Outlook for the Establishment of China’s International Board

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In September 2010, it was reported that relevant Chinese competent governmental authorities had managed to build consensus on the legal issues in connection with the listing of foreign companies on the international board of the China’s stock market (hereinafter referred to as “International Board”) according to one person close to the management personnel of the Shanghai Stock Exchange (hereinafter referred to as “SSE”). According to Geng Liang, chairman of SSE, the SSE has finished the preparations in techniques and trading rules for the International Board. We can clearly hear the footsteps of the International Board coming nearer and nearer.

The launch of the International Board is not a new story emerging. On June 17 and 18, 2008, China and the United States held the fourth strategic economic dialogue during which China promised that it would allow qualified foreign companies to list on China's stock exchanges through issuing shares or depository receipts in accordance with relevant prudential regulations. Since then, more and more attention has been concentrated on the development and establishment of the International Board.

Various famous foreign companies, such as HSBC, Standard Chartered, Bank of East Asia, Coca-Cola, General Electric, Wal-Mart, etc., have expressed their interests in issuing shares and raising capital in mainland China and being listed on the International Board.

Although China has agreed to open its stock market to foreign companies in the aforesaid strategic economic dialogue, the result of such strategic economic dialogue shall only be deemed as a framework cooperation memorandum. It represents a tendency rather than a binding rule. Before the detailed rules have been issued by the State Council of China or the China Securities Regulatory Commission (hereinafter referred to as “CSRC”), it is not feasible for foreign companies to be listed in China’s stock market. Fortunately, the State Council has just issued one rule regarding the International Board, which is described as follows. On April 14, 2009, the Opinions of the State Council on Propelling Shanghai to Accelerate the Development of a Modern Service Sector and an Advanced Manufacturing Sector and Build an International Financial Center and an International Shipping Center was promulgated by the State Council. It set forth that qualified foreign companies will be permitted to issue RMB-denominated shares in due time, meanwhile saying there is no clear schedule for the launch of the International Board.

What is the international board?

The International Board refers to a new board of SSE which permits companies that are registered outside of China to be listed on the SSE and issue shares in mainland China. By comparison, the International Board of the New York Stock Exchange (hereinafter referred to as “NYSE”) permits both the companies registered outside of the U.S. and the U.S. registered companies to be listed. Most of the major stock exchanges around the world allow foreign registered companies to be listed. Permitting offshore companies to offer shares in China is essential for China to bring its capital market in line with international standards.
At present, China only allows domestic companies to go public. However, it is worth noting that foreign invested companies will enjoy the same treatment as the domestic companies and will be entitled to apply for public offering in China's stock market. In fact, many foreign invested companies have been listed on SSE or Shenzhen Stock Exchange (hereinafter referred to as "SZSE") since 2005, but what is essential to draw our attention here is that such foreign invested companies differ from foreign registered companies because the former have their registration addresses in China and the latter are registered offshore. For example, many large Chinese state-owned enterprises that have been registered and listed outside China may apply for the listing on the International Board although most of their assets and business are in China.

Today, China's stock market is mainly based on the A-share market which is composed of three main parts, main board for blue chip companies, small and medium board for medium-sized companies and growth enterprise board for startup companies. The main board is located in the SSE and the small and medium board and growth enterprise board are located in the SZSE. China's stock market also contains B-share, H-share and other kinds of securities in addition to A-share. The International Board may become the fourth board of A-share or otherwise change into other kind securities. Based on the past experience regarding the introduction of growth enterprise board, it will take a long time commencing from the initial proposal to the final establishment of a new board. Indeed, there are lots of uncertainties and challenges in connection with the option of the basic models, potential candidates and the direction of the capital flow of the International Board. It is difficult to figure out the timetable for launch of the International Board based on current new reports and various rumors.

**Two possible listing vehicles**

In respect of listing vehicles, candidates may be allowed to list in mainland China via initial public offering of shares (hereinafter referred to as "IPO") or issuing China Depository Receipts (hereinafter referred to as "CDR"). Both of the foregoing possible paths have respective advantages and disadvantages. Compared with the CDR, the IPO is more straightforward for the regulators because China has already collected rich experience on formulating rules and regulations governing the activities of public offering of shares. That is to say, CDR still remains a new listing vehicle for China's regulators, market participants and investors.

CDR is similar to the American Depository Receipts (hereinafter referred to as "ADR") used by the NYSE. The shares of many non-US companies trade on US stock exchanges via the use of ADR, such as SouFun Holdings Limited, New Oriental Education & Technology Group Inc., and Ambow Education Holding Limited whose businesses are mainly operated within China. Similar to the ADR, the proposed CDR represents ownership in the shares of a company registered outside China that trade in Chinese stock market. CDR enables Chinese investors to buy shares in offshore companies without the troubles and inconveniences of cross-border and cross-currency transactions. CDR is denominated in RMB, pays dividends in RMB and can be traded like the shares of domestic companies.

Although CDR has many advantages, IPO of new shares dominated in RMB may be more likely to be chosen by the State Council of China or CSRC according to SSE chairman Geng Liang. IPO is preferred to CDR because the CDR relates to series of issues that are difficult to handle. It is difficult to convert the CDRs into shares of foreign registered companies under the current legal system in connection with the securities clearing. The State Council or CSRC have the concern that the CDR, as a new product in the Chinese stock market, may make the investors confused and further require lots of revision on the relevant laws and regulations. Technically, the issuance of the CDR may impose more strict technical demand on China's securities clearing system which is not mature enough nowadays.

In fact, China's current IPO system also faces many problems. China has the most cumbersome IPO procedures around the world. The listing candidates have to face much more uncertainties and higher listing expenses than elsewhere. The IPO approval procedures regulated by the CSRC may take three years or more and subject to heavy impact of the industrial policies and changes in the economic situation. For example, at the earlier stage of the international financial crisis in 2008, no companies have passed the IPO approval procedures. If the regulator finally chooses the IPO path, it is advisable to streamline the approval procedures. Converting the IPO approval system for the International Board into a registration system may be a good choice.

**Two potential listing candidates**

Among various foreign registered companies, two kinds of companies are the most likely listing candidates for the International Board according to the public available reports and interviews. Firstly, the international companies which have already been listed in other stock exchanges (hereinafter referred to as "Multinational Listed Companies") may be invited to apply for the secondary listing on the International Board. Secondly, certain large state-owned companies which have already been listed on offshore stock
exchanges (hereinafter referred to as "Red Chip Companies"), especially the Hong Kong Stock Exchange (hereinafter referred to as "HKEX"), also propose to apply for the listing on the International Board.

As set forth, a handful of famous Multinational Listed Companies are eager to be listed on the International Board. The China's regulators are formulating the thresholds for listing on the International Board. Generally speaking, the Multinational Listed Companies shall be mature and have a steady growth listing. Fortune 500 companies will be the perfect listing candidates for the International Board. Contrary to the Multinational Listed Companies, most of the Red Chip Companies are directly controlled, owned and strongly supported by the central government of China. The International Board may also be a good opportunity for Red Chip Companies listed on the HKEX proposing to return the China's stock market for secondary listing. Wang Jianzhou, chairman of China Mobile, has expressed his interests in listing on the International Board for many times. It is reported that China Mobile has engaged sponsors and underwriters to prepare the application documents for the secondary listing on the International Board.

Interestingly, there are certain conflicts between SSE and central government in connection with the potential listing candidates. In order to expand the scope of the potential candidates, enhance the prosperity of SSE and further make Shanghai an international financial hub, the International Board has been deemed as the stock market for return of the Red Chip Companies by the local government in Shanghai and SSE. On the contrary, the central government does not want to cause the Red Chip Companies to be the main body of the International Board. According to the central government, the International Board shall play a more important role, saying that the International Board shall become the global platform for high quality companies all over the world as the NYSE or other successful stock exchanges.

**Direction of capital flows**

Even if the regulators have addressed the foregoing problems and clarified the issues regarding the possible listing vehicles and potential listing candidates, it still faces obstacles in connection with the foreign exchange because Chinese currency, i.e. RMB, is not freely and fully convertible. In China, currencies conversion is heavily regulated according to the rules and regulations issued by the State Administration of Foreign Exchange (hereinafter referred to as "SAFE"). The crucial issue is whether the capital raised by the foreign registered companies from the International Board can be converted into foreign currencies and taken out of China.

Under current legal system regarding foreign exchange, there is no room for foreign companies to convert capital raised in China's stock market into foreign currencies. Upon the State Council and CSRC launch the International Board, it is predicted that SAFE may issue implementing rules to permit a range of capital raised by the foreign registered companies from the issuance of the IPO or CDR on the International Board to be taken out of China. To the extent permitted by the applicable rules and regulations, the foreign registered companies listed on the International Broad may have the right to carry out the cross-border capital transactions in future.

Certain Chinese analysts also express their concerns on the International Board which may become the "international ATM" of Multinational Listed Companies because share valuation tends to be higher on the China's stock market than in other stock market around the world. However, many officials from CSRC and SSE deny such allegations, claiming that cross-border capital transactions will be subject to heavy regulation to prevent any wrongdoing. At present, A-share and H-share cannot be converted into each other under the current circumstances that RMB still remains unconvertible.

**Conclusion**

The proposed International Broad will have a substantial impact on the Chinese capital market participants. First of all, dozens of Chinese companies having shares listed on the HKEX, the Nasdaq Stock Market or the NYSE may have the opportunity to return Chinese capital market for separate and secondary listing on the International Board. Secondly, the International Board will improve the quality of listings in the Chinese capital market and enable Chinese investors to purchase shares of the famous companies around the world or the red-chip companies listed overseas. In addition, the launch of the International Board may further spur the best-known investment banks to expand their presence in mainland China in order to look for potential clients. Finally, introduction of the International Board and the listing of the overseas companies in China may also improve the corporate governance of the domestic listed companies.

There is still a long way to go for the International Broad to be officially launched and finalized. The International Broad may help multinational companies integrate themselves with China’s economic development. It can be foreseen that the competition among the potential listing candidates will be fierce and prolonging. It is advisable for the potential listing candidates to keep a close relationship with the regulators in charge of the launch of the proposed International Broad.