Shanghai’s International Board

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In August 2009, Chinese officials, for the first time, released the timeline for the formal debut of the International Board of the Shanghai Stock Exchange (“International Board” of “SSE”). Since then, much attention has been focused on the specifics of the International Board. The promotion of the International Board is a significant step in China’s capital market development. Its successful implementation will help to make China a more favorable investment destination, and make China’s capital market more competitive and attractive. The promotion of the International Board, was officially and publicly announced by China’s State Council in the Opinions on Promoting Shanghai to Two Centers 1 (Guo Fa No. 200919) and was listed as one of the seven most important working assignments of the China Securities Regulatory Committee (“CSRC”). Many foreign companies have expressed interest in being listed on the International Board of the SSE including the New York Stock Exchange, HSBC Holdings, Hang Seng Bank, Reuters, Volkswagen, Mercedes-Benz, Coca-Cola, and Siemens. 2 Despite the enthusiasm for the debut of the International Board, the regulations that will control listings on the board and more detailed official documents have not been issued.

Relevant legal documents relating to the International Board have not been published nor has there been any specific timeline for their release. It was not until early May 2010 that Mr. Xu, Vice President of the Shanghai Financial Affairs Office, disclosed through the Shanghai municipal government press release that the International Board was likely to be put into effect by the end of this year. According to Mr. Xu, the SSE is busy designing the rules of the International Board and the CSRC is discussing the listing regulations and approval procedures of Initial Public Offerings on the International Board. Once the relevant rules are finalized, the International Board will be up and running. On April 13, 2010, the State Council issued Several Opinions on the Further Improvement of Foreign Investment Utilization (“Opinions”). Article 15 of the Opinions offers insight into how foreign companies will be able to list on the board by stating that the board will “[s]upport qualified foreign invested enterprises to offer shares publically, [and] enterprise bonds and mid-term notes domestically to expand the finance channels.” Some investment bankers see this as initial support from the Central Government for foreign listings on the International Board. Interestingly, in Article 15, those defined as “foreign invested enterprises” under this rule are not qualified to list on the

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1 Financial Center and Shipping Center

2 http://news.enfol.com/100210/101,1591,7251067,00.shtml
International Board. Those registered as “foreign registered enterprises” are qualified to be listed on the International Board. “Foreign invested enterprises” under the Opinions are those defined by the State Council as onshore registered wholly foreign-owned enterprises or registered joint ventures. For these “foreign invested enterprises,” the door for them to be listed on SSE was opened long ago, but not on the International Board of the SSE.

International Board in a nutshell

What is the “International Board”?

The International Board will allow enterprises that are registered outside of China to apply to be listed on the Shanghai Stock Exchange.

Who will likely be the “candidates” for the “International Board”?

“Red Chip” companies—“Red Chip” companies usually refers to large state-owned enterprises, that are already listed on overseas stock exchanges (in particular, the Hong Kong Stock Exchange or “HKEX”), and with strong government support. Most of these companies are very profitable and are directly controlled by the PRC government.

Multinational listed companies—Multinational listed companies may apply one of the following approaches to get listed on the International Board: 1) secondary public offering, 2) China depository receipts, or 3) cross-border exchange-traded fund.

What will the establishment of the International Board mean for Chinese companies?

The Shanghai government used the local media to interpret the International Board as a platform for the return of red-chip companies to China. The local government hopes that this will help to avoid certain obstacles for the International Board and to increase public support. Under a conventional private equity model, domestic Chinese founders and offshore fund investors would set up an offshore holding company, which would take over the domestic Chinese assets through a so-called round trip investment, and then get listed on an international capital market on a consolidated basis. This process is known as “red chip” listing. Due to historic reasons, many of the larger, well-established, state-owned enterprises, including China Mobile and China National Petroleum Corporation listed through this approach. According to Shanghai Stock Exchange statistics, at present there are 407 red-chip corporations being listed on offshore stock exchanges, among which, only 38 meet the proposed International Board listing qualifications. SSE has filed the suggestion to the central government to lower the qualifications for red-chip companies. If the standards are lowered, it is estimated that around 120 companies will be qualified to be listed on the International Board.

Contrary to the Shanghai local government plans, the central government does not share the same views that red-chip corporations should constitute the main part of the International Board. The central government rejected the idea of lowering the standards for red-chip listing. As planned by the central government, the key initiative and ultimate goal of the International Board is to turn the SSE into a global platform for introducing high quality corporations.
Chinese regulators expect the proposed International Board to be governed by Chinese securities regulations that match international standards. By attracting profitable companies from across the world to be listed on the SSE, Chinese investors will be able to share the dividends derived from foreign listed companies and to expedite the internationalization process of the RMB.

Challenges to the International Board

**Foreign Exchange: Renminbi not fully convertible**—The International Board shall be designed in conjunction with the internationalization of the Renminbi (RMB) in order for enterprises who have established businesses in China and other foreign companies to be listed on PRC stock exchanges. A foreseeable challenge will be to cross-border exchange-traded funds, China depository receipts, and foreign enterprise secondary offerings because they are all restricted by the PRC foreign exchange control.

**Coordinating the relationship with the Hong Kong Stock Exchange**—Presently the Renminbi is unconvertible and is limited by the A-share market, therefore international investors make investments in China through Hong Kong. The delay of the implementation of the International Board is due to the difficulties of coordinating the relationship with the Hong Kong Stock Exchange. The International Board will make Shanghai a financial center for foreign investment. Hong Kong, which now relies heavily on mainland investments, is likely to feel threatened. It is without a doubt that the HKEX is on the same playing field as the more mature European and U.S. stock exchanges with regards to its market capitalization and constituency of investors. The most attractive selling point for HKEX is the high-speed economic development of mainland China.

**Coordinating with the International Securities Exchange and Accounting Systems**—Since the RMB is unconvertible, a challenge will be how to design and coordinate the offering and exchange systems of the International Board and how to coordinate domestic accounting systems with international standards.

Conclusion

The International Board has great potential but there is still a long way to go before it is officially promoted and finalized. In the short-term, except for those enterprises mentioned above, the direct influence of the International Board on the broader scope of Chinese enterprises seems to be limited. Currently, the situation is such that there are still quite a few domestic Chinese enterprises queuing for the examination of the listing committee. These should be taken into consideration while considering listing on A-share stock exchanges. The International Board can make a significant impact on China’s securities market and deserves attention from market participants.

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