharath, Dahiya, and Saunders, 2011) and/or allow the financial institutions to engage in quid pro quo with firms (Ding, Xiong, and Zhang, 2022).

enforcing contracts in China (Li, Wong, and Yu 2020; Wong, 2020; DeFond, Li, Wong, and Wu, 2022).

The China market has two other salient features. First, we study the bond issuance of the interbank bond market, which accounts for over 90% of bonds outstanding in China. The National Association of Financial Market Institutional Investors (NAFMII), the regulator of the interbank bond market, issues CLs on their public disclosures to the borrowing firms as part of the registration process prior to the bond sales.² The CLs are specifically issued by NAFMII for the bond issuance, which is akin to the CLs for IPO firms in the U.S.. Second, the bond issuance is carried out in an auction after the issuers completed the registration and fully addressed the issues raised in the CLs. In the auction, the allotments are given to investors with the highest bids. We have obtained proprietary data of the successful bidders, whether they have prior lending relationships with the issuing firms and the amount of allotment.³

Thus, the setting allow us to investigate, on the one hand, whether CLs affect firms' issuance completion, and on the other hand, whether and how CLs impact connected and unconnected investors' investment decisions during the auction. In the first question, we test whether a firm's likelihood of bond issuance is influenced by the receipt of a CL during the registration process. We expect that the presence of CLs give rise to regulatory concerns regarding the firms' public disclosures that decrease the likelihood of bond issuance. This negative prediction is consistent

² While some of the CL topics, such as further discussions of the firm's accounting information, overlap with those of annual filings of listed firms on the Shanghai Exchange (Duan, Li, Rogo and Zhang 2023), other topics, such as the usage of funds, are bond specific. Table IA1 of the Internet Appendix contains a list of the CL topics.

³ This is the same data used by Ding et al. (2022).

with U.S. research (Lowry et al., 2020; Cunningham and Leidner, 2022), and Duan et al. (2023) who document a negative market reaction to CLs issued by China's regulators for firms' annual reports. We expect the market's negative response to CLs to be stronger in China given her weak institutions and the regulator's enforcement is investors' last line of defense (Duan et al., 2023). However, this, and almost all the U.S. evidence is based on the reactions of equity investors. To the extent that bond investors behave differently from equity investors and the presence of connected investors in the bond market may affect the completion of bond issuance, this remains to be an empirical issue to be tested in our analysis.

Among firms that have completed the bond issuance, we ask the second question by testing whether and how the CLs affect connected and unconnected bidders' investment decisions during the auction. We expect that CLs have a less negative impact on connected bidders' investment decisions than that of unconnected investors because the former can obtain private information from the issuing firms, and they may even be compensated for the information risks through future banking business with the issuing firms. Thus, we expect that connected investors increase their participation and receive a larger proportion of the allotment in the bond issuance of CL-recipients than non-CL-recipients.

Our expectation is based on two non-mutually exclusive hypotheses: the quid pro quo hypothesis and the private information hypothesis. In the quid pro quo hypothesis, we argue that connected investors are motivated by future economic incentives. That is, CL-recipients compensate connected investors' increase in bond purchases by awarding them future business

favors. We use the investing banks' total credit line to the issuers and the deposits to the investing banks by the issuers' local governments as proxies for future business favors.

The private information hypothesis predicts that connected investors bid higher and receive a larger allotment because they are less concerned about the issuers' public disclosures due to their access to private information. We use two different measures of ex-post performance of the bonds, credit rating and default rate, to test the private information hypothesis. If our private information story is valid, the increase in the purchase of CL-recipient's bonds by connected investors, everything else equal, should be associated with a better ex-post performance than CL-recipient's bonds that are not associated with an increase in connected investors' purchase. Since the two hypotheses are not mutually exclusive, it is possible to find evidence supporting both hypotheses. However, if we only find evidence supporting one of the two hypotheses, it suggests that our results are more likely to be explained by just that hypothesis.

China has the world's second-largest bond market, with outstanding corporate bonds that reached 4.3 trillion USD in 2019. Corporate bonds in China are traded in the exchange market and interbank bond market. The former is a small retail market with individuals and small-and-medium-sized institutional investors, while the latter is an over-the-counter wholesale market which accounts over 90% of bonds outstanding and over 88% of new bond issuance. We study the bond issuance of the interbank bond market, which includes all commercial paper (CP) and medium-term notes (MTN) issued by non-financial firms from 2015 to 2019. Bond characteristics, transaction information, and issuer information are from the WIND database and the China

Foreign Exchange Trade System (CFETS). In addition, we obtain proprietary bond allotment data from NAFMII. Our final sample consists of 15,465 bond issuances with a total monetary value of over 16 trillion RMB.

Our empirical results for the first question show that CLs have a significantly negative effect on firms' offering outcomes. Consistent with the U.S. evidence in Lowry et al. (2022) that CLs increase the probability of IPO withdrawal, our study demonstrates that CLs decrease the probability of bond issuance by 7.5%. Complementing the stock return reaction of equity investors in Duan et al. (2023), our results suggest that bond investors also find CLs to be undesirable in China.

Our main result for the second question shows that connected investors receive a significantly higher allotment of 6.4% from the CL-recipient in the auction. This supports our prediction that connected investors increase their participation in the bond purchase to assist the issuance. We conduct further analysis by dividing the syndicate of investors into underwriters and syndicate members. We find that both the connected underwriters and connected syndicate members receive a higher allotment, with 60% of the increase going to the former and 40% to the latter.

We address the endogeneity issue that the likelihood of the issuing firm receiving a CL is correlated with offering success and the proportion of connected investors' bond purchases. We use an instrument based on the regulatory regime shift in 2016 of reducing the number of days in

the review period which lowers the regulator's likelihood of issuing CLs.⁴ Using this instrumental variable (IV) approach, we find that the regime shift indeed lowers the regulator's likelihood of issuing CLs, and the predicted CL in the second stage regression is negatively associated with the issuance completion, and positively associated with connected investors' purchase, suggesting that CLs have a causal effect on reducing firms' offering success and increasing connected investors' bond purchase in the auction.

Next, we test whether connected investors' purchase decisions are explained by the quid pro pro hypothesis and/or the private information hypothesis. Using the issuer's credit line with a financial institution as a proxy for business relationships, we find that connected investors' allotment size in the bond issuance is positively associated with the change in credit line and negatively associated with the likelihood of credit line termination. Also, we document that the CL-recipient's local government will make more deposits into the connected financial institutions if the latter successfully purchase the bonds in the auction. These results support our quid pro quo hypothesis. Turning to the private information hypothesis, our evidence shows that the interaction effect of CL and the connected investors' allotment portion is not associated with a drop in the bond's default rate. In fact, the connected investors' increase in bond purchases from the CL-recipients are associated with a drop in credit rating, suggesting that the credit agencies do not view connected investors' investment decisions to be justified by better private information.

⁴ This IV is based on the notion that regulator's busyness influences the compliance activities (Gunny and Hermis, 2020).

Together, these results refute our private information hypothesis that connected investors' purchase is motivated by private information that the bond quality is better than public expectation.

Finally, to provide corroborating evidence that connected investors are helping the CL recipients in the auction, we find that the negative impact on CL-recipient's bond price is mitigated when connected investors receive a larger allotment in the auction, suggesting that their increase in participation helps reduce the negative effects of CL on the bond issuance.

Our study contributes to several strands of the accounting and finance literature. First, we extend the literature on regulatory enforcement of public disclosures in CLs from the study of equity markets to bond markets. Our evidence shows that CLs negatively impact firms' ability to complete the bond issuance, which is consistent with CLs' positive association with higher IPO withdrawal in Lowry et al. (2020).

Second, instead of examining arm's length investors' stock market reaction to CLs, we examine how CLs affect non-arm's length investors' investment decisions. Prior research finds that arm's length investors respond negatively to the CLs as regulatory concerns about firms' public disclosures heighten investors' attention to their information asymmetry problem (Li and Liu, 2017; Lowry et al., 2020; Cunningham and Leidner, 2022). However, we find that connected investors, through a quid pro quo relationship, are willing to increase their bond purchase when the issuers receive a CL. This finding contributes to the literature on the impact of CLs (e.g. Cassell, Dreher, and Myers, 2013; Bens, Cheng, and Neamtiu, 2016; Brown, Tian, and Tucker, 2018; Liu, Shu, Towery, and Wang, 2022). This also extends prior research that studies the role of business

and social ties in transferring private information and enforcing contracts in China (Li et al., 2020; DeFond et al., 2022; Wong, 2020).

Third, our paper also contributes to the literature on the impact of business relationships on the pricing of securities offerings. Prior studies have demonstrated that in the U.S. market, underwriters tend to allocate new issuances to investors with whom they maintain ongoing business relationships. This practice serves as a form of *quid pro quo*, ensuring future business benefits or kickbacks and resulting in the underpricing of these offerings (Reuter, 2006; Nimalendran, Ritter and Zhang, 2007; Liu and Ritter, 2010; Goldstein, Irvine and Puckett, 2011). However, our study reveals a different pattern in China's institutional context, where future business relationships between issuers and financial institutions lead to connected investors' willingness to mitigate the negative impact of CLs by paying a higher price and increasing their purchase at the auctions.

Finally, our paper also adds to the quickly growing literature on China's financial system, especially focusing on China's bond markets.⁵ Ang, Bai, and Zhou (2017) link the pricing of municipal bonds in China to real estate and political risks. Chen, He, and Liu (2020) find that the fast development of China's municipal bond market in the earlier 2010s is driven by the need for local governments' financing platforms to roll over bank loans initially given during China's 4 trillion RMB post-crisis stimulus package. Ding, et al. (2022) document the issuance overpricing

⁵ See the handbook edited by Amstad, Sun, and Xiong (2020) for chapters covering various sectors of China's financial system.

in China's debt securities market and attribute it to indirect benefits of future business. Geng and Pan (2020) discuss the impact of implicit guarantees on bond pricing. Our paper shares the common theme of these papers in exploring important characteristics of China's corporate bond market but with a distinct focus on the effect of CLs on bond issuance.

The remainder of the article is organized as follows. Section 2 introduces the institutional background of China's interbank bond market. Section 3 summarizes our data. Section 4 examines the impact of CL on bond issuance and investor participation, Section 5 examines the reasons behind the investors' purchase decisions and Section 6 provides the results of additional tests. We conclude the paper in Section 7. We also provide an Internet Appendix to report additional results.

2. Institutional Background

This section provides an overview of the key features of the Chinese interbank bond markets relevant to our study.

2.1. Overview of the Chinese bond markets

Due to China's economic reforms, the domestic bond market has developed rapidly in recent decades. By the end of 2019, outstanding corporate bonds in China reached 4.3 trillion USD, making it the world's second-largest corporate bond market, just behind the U.S., with 10.6 trillion USD in outstanding corporate bonds.⁶ The bond market in China consists of both exchange and interbank bond markets. These two markets complement, interconnect with, and complete each other. The interbank bond market is an over-the-counter wholesale market, whereas the exchange

⁶ The statistics are from SIFMA (<https://www.sifma.org>) and the Asian Development Bank (<https://asianbondsonline.adb.org>).

market is a retail market where individuals and small- and medium-sized institutional investors trade through a concentrated matchmaking method.

The interbank bond market was established in 1997 and has become the dominating market for bond issuance and trading in China. As a wholesale market, participants in the interbank market are restricted to various qualified institutional investors, including commercial banks, securities, mutual funds, and insurance companies. The total number of interbank market members reached 7,621 in June 2020, and these financial institutions cover almost the entire financial system in China nowadays. The interbank market is overseen by the People's Bank of China (PBC), the central bank in China. Under the guidance of PBC, the NAFMII is responsible for formulating rules to govern institutional participants in the interbank market.

China's interbank market consists of three major categories of fixed-income securities, which are classified based on issuing entities: government bonds, financial bonds, and non-financial corporate bonds. This paper focuses on non-financial corporate bonds issued by non-financial firms and administered by NAFMII. Figure IA1 of the Internet Appendix illustrates the issuance amount of non-financial corporate bonds in the interbank market by category. The data indicates a shortage of long-term corporate bonds in this market. CP and MTN account for more than 86% of all issuances, with the remainder being asset-backed notes and private placement notes. Our sample comprises CP and MTN.

2.2. Corporate bond registration

Figure 1 provides a timeline indicating the critical stages of the registration and issuance process. To issue a corporate bond in the interbank market, an issuer must register the instrument with NAFMII following its *Rules on the Registration for Issuance of Non-financial Enterprises Debt Financing Instruments in the Interbank Bond Market*. Specifically, the issuing company must

file the preliminary prospectus, credit rating report, and financial reports to the NAFMII. The NAFMII reviews documents that companies file. In its reviews, the NAFMII issues a CL when it deems a filing materially deficient or requires further clarification. The company needs to submit a response letter to the NAFMII within 10 working days after receiving a CL. A written explanation for delayed submission should be provided for those who fail to submit within the prescribed time. If the response letter is not received in 60 working days, NAFMII will terminate the registration. Companies' operating activities and risk factors are the two most common topics in CLs⁷, and CL questions usually trigger comprehensive supplementary disclosure.

Figure 2 describes the number of NAFMII CLs that pertain to the bond registrations from 2013 to 2019. The NAFMII is actively involved in the process, sending a non-trivial amount of CLs each year. The share of CL receipts remained above 50% of all registrations, even at its lowest point in 2017⁸. When the NAFMII accepts registration, it will issue a notice of registration acceptance to the company. The registration is valid for two years.⁹ During this period, the company may issue corporate bonds in one or multiple issuance(s). In our sample, each registration is associated with an average of 1.22 issuances. It is also worth mentioning that about 21% of registrations are not followed by any issuances.

2.3. Comment letters

⁷ See Panel A of Table 10 for the full list of CL topics and Table IA1 of the Internet Appendix for examples of each topic.

⁸ Duan et al. (2023) shows that only 13% of firms listed in Shanghai Stock Exchange receive CLs in a given year.

⁹ The company needs to re-file the registration if one of the following conditions is triggered: (1) The company has defaulted on a major debt obligation by failing to repay on time; (2) The enterprise has suffered material losses of more than 10% of its net assets; (3) The enterprise's de facto controller is a natural person who is under investigation or being imposed with compulsory measures by a competent authority for suspected violation of laws or disciplines; (4) The enterprise's auditor has issued a qualified opinion, adverse opinion, or disclaimer of opinion with respect to a recently disclosed audited financial statement of the enterprise; (5) The enterprise is downgraded in its corporate credit rating; or (6) Other circumstances that may have a major impact on the value of investment or the decision-making of investors.

The CL process serves two regulatory purposes: first, to notify investors regarding issuers' potential disclosure shortcomings, and second, to improve issuers' compliance with disclosure regulations (Duan et al., 2023). The receipt of a CL can impact a firm's bond issuance through these two channels. The first channel suggests that the market may interpret a CL as a signal that the firm has poor reporting quality. This may discourage investors from participating in the bond issuance. The second channel proposes that a CL can enhance the firm's information environment. The firm may be better positioned to facilitate the bond offering by improving its reporting practices.

In weak institutional environments where the economy is relationship-based, like China, firms' reporting and regulators' enforcement incentives likely affect CL's impact. For example, contrary to the evidence in the U.S. (e.g., Johnston and Petacchi, 2017), Duan et al. (2023) find that, in China, sometimes, CL recipients experience a significant increase in bid-ask spreads. In other words, interpretations of CL as a signal that the firm has poor reporting quality are likely to dominate in China. As a result, firms may have incentives to use their connections to support their issuance upon receiving a CL.

2.4. Corporate bond issuance

The issuance takes the form of a standard single-price auction. The issuer usually hires one, or sometimes two, underwriters to help form an underwriting syndicate and organize the issuance auction. As of the end of 2019, NAFMII has issued underwriter licenses to 68 institutions, including all the large banks and securities firms in China.¹⁰ NAFMII has also authorized 77 other financial institutions, including smaller banks, securities firms, trust companies, and insurance

¹⁰ This list of licensed underwriters was gradually expanded to include smaller banks and more securities firms, as well as subsidiaries of four non-Chinese banks, specifically, HSBC Bank (China), Standard Chartered Bank (China), BNP Paribas (China), and Deutsche Bank (China).

companies, to participate in issuance auctions. Only those 145 authorized financial institutions can join the underwriting syndicate and participate in the issuance auction. The syndicate members are responsible for participating in the auction and placing bids in the issuance auctions on behalf of their investment accounts or clients who are not qualified to participate directly.

The underwriting process after registration involves the following steps. The registration firm hires an underwriter to conduct the auction. Before the issuance auction, the underwriter releases a formal subscription statement, which includes major terms of the issuance, such as the interest rate range of the issuance, the subscription timeline and procedure, placement and payment terms, and the designated payment account. On the issuance day, a single-price auction is held. All syndicate members submit sealed bids of rate-quantity pairs that specify the amount to be purchased at a specified minimum yield to the underwriter. The clearing price is identified by equating the aggregate demand submitted by all bidders to the total issuance amount. In other words, all winning bidders pay the same price. The issuer could withdraw the issuance if the quantity submitted by bidders is insufficient or if the clearing price is unacceptable to the issuer. If the issuance succeeds, it is settled on the following day.

2.5. Connected financial institutions as connected investors

The 145 authorized financial institutions that can participate in the bond issuance auction are limited to licensed banks, securities firms, trust companies, and insurance companies, with banks and securities firms accounting for the majority of acquisitions.¹¹ We define a connected financial institution as one that has provided financial services to the issuer and, more importantly, has access to important proprietary information about the issuer. Specifically, we establish a financial

¹¹ In our sample, more than 68% of bonds are acquired by banks, about 31% of bonds are acquired by securities firms, and less than 1% of bonds are acquired by trust and insurance companies.

institution's connection with the firm if it has acted as a lender or an underwriter for the firm's securities in the recent past.¹²

We define prior lending as connections because lenders need to gather information about the creditworthiness of the borrowers. Information about borrowers is crucial to the lending process, and lending institutions can compile substantial amounts of data about the borrowing firms, which can be very helpful in the credit decision process (see e.g., Leland and Pyle, 1977; Diamond, 1984, 1991). A long-term relationship between the lender and borrower facilitates the lender to acquire privately relevant information about the prospects and creditworthiness from the borrower.

Similarly, when a company decides to issue new securities, it needs to share detailed and comprehensive information about its financial and operations information, and growth prospects with the underwriter. The underwriter also collects data on an issuer's prospects and assesses the objectivity of the information provided by the issuer (Beatty and Ritter, 1986). Thus, financial institutions with prior underwriting relationships may have developed private communication channels to obtain superior information from the issuer.

We also expect that connected financial institutions may benefit more from their participation in the bond issuance than unconnected financial institutions. Thus, the connected financial institutions have incentives to support the issuance and boost the issuance price by bidding more aggressively in the issuance auction. There are at least three sources of benefits for the financial institutions. First, supporting the issuance helps the connected financial institutions maintain the existing lending business with the issuers. Since these issuing firms are usually large and profitable firms in China, they are more valuable customers and thus attract more intense competition for

¹² It is worth mentioning that securities firms can also provide loans to firms in China.

their lending business. Also, this enables the financial institutions to compete for business because they cannot compete on the loan rates as they are highly regulated by the People's Bank of China.

Second, because these firms are usually closely related to the local economy (e.g., big employers), the local governments in their location may reward the commercial banks that support their bond issuance. Existing literature has studied how the relationship between underwriters and local governments affects municipal bond pricing. For example, Wang (2018) extends bond auction theory and proposes that local governments influence the bidding behavior of bond underwriters through their control over fiscal deposits and other resources. Empirically, Ba, Li, and Zhang (2019) find that local governments indirectly influence the pricing of municipal bonds by placing fiscal deposits in the underwriting banks.

Third, supporting the issuance helps the connected financial institutions to win the issuer's future underwriting business. Due to the short maturities in China's bond market, most firms need to repeatedly issue bonds. Existing literature indicates that underwriters compete for the underwriting business based on the issuance pricing. For instance, Ding et al. (2022) find evidence that a higher credit spread in the issuance predicts a higher probability of the issuer replacing its current underwriter for its subsequent issuance. Similarly, the issuer may reward its future underwriting business to the connected financial institutions that participate in its bond issuance and bid up the issuance price.

3. Data and Connected Institutions

3.1. Data sample

This article combines several novel data sets that provide comprehensive information on the registrations, syndicate structure, and issuance auction for corporate bonds issued in the China interbank market.

Our sample includes CP and MTN issued by non-financial firms in China's interbank market from 2015 to 2019.¹³ Our sample begins in 2015 because the issuance volume of corporate bonds was relatively low before 2015. Our sample ends in 2019 because the Chinese financial markets were substantially disrupted in early 2020 due to the COVID-19 pandemic.

Bond Registrations and Issuances. On its official website, NAFMII discloses the information for corporate bond registrations. We manually collect information on the CP and MTN registrations from the NAFMII's Debt Capital Market Filing Analysis Notification System (<http://zhuce.nafmii.org.cn/>). Because registration is valid for two years, a bond issued in 2015 can be registered in 2013, we collect information on the CP and MTN registrations from 2013 to 2019, which yields a sample of 15,151 registrations that have no missing firm information. The total registration size in our sample amounts to 42.8 trillion RMB.

Bond characteristics and issuer information are from the WIND database and the China Foreign Exchange Trade System (CFETS). Transactions in the secondary market are obtained from WIND. After merging the bond registrations with bond issuances and excluding bonds with missing issuer information, we successfully link the registration sample to 18,321 bond issuances between the years 2015 and 2019.

Syndicate Members and Bond Allotment Data. We collect information on the issuance syndicate members from WIND and the bond issuance prospectus. We utilize credit line

¹³ As shown in Figure IA1 of the Internet Appendix, CP and MTN account for about 86% of all nonfinancial corporate bonds issued in the interbank market. The rest include either private placement notes (PPN) or asset-backed notes (ABN). We exclude PPN and ABN from our analysis because PPN is not issued through the auction process and ABN is fundamentally different from CP and MTN.

information as a means to identify financial institutions that have a relationship with the issuers.¹⁴ After cross-checking and verifying information from WIND and the issuance prospectus, our sample includes information on the syndicate members and whether they have a credit line with the issuer for a total of 17,069 bonds.¹⁵ Following Ding et al. (2022), we further obtain detailed bond allotment data from the NAFMII. This proprietary dataset contains the complete allotment of the issues to each winning bidder on the syndicate.¹⁶ After merging the syndicate member data with the bond allotment data, our final sample includes 15,465 bond issuances, which enables us to track the participating financial institutions' bond allotment and whether they have a credit line with the issuer.

3.2. Summary statistics

Panel A of Table 1 provides summary statistics of our sample's bond registrations. The mean (median) bond registration amount is 2.83 (1.00) billion RMB.¹⁷ Among all the registrations in our sample, more than 56% are associated with at least one comment letter. We define the variable *Issuance Dummy* as equal to 1 if a bond issuance is completed and 0 otherwise. According to the statistics of the *Issuance Dummy*, about 78.9% of registrations are associated with at least one bond issuance. We define the variable *First Reg. Dummy* as equal to 1 if it is the first time the issuer has ever registered a bond in the interbank market and 0 otherwise. From the statistics of the *First Reg. Dummy*, about 26.7% of the registrations in our sample are first-time registration.

¹⁴ Credit lines are a major source of funding for corporations as well as an important business line for banks and securities firms. Sufi (2008) finds that credit lines account for over 80% of the bank financing provided to U.S. public firms. Through the credit evaluation process, financial institutions assess factors such as a company's credit status, repayment capability, and operating conditions to determine whether to grant a loan and the specific loan amount, interest rate, and term.

¹⁵ We encountered a reduction in the number of observations due to issuers not being obligated to fully disclose the identities of their creditors in the prospectuses.

¹⁶ The data from NAFMII contains bond allotment information for almost all CP and MTNs issued from 2016 to 2019 and about 60% of the CP and MTN issued in 2015.

¹⁷ 2.83 billion RMB is approximately \$0.7 billion USD using an exchange rate of 0.143

We convert letter credit ratings into numerical values: AAA to 1, AA+ to 2, AA to 3, AA- to 4, etc. The median rating is 2 (i.e., AA+). Generally, the issuers are large firms with mean (median) total assets of 105 (34) billion RMB. They have an average leverage ratio of 0.62 and an average ROA of 2%. Unlike the U.S. bond market, bonds issued in China's interbank market tend to have much shorter maturities. Panel B reports the characteristics of the bonds in our sample. The average maturity is 1.69 years, with an average issuance size of 1.06 billion RMB. The mean of *Trading Vol.*, which is for the month after issuance, is 1.24 billion RMB.

Our proprietary dataset also allows us to examine the syndicate structure and bond allotment in issuance auctions. As aforementioned in section 3.2, we define a financial institution that has a connection with the firm if it is the firm's creditor or has been an underwriter of the firm's equity or bond offerings within one year before the issuance. Panel C reports summary statistics of the syndicate structure and bond allotment. The average syndicate size is about 14, of which about 3.3 institutions have a connection with the issuing firm. We construct a variable called *Connected Institution Share* by aggregating the shares purchased by all connected institutions in each issuance. In our sample, connected institutions, on average, purchased 42.5% of the issues. We further partition the *Connected Institution Share* into those acquired by underwriters and those acquired by other institutions to dive deeper into the mechanisms of the issuance auction (Ding et al., 2022).¹⁸

4. The Effect of Comment Letters on Bond Issuance and Investor Participation

4.1. CL and bond issuance

¹⁸ Underwriters have strong incentives to purchase the bond to maintain their underwriting business with the issuer (Ding et al., 2022).

Upon the registration’s completion, the company can appoint underwriters to arrange the bond issuance. However, it is important to note that the bonds may not be issued for various reasons, such as the firm may no longer require additional funds or may fail to complete the auction for the bonds.¹⁹ We analyze the impact of comment letters on the issuance of bonds through the following model:

$$Issuance\ Dummy_{r,j,t} = \theta_1 CL\ Dummy_r + \sum \theta_m Control_{m,r,j} + \alpha_j + \alpha_t + \mathcal{E}_{r,j,t}, \quad (1)$$

where r indexes the registration, j indexes the firm, and t indexes the year. Our variable of interest is *CL Dummy*, an indicator variable that takes the value of one if a firm receives a CL in the registration, and zero otherwise. We examine the impact of CL on bond issuance of whether the company can successfully raise funds using *Issuance Dummy*. We also include firm and issuance controls commonly used in the literature (Geng and Pan, 2020). Firm and year fixed effects are used to control for market-wide changes over time and time-invariant unobservable firm characteristics. We cluster standard errors by bond registration date because bonds registered on the same day are subject to the same macroeconomic shocks.

The regression results of equation (1) are reported in Table 2, which examines the impact of CLs on bond issuance. The analysis is based on the registration level. Column (1) reports the results with controls, rating fixed effect, and year fixed effect. Firm fixed effect is included in Column (2). Consistent with prior findings in the U.S. (Lowry et al., 2020), which document that CL from the Securities and Exchange Commission (SEC) is associated with a higher probability of IPO withdrawal, we find that CL significantly reduces the likelihood of bond issuance by about 7.5%.²⁰

¹⁹ An auction could fail if the quantity submitted by bidders is insufficient to clear the issuance amount or if the clearing price is unacceptable to the issuer.

²⁰ Similar to Naughton, Rogo, Sunder and Zhang (2018), we repeat our analyses using the number of pages of CL to capture the intensity of CL. Table IA2 of the Internet Appendix reports the results, which closely resemble those in Table 2.

4.2. CL and syndicate structure

CL firms may seek help from connecting institutions to facilitate bond issuance. The connecting institutions may be more likely to participate in the syndicate and purchase more bonds from the CL firms because of two non-mutually exclusive hypotheses. We examine the impact of CL on the number of connected financial institutions and the percentage of connected financial institutions in the syndicate by using the following regression:

$$\text{Num. or Percentage of Connected Institutions}_{i,j,t} = \beta_1 \text{CL Dummy}_i + \sum \beta_m \text{Control}_{m,i,j} + \alpha_j + \alpha_t + \varepsilon_{i,j,t}, \quad (2)$$

where i indexes the bond, j indexes the firm, and t indexes the year. The results are presented in Table 3. Columns (1) and (2) present the results of the impact of CL on the number of connected institutions participating in the syndicate. We find that, on average, connected financial institutions are more likely to participate in the syndicate of CL recipients.²¹ The magnitude of the coefficient is also economically significant. On average, the number of connected institutions increased by 13.4%.²² This is supported by the results presented in Columns (3) and (4), which demonstrate a similar impact of CL on the percentage of connected institutions in the syndicate. We also use the strength of the connection of financial institutions in the syndicate, as an alternative measure of connected investors involvement, and find the same results. Results are reported in Table IA3 of the Internet Appendix. Overall, the evidence supports our hypothesis that CL recipients invite more connected financial institutions to participate in the issuance auction to support the bond issuance.

4.3. CL and bond allotment

²¹ We can only observe the outcome of investor participation. In other words, the connected investors need also be willing to participate in the offerings. Throughout the paper, we use invitations from the issuing firms and investors' willingness to participate interchangeably.

²² The average number of connected institutions is 3.344. The coefficient 0.447 divided by 3.344 is roughly 13.4%.

If CL recipients rely on connected financial institutions to purchase bonds after receiving CLs, we would expect a greater allotment to such connected institutions in the bond auction. We further explore the relationship between connected institution purchases and CL recipients using the *Connected Institution Share*, the share of issuances acquired by financial institutions with a relationship, as the dependent variable for equation (2). This test is based on the results of the bond auction and complements Table 3, as syndicate participation may not translate into actual purchases. Column (1) of Table 4 presents the regression with the dependent variable, *Connected Institution Share*. The coefficient on *CL Dummy*, is positive and economically significant, suggesting that CL recipients are associated with, on average, 6.4% higher allotment to connected institutions. To provide a more detailed analysis, we divide our dependent variable into two categories: shares acquired by underwriters, labeled as *Connected Institution Share - Underwriters*, and shares acquired by other connected institutions, labeled as *Connected Institution Share - Other Institutions*, as shown in columns (2) and (3) of Table 4. Our results indicate that about 60% of the observed increases in shares allocated to connected institutions are associated with underwriters, while 40% is associated with other connected institutions. This result is consistent with Ding et al. (2022), which documents that underwriters have strong incentives to purchase the bond to maintain their underwriting business with the issuer.²³

4.4. Instrumental variable approach

One of the most important challenges in studying the impact of enforcement actions is to address the endogenous selection problem because the probability of the receipt of CL is not random (Cunningham and Leidner, 2022). The factors (i.e., financial institution connections)

²³ In Table IA4 and Table IA5 of the Internet Appendix, we enhance the validation of our findings by conducting a bond-institution level analysis. This involves using a sample that includes all possible combinations of bonds and their syndicate members, enabling us to control for institution fixed effects. The results confirm that CL recipients are linked to a greater allotment to connected institutions.

leading to the receipt of a comment letter may also be correlated with our two main dependent variables, *Issuance Dummy* and *Connected Institution Share*. In other words, firms that are connected with more financial institutions are likely to be lower quality. Thus, they may receive more CLs, experience less success and require more help from connected institutions in the bond issuance.

We address this endogeneity problem in three ways. We first control for the factors that could be correlated with both the receipt of a comment letter and the dependent variables, such as size and performance. We also conduct within-firm analysis to control for time-invariant firm-specific factors. We further address the endogeneity issue by using a two-stage model with a shift of regulatory regime as the exogenous variable.

We instrument for the receipt of CLs using the regulatory regime change in 2016. Before February 19, 2016, the registry office of NAFMII had 20 working days to review the filings. Starting on February 19, 2016, NAFMII adopted a new regime to expedite the registration process to meet the growing demand for bond issuance in the interbank market. In particular, NAFMII has introduced a new system to classify firms with recent issuances and no delinquencies or administrative penalties, and meet certain financial requirements, as Type-I firms.²⁴ The rest of the firms are classified as Type-II firms. Under this new regime, the registry office must review Type-I firms within 5 working days and Type-II firms within 10 working days. This shorter review window would potentially be associated with differences in review intensity between Type-I and Type-II firms. In other words, under the new regime, the more established and profitable Type-I firms are less likely to receive CLs relative to the Type-II firms. The 2016 regulatory change is a

²⁴ Please see Appendix B for the detailed definition of Type-I and Type-II firms.

plausibly exogenous determinant of offering outcomes because the regime change is unlikely driven by individual firm characteristics.

The sample of the 2SLS analysis includes all bonds registered from February 19, 2015, to February 19, 2017, a 24-month window around the registry policy change on February 19, 2016. The results are reported in Table 5. We include *Treatment Dummy*, an indicator variable equal to 1 if the firm is classified as a Type-I firm, *Post Dummy*, an indicator variable equal to 1 in the months following the registry policy change, and the interaction of the two variables in the first stage regression. Panel A of Column (1) of Table 5 presents the results from the first stage regressions of bond issuance analysis, where we find that the coefficient on the interaction variable (i.e., $Treatment\ Dummy \times Post\ Dummy$) is negative and significant. The first stage coefficients indicate the regulatory change is associated with a 21% decrease in receiving CLs, which is economically significant. Column (2) presents the second-stage results. The coefficients on *CL Dummy* are negative and statistically significant, supporting our main inference that CLs lead to a lower probability of bond issuance. Panel B of Table 5 presents the results of bond allotment. Similar to Column (1) of Panel A of Table 5, Column (2) of Panel B presents the results from the first stage regressions, where we find that the coefficient on the interaction variable (i.e., $Treatment\ Dummy \times Post\ Dummy$) is negative and significant. The economic magnitude of the coefficient is also similar to Panel A, in which we find that the regulatory change is associated with a 19% decrease in receiving CLs. More importantly, in Column (2) of Panel B, we document that *CL Dummy* is associated with higher connected institution allotments. The Kleibergen Paap F-statistic of the model in Panel A (B) is 16.2 (35.5), well surpassing the established rule-of-thumb benchmark of 10, as Stock and Yogo (2005) suggested, thus providing evidence supporting the relevance of the instrument. Overall, evidence in Table 5 suggests that using the IV approach, we

find consistent evidence that CL impacts bond issuance success and connected financial institutions' participation.

5. Reasons for Connected Investors' Investment Decisions

5.1. *Quid Pro Quo Hypothesis*

If connected institutions help CL recipients by supporting the bond issuance, we expect the connected institutions could receive favors in return, consistent with the quid pro quo hypothesis. In other words, we expect the connected financial institutions to participate in the primary market in exchange for other benefits from the CL recipients and local governments (Liu et al., 2021). We, therefore, construct two sets of outcome variables to capture the potential return of other benefits to the participating connected financial institutions. First, we examine whether the CL recipients return the favor to the connected institutions after the connected institutions participate in financing upon receiving CL. Following prior literature, we use the change in the issuer's total credit line with a financial institution and the termination of an existing credit line between a financial institution and the issuer in the year subsequent to the bond issuance as proxies of changes in future business relationships.²⁵ We use the following bond-institution level specification to examine the relationship between financial institutions' participation and post-offering business relationship:

$$\Delta \text{Credit lines}_{i,j,f,t} \text{ or } \text{Termination Dummy}_{i,j,f,t} = \delta_1 \text{CL Dummy}_i + \delta_2 \text{Allotment Dummy}_{i,f} + \delta_3 \text{CL Dummy}_i \times \text{Allotment Dummy}_{i,f} + \sum \delta_m \text{Control}_{m,i,j} + \alpha_j + \alpha_f + \alpha_t + \varepsilon_{i,j,f,t}, \quad (3)$$

where i indexes the bond, j indexes the firm, f indexes the financial institution and t indexes the year. *Allotment Dummy* _{i,f} equals 1 if the institution f acquired any shares in the issuance of bond j . Column (1) of Table 6 presents the results of the future change of credit lines. We observe a

²⁵ Our results remain unchanged when using longer periods, such as two years.

positive and significant coefficient on the interaction terms of *CL Dummy* and *Allotment Dummy* (i.e., $CL\ Dummy \times Allotment\ Dummy$), which suggests that CL recipients return the favor to supporting financial institutions in the allotment process by extending the future lending business to these financial institutions. The coefficient on the interaction term suggests that participation in offering upon receiving CL is associated with 706 million RMB increases in credit lines at the financial institutions from the CL recipient. This increase is roughly 2.34 times the average allotment amount,²⁶ which is economically significant. Column (2) of Table 6 presents the results of the likelihood of termination of the business relationship between the CL recipients and the lender. A negative and significant coefficient is observed for the interaction term of CL and *Allotment Dummy* (i.e., $CL\ Dummy \times Allotment\ Dummy$), indicating that CL recipients are less likely to terminate the lending business if the financial institution supports the offering.

Second, prior literature suggests that local governments engage in inter-jurisdictional competition for capital, and a way to do so is by assisting local firms (Chen, Lee and Li, 2008). We examine whether local government is part of the reasons for the connected financial institutions' participation in bond issuance upon receiving CL. Although the local government may not directly control financial institutions, local officials can still exercise their influence by other means, such as fiscal deposits and approval of new local branches (Liu et al., 2021). As a result, we use the fiscal deposits that underwriters receive in the local treasury cash management to measure the benefits.

We manually collect the data of the bid-winning banks and their winning amount from announcements of local financial departments. We then construct the sample of banks and local

²⁶ The average allotment amount is 301.47 million RMB for the lenders in our sample. Therefore, the ratio of 706.17 to 301.47 equals 2.34.

government fiscal deposits pair.²⁷ The dependent variable, *Deposit Dummy*, which equals 1 if the bank receives deposits from the local government and 0 otherwise. We examine the local government deposits because attracting local government deposits is crucial to banking operations, as deposits from the local government constitute a major part of a bank's deposits (Agarwal, Qian, Seru and Zhang, 2020). The variable of interest in the model is *CL Investment Dummy*, which equals 1 if a bank has purchased any bonds issued by local CL recipients in the past 12 months. In the model, we also control variables related to deposits, such as *Local SOE Investment Dummy*, an indicator equals one if a bank has purchased any bonds issued by local SOE, and the bank's size, liability, and the non-performing loan ratio. Table 7 presents the result of the allocation of local government treasury deposits. The positive and statistically significant coefficient of the *CL Investment Dummy* suggests that local governments reward fiscal deposits to banks that participate in the issuances of local firms upon receiving CL. The magnitude of the coefficients suggests that investment in local CL recipient offerings is associated with a 5-7% higher likelihood of receiving fiscal deposits from the local government. Collectively, the evidence presented in Table 6 and Table 7 supports our quid pro quo hypothesis.

Third, we also find results (untabulated) that CL recipients are more likely to hire financial institutions, which support the current bond issuance, as underwriters for their future issuances, further supporting the quid pro quo hypothesis. These results are not reported due to a small sample size, with only 68 financial institutions holding licenses to underwrite bonds in the interbank bond market.

5.2. Private Information Hypothesis

²⁷ In 2019, the Guangdong province made 4 fiscal deposits (quarterly), and there are 81 banks. Consequently, the number of observations for the Guangdong-bank pair in 2019 is $4 \times 81 = 328$ pairs.

The private information hypothesis predicts that connected institutions' participation upon receiving CLs is associated with better ex-post bond performance. That is, if these connected investors' purchase decisions are motivated by superior private information, we will expect that their ex-post performance will be better than CL recipients with more connected institutions' participation than those with less connected institutions' participation. In the analysis, we use credit rating downgrade and bond default as measures of the ex-post performance. Specifically, we employ the following specification:

$$\text{Downgrade}_{i,j,t} \text{ or } \text{Default Dummy}_{i,j,t} = \gamma_1 \text{CL Dummy}_i + \gamma_2 \text{Connected Institution Share}_i + \gamma_3 \text{CL Dummy}_i \times \text{Connected Institution Share}_i + \sum \gamma_m \text{Control}_{m,i,j} + \alpha_j + \alpha_t + \mathcal{E}_{i,j,t} \quad (4)$$

where i indexes the bond, j indexes the firm, and t indexes the year. Table 8 presents the results. The dependent variable *Downgrade Dummy* equals 1 if a bond is downgraded in its lifetime and 0 otherwise. The dependent variable *Default Dummy* equals 1 if a bond issuer fails to pay the coupon or principal and 0 otherwise. We document that more participation of connected institutions is associated with a higher subsequent downgrade, as suggested by the positive and significant coefficient of the *CL Dummy* \times *Connected Institution Share* in Column (1); however, it is not associated with default, as indicated by the insignificant coefficient on the *CL Dummy* \times *Connected Institution Share* in Column (2). Together, these results refute the private information hypothesis that connected investors' increase in bond purchases is motivated by private information about the bond's future performance.

6. Additional tests

6.1. CL, bond allotment, and credit spread

In section 4, we find that connected financial institutions support the bond issuance by purchasing more bonds when the issuer receives a comment letter from the regulator. In this subsection, we provide corroborating evidence that connected financial institutions support CL recipients by bidding more aggressively in the bond issuance. To investigate this, we replicate equation (4) with *Credit Spread* as the dependent variable. The results are presented in Table 9. The variables of interest are the *CL Dummy* and the interaction term of *CL Dummy* and *Connected Institution Share*. The findings in Column (1) indicate that the presence of CLs is associated with an increase (a decrease) in credit spreads (bond price), as indicated by the positive and statistically significant coefficient on *CL Dummy*. This suggests that CL is a bad signal and the market prices the risk, which is consistent with findings in the U.S. IPO market (e.g., Lowry et al., 2020),.

However, firms with CLs are less impacted if they receive support from connected institutions, as demonstrated by the negative and statistically significant coefficient on the *CL Dummy* and *Connected Institution Share* interaction term. This suggests that connected financial institutions are bidding higher to reduce the negative price pressure of the CL. We further examine the impact of connected institution purchases by separating the total connected institution shares into underwriters' allotment and other connected institutions' allotment. The negative and statistically significant coefficients on the interaction terms (i.e., *CL Dummy* \times *Connected Institution Share-Underwriters* and *CL Dummy* \times *Connected Institution Share-Other Institutions*) of Column (2) suggest that the purchases from both groups of connected institutions are associated with a lower credit spread. Overall, the results of Table 9 confirm our conjecture that CL recipients use their connections in the allotment process to mitigate the negative impact of the CLs.

6.2. Textual Characteristics of the CLs

To further provide insights into how the content of the CLs shape the bond issuance, we examine the textual characteristics of the CLs. This exploration is motivated by the potential meaningful variation in the topics raised by the regulator and in their respective degrees of importance. To manually classify the CLs, we first randomly select 200 CLs, and identify 9 topics based on our manual inspection of the headings of the 200 CLs.²⁸ We then classify the headers of the remaining CLs into the 9 topics. Panel A of Table 10 describes the distribution of each topic. Consistent with our expectation, the descriptive statistics illustrate that the question about the company's operating activities is the most common topic in the CLs. On the other hand, the question about the impact of government policies is the least mentioned topic in the CLs.

Next, we examine how the specific topics of CLs will impact the issuance of bonds by adding the topic dummies into the regression of equation (1). Our variables of interest are the 9 topic dummies. Panel B of Table 10 reports the results. Consistent with our result in Table 2, we document that the receipt of CLs is negatively associated with issuance success. More importantly, we find that the question related to government policies (i.e., *Government Policies*) is the most influential topic. This result suggests that investors are likely to be more concerned about how government policies impact the firm's operations and its ability to repay to debt.

6.3. Determinants of issuance of CLs

In this subsection, we examine the determinants of the issuance of CLs by the regulator and report the results of the logit regressions in Table 11. We find that the regulator is focusing on the firms with higher risks. Specifically, we find that first registration (i.e., *First Reg. Dummy*) and large offerings (i.e., $\ln(\text{Registration Amount})$) are positively associated with the issuance of CLs. In contrast, firm size (i.e., $\ln(\text{Asset})$) is negatively associated with the issuance of CLs. In addition,

²⁸ The NAFMII structures the letters as sets of questions that fall under specific headings.

consistent with the literature that SOEs are less transparent, we find that SOEs are more likely to receive CLs. We also find that total cash holdings (i.e., $\ln(\text{Cash})$) are positively related to the issuance of CLs. One interpretation is that the regulator will question issuers' rationale of the offering if they have plenty of cash on hand.

7. Conclusion

In this paper, we study the impact of CLs on corporate bond issuance and the role of connected investors in mitigating such impact. Using a dataset of CLs issued by China's bond market regulator prior to bond issuance, we observe that issuers are less likely to complete the bond issuance after receiving the CLs, which suggests that the regulator's concerns regarding the issuers' public disclosures have a negative influence on the issuance process. We also find that connected investors are more likely to pay a higher price and receive a larger allotment of the bonds from CL recipients than non-CL recipients. We document that a quid pro quo relationship between the CL recipients and the connected investors is likely the explanation for the latter's support of the bond issuance.

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Appendix A: Variable Definition.

Variable	Definition
Variable of interests	
<i>CL Dummy</i>	An indicator variable equals to 1 if there is a comment letter (CL) issued by NAFMII during the bond registration.
Bond registration and issuance variables	
<i>Registration Amount</i>	The total bond registration size (in million RMB).
<i>Issuance Dummy</i>	An indicator variable equals to 1 if at least one bond is issued following a registration, and 0 otherwise.
<i>First Reg. Dummy</i>	An indicator variable equals 1, if the registration is the firm's first registration in the interbank market, and 0 otherwise.
<i>Rating</i>	Numerical values of credit ratings are assigned as follows: AAA is converted to 1, AA+ to 2, AA to 3, AA- to 4, and so forth.
<i>Issue Amount</i>	The bond issue size (in million RMB).
<i>Credit spread</i>	Coupon rate of the bond minus the corresponding Chinese Treasury Yield Index of similar maturity
<i>Maturity</i>	The bond's term to maturity (in years).
<i>Trading Vol.</i>	The trading volume in the month following the issuance (in million RMB).
<i>Zero Days</i>	The percentage of non-trading days in the month following the issuance.
<i>Downgrade Dummy</i>	An indicator variable equals 1 if the bond is downgraded before maturity, and 0 otherwise
<i>Default Dummy</i>	An indicator variable equals 1 if a bond issuer fails to make payments on the coupon or principle, and 0 otherwise.
<i>Leverage</i>	Issuer's leverage, calculated as total liabilities divided by total assets.
<i>ROA</i>	Issuer's return on assets ratio, calculated as net income divided by total assets.
<i>Asset</i>	Issuer's total assets (in million RMB).
<i>Cash</i>	Issuer's cash and short-term investments (in million RMB).
Syndicate and allotment variables	
<i>Syndicate Size</i>	The number of intuitional investors in the syndicate
<i>Num. of Connected Institutions</i>	The number of connected financial institutions in the syndicate.
<i>Percentage of Connected Institutions</i>	The share of connected financial institutions in the underwriter syndicate.
<i>Connected Institution Share</i>	The share of issuances acquired by financial institutions with a relationship.
<i>Connected Institution Share -Underwriters</i>	The share of issuances acquired by the underwriters with a relationship.
<i>Connected Institution Share -Other Institutions</i>	The share of issuances acquired by the other financial institutions (except the underwriters) with a relationship.
Variables in tests for quid pro quo hypotheses	
<i>ΔCredit Line</i>	The change in issuer's total credit line with a financial institution in the year subsequent to the bond issuance (in million RMB).
<i>Termination Dummy</i>	An indicator variable equals to 1 if an existing credit line is terminated between a financial institution and the issuer in the year subsequent to the bond issuance, and 0 otherwise.
<i>Allotment Dummy</i>	An indicator variable equals to 1 if a syndicate member has purchased any shares in the issuance.
<i>Deposit Dummy</i>	An indicator variable equals to 1 if the bank receives fiscal deposits from the local government, and 0 otherwise.

<i>CL Investment Dummy</i>	An indicator variable equals to 1 if a bank has purchased any bonds issued by local CL recipients in one year prior to the local government deposits, and 0 otherwise.
<i>Local SOE Allotment Dummy</i>	An indicator variable equals to 1 if a bank has purchased any bonds issued by local CL recipients in one year prior to the local government deposits, and 0 otherwise.
<i>Bank Asset</i>	Bank's total assets (in million RMB).
<i>Bank Liability</i>	Bank's total liabilities (in million RMB).
<i>NPL</i>	Bank's non-performing loan ratio.

Appendix B: Definition of the Type-I and Type-II Firms.

According to the No. 4 [2016] of the National Association of Financial Market Institutional Investors (NAFMII), February 19, 2016, “*Regulations on the Registration of Public Issuance of Debt Financing Instruments by Non-financial Enterprises*,” firms that meet the following requirements are classified as Type-I firms:

(1) High market recognition, significant industry status, and stable financial conditions (specific standards are detailed in the table followed), with no consecutive losses in the past two accounting years;

Industry	Asset (¥bil)	Sale (¥bil)	Leverage	ROA
Light industry, retail, and trade	–	>10	<0.75	>0.03
Construction, building materials, and real estate	>15	–	<0.85	>0.03
Other	>10	–	<0.85	>0.03

(2) The cumulative public offering of debt financing instruments has been no less than three times in the past 36 months, with a public offering scale of no less than 10 billion RMB;

(3) In the past 24 months, there have been no occurrences of debt securities or any other debt defaults or delayed payments on the coupon or principle. Furthermore, there have been no instances of debt securities defaults or delayed payments on the coupon or principle involving the firm’s controlling shareholders or subsidiaries;

(4) In the past 12 months, no administrative penalties, warning or sanctions have been taken by the relevant regulatory authorities to restrict direct debt financing.

Firms that do not meet the above requirements are classified as Type-II firms.

Figure 1. Bond Issuance Timeline

This figure provides a timeline indicating the critical stages involved in the registration and issuance of corporate bonds in the interbank market.

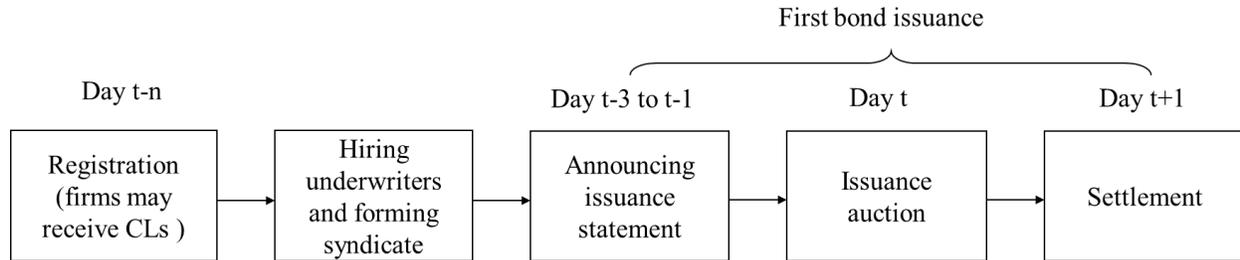


Figure 2. Comment letters from 2013 to 2019

This figure plots the distribution of comment letters over time.

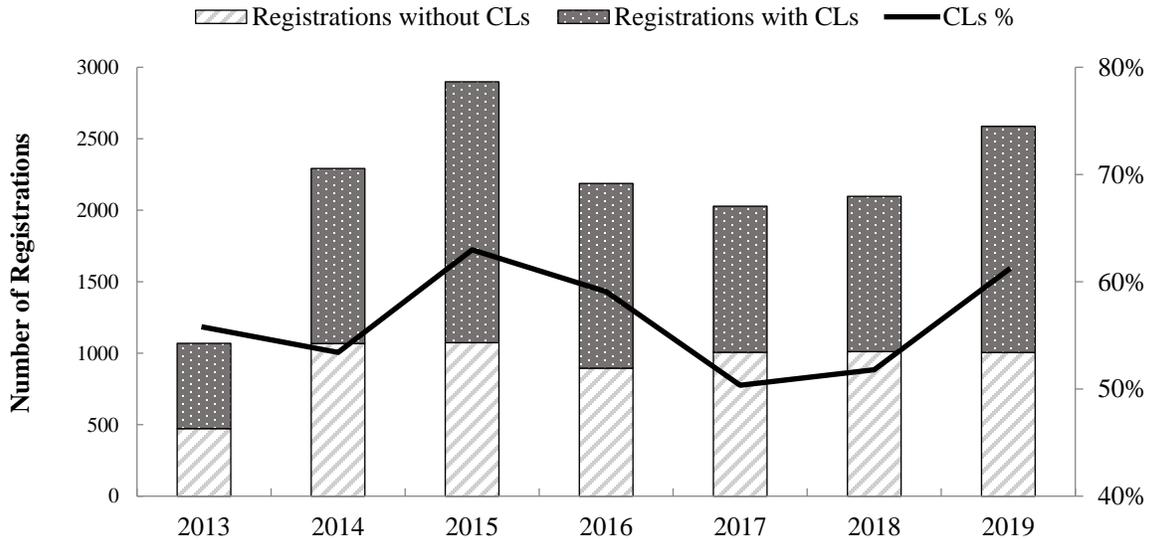


Table 1. Summary Statistics

This table reports the summary statistics of bond registration and issuance characteristics. We convert letter credit ratings into numerical values: AAA to 1, AA+ to 2, AA to 3, AA- to 4, etc. *ROA* is defined as net income divided by total assets. *Issuance Dummy* equals 1 if the bonds are issued following registration and 0 otherwise. *First Reg. Dummy* equals 1, if the registration is the firm's first registration in the interbank market, and 0 otherwise. *Credit spread* is defined as the difference in yield between the coupon rate of a given bond and the corresponding Chinese Treasury Yield Index of similar maturity. *Trading Vol.* is for the month following the issuance. *Zero Days* is the percentage of non-trading days in the month following the issuance. *Downgrade Dummy* equals 1 if the bond is downgraded before maturity, and 0 otherwise. *Default Dummy* equals 1 if a bond issuer fails to make payments on the coupon or principle, and 0 otherwise. *Syndicate Size* is the number of intuitional investors in the syndicate. *Num. of Connected Institutions* is the number of connected financial institutions in the syndicate. *Connected Institution Share* is the share of issuances acquired by financial institutions with relationships, which can be categorized into those acquired by underwriters and those acquired by other institutions. The number of observations (N), the mean, the standard deviation (SD), the 25th percentile (P25), the median (P50), and the 75th percentile (P75) are reported. The definition of all the other variables is presented in Appendix A.

Panel A: Registration Characteristics						
	N	Mean	SD	P25	P50	P75
<i>Registration Amount (¥mil)</i>	15,151	2,827	10,343	500	1,000	2,000
<i>CL Dummy</i>	15,151	0.569	0.495	0.000	1.000	1.000
<i>Issuance Dummy</i>	15,151	0.789	0.408	1.000	1.000	1.000
<i>First Reg. Dummy</i>	15,151	0.267	0.442	0.000	0.000	1.000
<i>Rating</i>	15,151	2.282	0.972	1.000	2.000	3.000
<i>Leverage</i>	15,151	0.624	0.138	0.540	0.642	0.719
<i>ROA</i>	15,151	0.021	0.027	0.005	0.014	0.030
<i>Asset (¥mil)</i>	15,151	105,150	1,095,107	15,140	33,591	81,585
<i>Cash (¥mil)</i>	15,151	10,312	122,343	1,424	3,441	8,513
Panel B: Issuance Characteristics						
	N	Mean	SD	P25	P50	P75
<i>Issue Amount (¥mil)</i>	15,465	1,055	996	500	800	1,200
<i>Credit spread (%)</i>	15,465	1.742	1.064	0.963	1.528	2.277
<i>Maturity (year)</i>	15,465	1.685	1.687	0.738	0.740	3.000
<i>Trading Vol. (¥mil)</i>	15,465	1,235	1,589	400	790	1,498
<i>Zero Days (%)</i>	15,465	82.617	14.247	77.273	86.364	90.909
<i>Downgrade Dummy</i>	15,465	0.065	0.246	0.000	0.000	0.000
<i>Default Dummy</i>	15,465	0.010	0.099	0.000	0.000	0.000
Panel C: Syndicate Structure and Bond Allotment						
	N	Mean	SD	P25	P50	P75
<i>Syndicate Size</i>	15,465	14.080	7.649	9.000	13.000	19.000
<i>Num. of Connected Institutions</i>	15,465	3.344	3.126	1.000	2.000	5.000
<i>Connected Institution Share</i>	15,465	0.425	0.311	0.160	0.400	0.662
-Underwriters	15,465	0.270	0.296	0.000	0.190	0.460
-Other Institutions	15,465	0.157	0.191	0.000	0.086	0.275

Table 2. Effect of Comment Letter on Bond Issuance

This table presents registration-level regressions of bond issuance on the comment letter receipts. The dependent variable, *Issuance Dummy*, equals 1 if at least one bond is issued following a registration, and 0 otherwise. The independent variable *CL Dummy* takes the value of 1 if a firm receives a CL in the registration, and 0 otherwise. Heteroskedasticity-consistent *t*-statistics clustered by bond registration date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Dependent: <i>Issuance Dummy</i>	(1)	(2)
<i>CL Dummy</i>	-0.083*** (-11.55)	-0.075*** (-9.53)
<i>Ln(Registration Amount)</i>	0.080*** (16.88)	0.085*** (14.63)
<i>First Reg. Dummy</i>	0.008 (0.84)	0.008 (0.66)
<i>Leverage</i>	0.009 (0.29)	-0.076 (-0.84)
<i>ROA</i>	-0.518*** (-3.54)	0.635** (2.18)
<i>Ln(Asset)</i>	-0.033*** (-5.06)	0.007 (0.28)
<i>Ln(Cash)</i>	0.012** (2.47)	0.010 (0.82)
Rating FE	Yes	Yes
Firm FE	No	Yes
Registration Year FE	Yes	Yes
Observations	15,151	15,151
Adjusted R-squared	0.068	0.144

Table 3. Effect of Comment Letter on Issuance Syndicate Structure

This table reports regressions of syndicate structure on the comment letter receipts. A financial institution has a connection with the issuer if it is the issuer's creditor, or has been a lead underwriter of the issuer's equity or bond offerings one year prior to the issuance. The dependent *Num. of Connected Institutions* is the number of connected financial institutions in the syndicate. The dependent *Percentage of Connected Institutions* is the share of connected financial institutions in the underwriter syndicate. Heteroskedasticity-consistent *t*-statistics clustered by bond issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Dependent:	<i>Num. of Connected Institutions</i>		<i>Percentage of Connected Institutions</i>	
	(1)	(2)	(3)	(4)
<i>CL Dummy</i>	0.451***	0.447***	0.031***	0.023***
	(8.95)	(7.25)	(12.23)	(7.93)
<i>Ln(Issue Amount)</i>	0.117**	0.200***	0.008***	0.009***
	(2.15)	(3.01)	(2.65)	(2.66)
<i>Maturity</i>	-0.139***	-0.049***	-0.007***	-0.002***
	(-9.54)	(-2.73)	(-9.45)	(-2.74)
<i>Leverage</i>	2.345***	1.409**	0.138***	0.103***
	(10.45)	(2.00)	(11.88)	(2.70)
<i>ROA</i>	2.908***	2.219	0.145**	0.164
	(2.74)	(1.11)	(2.41)	(1.61)
<i>Ln(Asset)</i>	0.057	0.966***	-0.001	0.054***
	(1.07)	(4.75)	(-0.48)	(4.76)
<i>Ln(Cash)</i>	0.091***	0.096	0.010***	0.001
	(2.72)	(1.09)	(5.80)	(0.24)
<i>Ln(Trading Vol.+1)</i>	0.181***	0.209***	0.004***	0.006***
	(8.11)	(8.57)	(3.17)	(4.37)
<i>Zero Days (%)</i>	-0.007***	-0.005**	0.000	0.000
	(-3.40)	(-2.33)	(0.37)	(1.13)
Rating FE	Yes	Yes	Yes	Yes
Firm FE	No	Yes	No	Yes
Issuance Year FE	Yes	Yes	Yes	Yes
Observations	15,465	15,465	15,465	15,465
Adjusted R-squared	0.088	0.249	0.097	0.319

Table 4. Effect of Comment Letter on Bond Issuance Allotment

This table reports regressions of bond issuance and allotment on the comment letter receipts. In Column (1), the dependent variable is *Connected Institution Share*, the share of issuances acquired by connected financial institutions. In columns (2) and (3), we partitioned *Connected Institution Share* into those acquired by underwriters, *Connected Institution Share - Underwriters*, and those acquired by other institutions, *Connected Institution Share - Other Institutions*. Heteroskedasticity-consistent *t*-statistics clustered by bond issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Dependent:	<i>Connected Institution Share</i>	<i>Connected Institution Share - Underwriters</i>	<i>Connected Institution Share - Other Institutions</i>
	(1)	(2)	(3)
<i>CL Dummy</i>	0.064*** (9.67)	0.039*** (6.36)	0.025*** (6.05)
<i>Ln(Issue Amount)</i>	0.069*** (10.26)	0.041*** (6.15)	0.027*** (6.23)
<i>Maturity</i>	-0.010*** (-5.26)	-0.012*** (-7.48)	0.003** (2.49)
<i>Leverage</i>	-0.007 (-0.09)	-0.049 (-0.69)	0.042 (0.84)
<i>ROA</i>	-0.044 (-0.17)	-0.400* (-1.71)	0.355** (2.23)
<i>Ln(Asset)</i>	-0.164*** (-9.36)	-0.205*** (-12.25)	0.040*** (3.32)
<i>Ln(Cash)</i>	0.033*** (3.54)	0.028*** (3.11)	0.005 (0.90)
<i>Ln(Trading Vol.+1)</i>	-0.047*** (-18.53)	-0.056*** (-22.06)	0.009*** (6.50)
<i>Zero Days (%)</i>	-0.001*** (-3.22)	-0.001*** (-5.21)	0.000*** (2.96)
Rating FE	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Issuance Year FE	Yes	Yes	Yes
Observations	15,465	15,465	15,465
Adjusted R-squared	0.245	0.244	0.155

Table 5. Addressing the Endogeneity Concern – Instrumental Variable Approach

This table presents the impact of comment letter receipts on bond issuance and connected institution allotment using instrumental variables and two-stage least squares regressions. The sample includes all MTN and CP registered by non-financial firms in China's interbank market from February 19, 2015, to February 19, 2017, a 24-month window around the registry policy change on February 19, 2016. *Treatment Dummy* equals 1 if the registered firm is a type-I firm, and 0 otherwise. Detailed definition of type-I firm is provided in Appendix B. *Post* equals 1 in the months following the registry policy change. Panel A presents the registration-level regressions of bond issuance, while panel B reports the bond-level regressions of connected institution allotment. In both panels, column 1 presents the first-stage regression with the *CL Dummy* as the dependent variable and the instrumental variables including *Treatment Dummy*, *Post Dummy*, and *Treatment Dummy* × *Post Dummy*. In Panel A(B), column 2 reports the second-stage regression, with *Issuance Dummy (Connected Institution Share)* as the dependent variables. Heteroskedasticity-consistent *t*-statistics clustered by bond registration date (issuance date) are reported in parentheses in Panel A(B). ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Panel A: Regressions of bond issuance

Dependent:	<i>CL Dummy</i>	<i>Issuance Dummy</i>
	(1)	(2)
<i>CL Dummy</i>		-0.326** (-1.99)
<i>Treatment Dummy</i>	0.285*** (3.56)	
<i>Post Dummy</i>	-0.166*** (-4.30)	
<i>Treatment Dummy</i> × <i>Post Dummy</i>	-0.205*** (-3.23)	
<i>Ln(Registration Amount)</i>	0.056*** (4.80)	0.069*** (4.82)
<i>First Reg. Dummy</i>	0.273*** (9.65)	-0.055 (-0.96)
<i>Leverage</i>	0.182 (0.53)	0.016 (0.05)
<i>ROA</i>	0.523 (0.67)	0.549 (0.69)
<i>Ln(Asset)</i>	-0.134 (-1.19)	0.108 (1.12)
<i>Ln(Cash)</i>	0.049 (1.17)	-0.055 (-1.34)
Rating FE	Yes	Yes
Firm FE	Yes	Yes
Registration Year FE	Yes	Yes
Observations	5,253	5,253
Adjusted R-squared	0.213	0.104

Panel B: Regressions of connected institution allotment

Dependent:	<i>CL Dummy</i>	<i>Connected Institution Share</i>
	(1)	(2)
<i>CL Dummy</i>		0.124** (2.00)
<i>Treatment Dummy</i>	0.161** (2.01)	
<i>Post Dummy</i>	-0.191*** (-7.83)	
<i>Treatment Dummy × Post Dummy</i>	-0.193*** (-3.28)	
<i>Ln(Issue Amount)</i>	-0.002 (-0.13)	0.089*** (7.28)
<i>Maturity</i>	0.011** (1.99)	-0.004 (-1.14)
<i>Leverage</i>	-0.088 (-0.39)	-0.080 (-0.57)
<i>ROA</i>	-0.342 (-0.80)	0.085 (0.20)
<i>Ln(Asset)</i>	-0.039 (-0.71)	-0.048 (-1.21)
<i>Ln(Cash)</i>	0.006 (0.23)	0.005 (0.30)
<i>Ln(Trading Vol. +1)</i>	0.001 (0.12)	-0.042*** (-5.22)
<i>Zero Days (%)</i>	-0.000 (-0.37)	-0.000 (-0.00)
Rating FE	Yes	Yes
Firm FE	Yes	Yes
Issuance Year FE	Yes	Yes
Observations	6,297	6,297
Adjusted R-squared	0.564	0.262

Table 6. Effect of Comment Letter on Banking

This table reports the bond-institution level regressions of bond allotments on the issuer's banking business. The dependent variable $\Delta Credit Line$ is the change of issuer's total credit line with a financial institution in the year subsequent to the bond issuance. The dependent variable *Termination Dummy* equals to 1 if an existing credit line is terminated between a financial institution and the issuer in the year subsequent to the bond issuance, and 0 otherwise. The dependent variable *Allotment Dummy* equals to 1 if a syndicate member has purchased any shares in the issuance, and 0 otherwise. Heteroskedasticity-consistent *t*-statistics clustered by bond issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Dependent:	$\Delta Credit Line$	<i>Termination Dummy</i>
	(1)	(2)
<i>CL Dummy</i>	-163.600 (-0.28)	-0.001 (-0.31)
<i>Allotment Dummy</i>	358.217 (1.56)	-0.019*** (-7.26)
<i>CL Dummy</i> × <i>Allotment Dummy</i>	706.174** -2.03	-0.009** (-2.58)
<i>Ln(Issue Amount)</i>	-605.103 (-0.79)	0.003* (1.72)
<i>Maturity</i>	-490.439 (-1.25)	-0.000 (-0.04)
<i>Leverage</i>	37,567.797 (1.23)	0.054* (1.68)
<i>ROA</i>	48,913.145 (1.12)	0.036 (0.60)
<i>Ln(Asset)</i>	-967.725 (-0.82)	0.005 (0.50)
<i>Ln(Cash)</i>	2,259.395 (1.29)	-0.003 (-0.95)
Firm FE	Yes	Yes
Institution FE	Yes	Yes
Issuance Year FE	Yes	Yes
Observations	163,318	150,312
Adjusted R-squared	0.020	0.099

Table 7. Effect of Comment Letter and Bond Allotment on the Allocation of Fiscal Deposit

This table reports the bank level regressions of the bond issuers' local governments' bank deposits. The dependent variable, *Deposit Dummy*, equals 1 if the bank receives deposits from the local government, and 0 otherwise. The independent variable *CL Investment Dummy* equals 1 if a bank has purchased any bonds issued by local CL recipients in one year prior to the local government deposits, and 0 otherwise. The independent variable *Local SOE Investment Dummy* equals 1 if a bank has purchased any bonds issued by local SOEs in one year prior to the local government deposits, and 0 otherwise. *NPL* is the bank's non-performing loan ratio in year *t*. Heteroskedasticity-consistent *t*-statistics clustered by institution are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Dependent: <i>Deposit Dummy</i>	(1)	(2)
<i>CL Investment Dummy</i>	0.072*** (2.78)	0.054*** (2.69)
<i>Local SOE Investment Dummy</i>	0.130*** (4.01)	0.122*** (4.06)
<i>Ln(Bank Asset)</i>	0.208 (0.12)	2.382** (2.06)
<i>Ln(Bank Liability)</i>	0.026 (0.01)	-2.305** (-2.11)
<i>NPL</i>	0.074 (1.38)	0.016 (0.81)
Institution FE	No	Yes
Province FE	Yes	Yes
Issuance Year FE	Yes	Yes
Observations	14,913	14,913
Adjusted R-squared	0.566	0.685

Table 8. Comment Letter and Bond Ex-post Performance

This table reports the regressions of a bond's downgrade or default on the comment letter dummy. In column (1), the dependent variable, *Downgrade Dummy*, equals 1 if a bond is downgraded before maturity, and 0 otherwise. In column (2), the dependent variable, *Default Dummy*, equals 1 if a bond issuer fails to make payments on the coupon or principle, and 0 otherwise. Heteroskedasticity-consistent *t*-statistics clustered by bond issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Dependent:	<i>Downgrade Dummy</i>	<i>Default Dummy</i>
	(1)	(2)
<i>CL Dummy</i>	0.001 (0.19)	0.002 (0.83)
<i>Connected Institution Share</i>	-0.019** (-2.29)	-0.005 (-1.49)
<i>CL Dummy</i> × <i>Connected Institution Share</i>	0.019* (1.76)	-0.001 (-0.24)
<i>Ln(Issue Amount)</i>	0.004 (0.87)	0.002 (1.06)
<i>Maturity</i>	0.023*** (16.22)	0.005*** (8.02)
<i>Leverage</i>	-0.040 (-0.88)	-0.014 (-0.54)
<i>ROA</i>	-1.076*** (-5.29)	-0.239 (-1.39)
<i>Ln(Asset)</i>	0.089*** (5.56)	0.035*** (4.38)
<i>Ln(Cash)</i>	-0.005 (-0.99)	-0.007** (-2.10)
<i>Ln(Trading Vol. +1)</i>	-0.000 (-0.33)	-0.001*** (-2.64)
<i>Zero Days (%)</i>	-0.000 (-1.45)	-0.000 (-0.03)
Rating FE	Yes	Yes
Firm FE	Yes	Yes
Issuance Year FE	Yes	Yes
Observations	15,465	15,465
Adjusted R-squared	0.032	0.014

Table 9. Effect of Connected Institution Allotments on Bond Pricing

This table reports bond level regressions of bond pricing on the comment letter receipts and connected institution allotments. The dependent variable *Credit Spread* is calculated as the coupon rate minus the corresponding Chinese Treasury Yield Index of similar maturity. The independent variable *Connected Institution Share* is constructed by aggregating the shares acquired by all connected institutions in each issuance. In columns (2), we partition *Connected Institution Share* into those acquired by underwriters, *Connected Institution Share-Underwriters*, and those acquired by other institutions, *Connected Institution Share-Other Institutions*. Heteroskedasticity-consistent *t*-statistics clustered by bond issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Dependent: <i>Credit Spread</i>	(1)	(2)
<i>CL Dummy</i>	0.037* (1.88)	0.042** (2.09)
<i>Connected Institution Share</i>	-0.091*** (-3.39)	
<i>CL Dummy × Connected Institution Share</i>	-0.155*** (-4.64)	
<i>Connected Institution Share-Underwriters</i>		-0.113*** (-3.88)
<i>CL Dummy × Connected Institution Share-Underwriters</i>		-0.133*** (-3.68)
<i>Connected Institution Share-Other Institutions</i>		-0.023 (-0.51)
<i>CL Dummy × Connected Institution Share-Other Institutions</i>		-0.224*** (-3.98)
<i>Ln(Issue Amount)</i>	-0.015 (-1.13)	-0.015 (-1.17)
<i>Maturity</i>	0.128*** (30.25)	0.127*** (30.17)
<i>Leverage</i>	1.761*** (10.05)	1.755*** (10.01)
<i>ROA</i>	-4.186*** (-8.37)	-4.194*** (-8.38)
<i>Ln(Asset)</i>	0.309*** (6.26)	0.306*** (6.20)
<i>Ln(Cash)</i>	-0.113*** (-5.62)	-0.114*** (-5.63)
<i>Ln(Trading Vol.+1)</i>	0.014*** (3.00)	0.014*** (2.84)
<i>Zero Days (%)</i>	-0.000 (-0.59)	-0.000 (-0.62)
Rating FE	Yes	Yes
Firm FE	Yes	Yes
Issuance Year FE	Yes	Yes
Observations	15,465	15,465
Adjusted R-squared	0.757	0.757

Table 10. Robustness test – Effect of Comment Letter Textual Characteristics on Bond Issuance

Panel A of this table reports the summary statistics of the CLs' textual characteristics. Textual characteristics variables of the 9 topics are dummy variables equal 1 if the specific topic is covered in comment letter. Examples of each of the topic are presented in Table IA1 of the Internet Appendix. Panel B of this table presents registration-level regressions of bond issuance on the CLs' textual characteristics. The dependent variable, *Issuance Dummy*, equals 1 if at least one bond is issued following a registration, and 0 otherwise. Heteroskedasticity-consistent *t*-statistics clustered by bond registration date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all other variables is presented in Appendix A.

Panel A: Summary statistics of textual characteristics of the CLs

Variable	N	Mean	SD	P25	P50	P75
Corporate's Operating Activities	15,151	0.482	0.500	0.000	0.000	1.000
Accounting Information	15,151	0.392	0.488	0.000	0.000	1.000
Compliance Issues	15,151	0.253	0.435	0.000	0.000	1.000
Usage of Funds	15,151	0.363	0.481	0.000	0.000	1.000
Subsidiaries Situations	15,151	0.072	0.258	0.000	0.000	0.000
Government Policy	15,151	0.067	0.250	0.000	0.000	0.000
Corporate Ownership	15,151	0.069	0.254	0.000	0.000	0.000
Corporate Governance	15,151	0.370	0.483	0.000	0.000	1.000
Risk Reporting	15,151	0.446	0.497	0.000	0.000	1.000

Panel B: Regressions of textual characteristics on bond issuance

Dependent: <i>Issuance Dummy</i>	(1)	(2)
Corporate's Operating Activities	0.001 (0.06)	0.007 (0.49)
Accounting Information	-0.006 (-0.64)	-0.009 (-0.80)
Compliance Issues	0.007 (0.70)	0.001 (0.13)
Usage of Funds	0.011 (1.10)	0.017 (1.46)
Subsidiaries Situations	0.006 (0.45)	0.010 (0.61)
Government Policy	-0.042^{***} (-2.77)	-0.050^{***} (-2.86)
Corporate Ownership	-0.030 ^{**} (-2.02)	0.016 (0.85)
Corporate Governance	-0.009 (-0.95)	-0.007 (-0.62)
Risk Reporting	-0.004 (-0.37)	-0.003 (-0.23)
<i>CL Dummy</i>	-0.072 ^{***} (-4.46)	-0.075 ^{***} (-4.08)
<i>Ln(Registration Amount)</i>	0.080 ^{***} (16.70)	0.084 ^{***} (14.48)
<i>First Reg. Dummy</i>	0.010 (1.12)	0.009 (0.75)
<i>Leverage</i>	0.009 (0.31)	-0.066 (-0.73)
<i>ROA</i>	-0.503 ^{***} (-3.42)	0.656 ^{**} (2.25)
<i>Ln(Asset)</i>	-0.033 ^{***} (-4.93)	0.006 (0.25)
<i>Ln(Cash)</i>	0.011 ^{**} (2.37)	0.010 (0.84)
Rating FE	Yes	Yes
Firm FE	No	Yes
Registration Year FE	Yes	Yes
Observations	15,151	15,151
Adjusted R-squared	0.069	0.144

Table 11. Determinants of the Issuance of CLs

This table examines the determinants of the issuance of CLs during the bond registration. Heteroskedasticity-consistent *t*-statistics clustered by bond registration date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively. The definition for all variables is presented in Appendix A.

Dependent: <i>CL dummy</i>	(1)	(2)
<i>Ln(Registration Amount)</i>	0.209*** (8.77)	0.225*** (9.28)
<i>SOE Dummy</i>	0.159*** (2.88)	0.113** (1.97)
<i>First Reg. Dummy</i>	0.921*** (18.28)	1.105*** (20.20)
<i>Leverage</i>	-0.122 (-0.72)	-0.020 (-0.12)
<i>ROA</i>	-1.199 (-1.38)	-0.474 (-0.53)
<i>Ln(Asset)</i>	-0.416*** (-10.42)	-0.436*** (-9.97)
<i>Ln(Cash)</i>	0.052* (1.65)	0.063** (1.96)
Rating FE	No	Yes
Registration Year FE	No	Yes
Observations	15,151	15,151
Pseudo R-squared	0.055	0.070

Internet Appendix for
“Regulatory Enforcement of Public Disclosure and Connected Investors in
Corporate Bond Issuance ”

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In this Internet Appendix, we report the following figures, tables, and additional analyses omitted from the main paper.

Figure IA1. Corporate Bond Issuance by Category

This figure plots issuance amount of bonds issued by non-financial enterprises in the interbank market by category from 2009–2019.

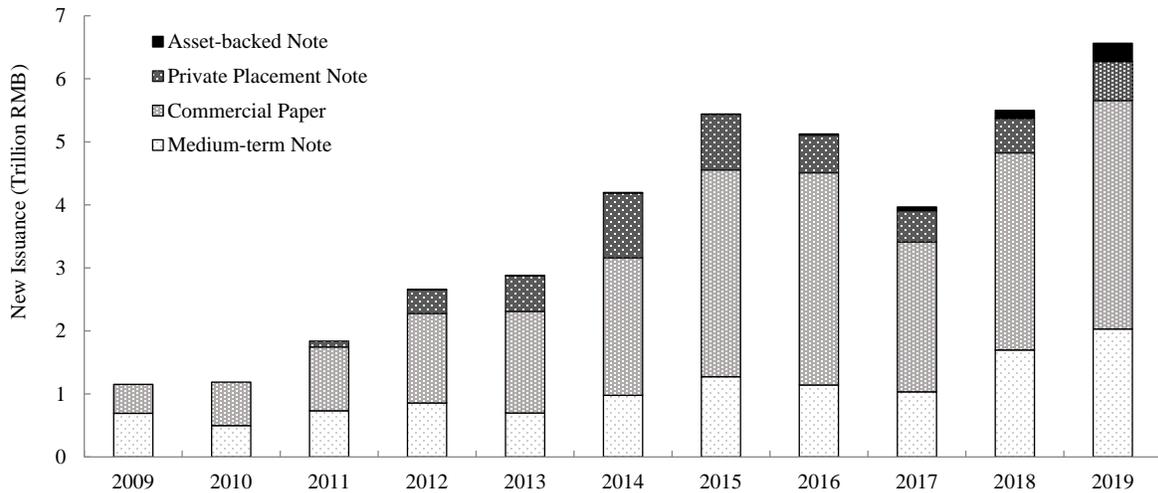


Table IA1. Topics of Comment Letters

Topics	Example 1	Example 2	Example 3
Corporate's Operating Activities	It is recommended to further elaborate on overseas investments.	It is recommended to further provide details on the main business segments, including but not limited to profit models, upstream and downstream industry chains, production and sales regions, industry status, etc.	It is recommended to further disclose the business model of entrusted construction, agreement signing, performance status, and accounting treatments, including but not limited to the project name, total investment, invested amount, source of funds, repurchase plan, and actual repayment status.
Accounting Information	It is recommended to provide updates on significant changes in accounting policies.	It is recommended to further elaborate on cash flow analysis.	It is recommended to further analyze key accounting items, including but not limited to monetary funds, other receivables, inventory, available-for-sale financial assets, fixed assets, investment returns, etc.
Compliance Issues	It is recommended to further disclose the legality and compliance of the issuer's various business operations.	It is recommended to clarify whether the setup of senior management complies with relevant laws and regulations such as the "Company Law" and the company's articles of association.	Lawyers are recommended to further provide legal opinions on whether the registration amount for this time complies with the requirements of rule guidelines.
Usage of Funds	It is recommended to further calculate the use of the raised funds.	Supplement the use of the raised funds, the basis for calculation, and the commitment to use.	It is recommended to further provide the name, amount, and gap calculation of the main entity using the raised funds.
Subsidiaries Situations	It is recommended to further provide details on subsidiaries that have a significant impact on the enterprise.	It is recommended to provide reasons for the subsidiary's losses.	It is recommended to provide details on the issuer's internal control systems for its subsidiaries, including management regulations and major investment and financing management systems.
Government Policy	Disclose if there are situations of providing services for government purchases or advancing funds for government projects.	It is recommended to provide details on government support.	It is recommended to further provide details on government subsidies, including the basis for the subsidies, relevant government documents, and future subsidy plans.

Corporate Ownership	It is recommended to further elaborate on the issuer's controlling shareholders and actual controllers.	It is recommended to further detail the situation of the issuer's actual controllers and concerted actors, including but not limited to basic situations, concerted action agreements, share pledge situations, major investments in other companies, etc.	It is recommended to supplement the main business and financial situation of the actual controller according to M-5-3.
Corporate Governance	It is recommended to provide details on the emergency response plan system for sudden incidents.	It is recommended to provide details on the budget management system.	It is recommended to further elaborate on the investor protection mechanism.
Risk Reporting	It is recommended to add risks associated with sudden incidents affecting operations and sudden changes in corporate governance structure caused by unexpected events.	It's advised to add risks associated with large-scale entrusted loans, some subsidiaries incurring losses, fluctuations in the value of available-for-sale financial assets, lower qualifications for real estate development, yearly declines in net cash flow from financing, and a high proportion of minority shareholders' equity.	It is suggested to add risks of large capital expenditures in the future.

Table IA2. Effect of Number of Pages in Comment Letter on Bond Issuance

This table presents registration-level regressions of bond issuance on the number of pages in comment letters. The dependent variable, *Issuance Dummy*, equals 1 if at least one bond is issued following a registration, and 0 otherwise. The independent variable *Number of Page* is the number of pages in comment letters. If the registration does not receive a comment letter, the *Number of Page* is set to 0. Heteroskedasticity-consistent *t*-statistics clustered by bond registration date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Dependent: <i>Issuance Dummy</i>	(1)	(2)
<i>Number of Pages</i>	-0.005*** (-2.68)	-0.004** (-2.22)
<i>Ln(Registration Amount)</i>	0.077*** (16.33)	0.080*** (14.10)
<i>First Reg. Dummy</i>	-0.009 (-1.02)	-0.008 (-0.64)
<i>Leverage</i>	0.009 (0.29)	-0.068 (-0.75)
<i>ROA</i>	-0.506*** (-3.43)	0.650** (2.23)
<i>Ln(Asset)</i>	-0.026*** (-4.01)	0.015 (0.58)
<i>Ln(Cash)</i>	0.011** (2.26)	0.008 (0.65)
Rating FE	Yes	Yes
Firm FE	No	Yes
Registration Year FE	Yes	Yes
Observations	15,151	15,151
Adjusted R-squared	0.060	0.137

Table IA3. Effect of Comment Letter on the Strength of Connection of Financial Institutions in the Syndicate

This table presents regression analyses examining on the strength of connection of financial institutions in the syndicate in relation to the comment letter receipts. The strength of connection is measured by *Syndicate Creditline*, the total amount of creditline from connected financial institutions in the syndicate. Heteroskedasticity-consistent *t*-statistics clustered by bond issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Dependent: $\ln(\text{Syndicate Creditline}+1)$	(1)	(2)
<i>CL Dummy</i>	0.111*** (2.70)	0.117*** (2.68)
$\ln(\text{Issue Amount})$	0.186*** (4.46)	0.114** (2.13)
<i>Maturity</i>	-0.047*** (-3.91)	0.027* (1.95)
<i>Leverage</i>	2.344*** (13.92)	2.319*** (3.77)
<i>ROA</i>	4.787*** (5.55)	0.450 (0.33)
$\ln(\text{Asset})$	0.692*** (16.53)	1.078*** (6.69)
$\ln(\text{Cash})$	-0.028 (-0.99)	-0.125* (-1.90)
$\ln(\text{Trading Vol.}+1)$	0.175*** (7.84)	0.196*** (8.65)
<i>Zero Days (%)</i>	0.004*** (2.65)	0.003** (2.02)
Rating FE	Yes	Yes
Firm FE	No	Yes
Year FE	Yes	Yes
Observations	15,465	15,465
<i>R</i> -squared	0.301	0.501

Table IA4. Effect of Comment Letter on Bond Issuance Allotment

This table reports bond-institution level regressions of bond allotments on the comment letter receipts. The dependent variable *Allotment Dummy* equals to 1 if a syndicate member has purchased any shares during the issuance, and 0 otherwise. *Allocated amount* is the RMB amount of bonds purchased by a syndicate member. The independent variable *Connected Institution Dummy* equal 1 if the syndicate member has a connection with the issuer, i.e., the syndicate member is the issuer's creditor, or has been a lead underwriter of issuer's equity or bond offerings one year prior to the issuance. Heteroskedasticity-consistent *t*-statistics clustered by issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Dependent:	<i>Allotment Dummy</i>	<i>Ln(Allocated Amount +1)</i>
	(1)	(2)
<i>CL Dummy</i>	-0.004 (-0.90)	-0.023 (-1.09)
<i>Connected Institution Dummy</i>	0.098*** (20.17)	0.620*** (24.87)
<i>CL Dummy</i> × <i>Connected Institution Dummy</i>	0.028*** (5.38)	0.142*** (5.47)
<i>Ln(Issue Amount)</i>	0.030*** (5.73)	0.411*** (17.80)
<i>Maturity</i>	0.007*** (4.59)	0.031*** (4.83)
<i>Leverage</i>	0.067 (1.15)	0.082 (0.32)
<i>ROA</i>	0.447*** (2.95)	1.867*** (2.99)
<i>Ln(Asset)</i>	0.003 (0.21)	0.002 (0.03)
<i>Ln(Cash)</i>	-0.011 (-1.52)	-0.042 (-1.33)
<i>Ln(Trading Vol. +1)</i>	0.038*** (20.25)	0.148*** (16.86)
<i>Zero Days (%)</i>	0.000** (2.01)	0.002** (2.29)
Rating FE	Yes	Yes
Firm FE	Yes	Yes
Year FE	Yes	Yes
Institution FE	Yes	Yes
Observations	217,092	217,092
<i>R</i> -squared	0.211	0.185

Table IA5. Effect of Comment Letter on Bond Issuance Allotment – Controlling the Strength of Connection

This table reports bond-institution level regressions of bond allotments on the comment letter receipts, while controlling for the strength of connection. The dependent variable *Allotment Dummy* equals to 1 if a syndicate member has purchased any shares during the issuance, and 0 otherwise. *Allocated amount* is the RMB amount of bonds purchased by a syndicate member. The independent variable, *Creditline*, the amount of creditline extended from the connected financial institution to the issuer. Heteroskedasticity-consistent *t*-statistics clustered by issuance date are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Dependent:	<i>Allotment Dummy</i>	<i>Ln(Allocated Amount +1)</i>
	(1)	(2)
<i>CL Dummy</i>	-0.005 (-0.92)	-0.022 (-1.04)
<i>Ln(Creditline+1)</i>	0.010*** (14.93)	0.063*** (18.17)
<i>CL Dummy</i> × <i>Ln(Creditline+1)</i>	0.004*** (5.94)	0.021*** (5.72)
<i>Ln(Issue Amount)</i>	0.030*** (5.58)	0.406*** (17.52)
<i>Maturity</i>	0.007*** (4.58)	0.031*** (4.81)
<i>Leverage</i>	0.068 (1.15)	0.083 (0.32)
<i>ROA</i>	0.458*** (3.02)	1.935*** (3.10)
<i>Ln(Asset)</i>	0.003 (0.16)	-0.003 (-0.04)
<i>Ln(Cash)</i>	-0.010 (-1.43)	-0.038 (-1.20)
<i>Ln(Trading Vol.+1)</i>	0.038*** (20.33)	0.150*** (16.98)
<i>Zero Days (%)</i>	0.000** (2.05)	0.002** (2.35)
Rating FE	Yes	Yes
Firm FE	Yes	Yes
Year FE	Yes	Yes
Institution FE	Yes	Yes
Observations	217,092	217,092
<i>R</i> -squared	0.209	0.182