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CSRC Scraps Quantitative Thresholds for Offshore Listings by PRC Companies and Paves the Way for Direct Overseas Listings by Private SMEs

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China Securities Regulatory Commission ("CSRC"), the securities regulator of the People's Republic China (the "PRC" or "China"), has scrapped quantitative threshold requirements for Chinese companies applying for offshore listings by promulgating new guidelines on December 20, 2012 (the "2012 Guidelines")[1]. The 2012 Guidelines became effective as of January 1, 2013.

Under Chinese securities laws[2], CSRC is the authorized regulatory authority to approve all offshore listings by PRC incorporated companies. In the past, CSRC had exercised tight control over offshore listing applications and applied relatively onerous qualifications as set out in its July, 1999 circular (the "1999 Circular")[3]. Under the 1999 Circular, a PRC incorporated company seeking to list offshore was required to have net assets of not less than RMB400 million (approximately US$63.6 million), net profit of not less than RMB60 million (approximately US$9.6 million) for the most recent year and a fundraising size of not less than US$50 million based on a reasonably expected price/earnings ratio, in addition to *satisfying* other requirements. These quantitative requirements were stricter than the listing requirements of many of the offshore stock exchanges Chinese companies typically sought listings on. For example, the main board of The Stock Exchange of Hong Kong Limited (the "SEHK"), which has been the most popular venue for Chinese companies seeking to list offshore[4], requires only net profit of HK$20 million (approximately US$2.6 million) for the most recent year and an aggregate net profit of HK$30 million (approximately US$3.9 million) for the prior two years under the profit test and even these lower profits thresholds do not apply if the company seeking to list can satisfy either the alternative market capitalization/revenue or market capitalization/cash flow test. SEHK, like many other international stock exchanges, imposes no requirements as to asset size. Due to the relatively onerous requirements of the 1999 Circular, most of the Chinese companies listed on the main board of the SEHK (often referred to as H-share Companies) are asset-heavy State-owned enterprises, with relatively high profits and large fundraising size; and most privately owned Chinese companies, which are typically small or medium-sized enterprises ("SMEs"), are either listed on China's domestic stock exchanges in Shanghai or Shenzhen, or listed overseas by adopting the so called "small red-chip" structure, in which an offshore holding company is set up to hold the Chinese operations and assets acquired by it, and the listing entities are the offshore holding companies rather than the PRC incorporated operating companies[5]. Following promulgation of the

[1] *Guidelines on Submission of Documents and Review Procedures for Joint Stock Companies Seeking Offshore Listings* (关于股份有限公司境外发行股票和上市申报文件及审核程序的监管指引)

[2] Article 10 of the *Securities Law* (证券法) and Article 5 of the *Special Provisions of the State Council Concerning Overseas Offerings and Listings by Joint Stock Companies* (国务院关于股份有限公司境外募集股份及上市的特别规定)

[3] *Circular on Questions relating to Offshore Listings by Enterprises* (关于企业申请境外上市有关问题的通知)

[4] According to data released by the SEHK, as of the end of November 2012, there were a total of 172 H-share Companies listed on the main board and Growth Enterprise Market ("GEM") of SEHK.

[5] For tax and other reasons, the "small red-chip" holding companies are usually incorporated in the Cayman Islands, and they sometimes have a VIE structure to comply with the restriction on foreign investment into certain restricted industries in the PRC.

Rules Regarding the Acquisition of Domestic Enterprises by Foreign Investors (关于外国投资者并购境内企业的规定) by MOFCOM and a number of other regulatory authorities (the "Circular 10")[6] in 2006, implementing the "small red-chip" structure has become costly, time-consuming and, in some cases, difficult or impossible.

Market conditions and the demand for listing by Chinese companies have changed significantly since 1999. It is reported that more than 800 Chinese companies are currently seeking approval from CSRC to be listed on the Shanghai or Shenzhen stock exchange, and most of these are privately-owned SMEs. Most market commentators agree that China's domestic exchanges cannot support such a large number of applications in a short period of time. Against this backdrop, CSRC policy towards overseas offerings by Chinese companies is gradually shifting from one of that seeks to control and limit such listings to one that promotes and encourages them.

The 2012 Guidelines completely scrap the assets/profit/fundraising size requirements provided for in the 1999 Circular. They require instead that Chinese companies seeking to list offshore prove to CSRC that they meet the listing requirements of the relevant offshore stock exchange, a regulatory shift that has been very well received in the market.

Certain other steps taken by CSRC under the 2012 Guidelines are also welcomed by the market. For example, the 2012 Guidelines simplify application procedures for Chinese companies seeking an offshore listing by eliminating the requirement to obtain approval from the provincial government where the company is located before applying to CSRC and make it clear that a company can apply directly to CSRC without the involvement of local government.

The 2012 Guidelines are expected to provide Chinese SMEs with an alternative to a domestic IPO as well as to help ease the backlog of public offer applications faced by CSRC. If CSRC officials can implement the 2012 Guidelines in an open minded way and leave stock offerings more subject to market forces and less to the discretion of officials in Beijing, then the 2012 Guidelines should also help to promote more H-share listings on the SEHK, and thereby help restore Hong Kong's booming stock market.

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[6] Please refer to our client alert entitled *Amended China M&A Rules Alter the Landscape of Offshore-Onshore Restructurings in China*, which is available at www.mofo.com, for more details.