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The Regression of Chinese Stocks Listed in the U.S.

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Abstract: The United States is an important place for Chinese companies to list overseas. In recent years, the US has continuously strengthened regulatory policies involving Chinese companies, leading to the delisting pressure of most Chinese companies. At the same time, increased volatility in Chinese equity prices has had a clear contagion effect on the Hong Kong and mainland markets. In this context, Chinese companies not only need to explore new financing channels, but also need to consolidate the corporate governance mechanism according to international rules, strengthen coordination and communication with cross-border financial regulation, and maintain the two-way opening of the capital market.

1. Introduction

The United States is an important market for Chinese companies to list overseas. Since 2020, relevant agencies in the United States have successively launched a list of transaction restrictions and sanctions in the name of national security [1]. By the end of 2021, the number of sanctioned entities in the List of "Non-SDN Chinese Military-Industrial Complex Companies List" has increased to 67. According to the Holding Foreign Companies Accountable Act (HFCAA) passed in December 2020, if the Public Company Accounting Oversight Board (PCAOB) is unable to inspect foreign-controlled accounting firms hired by U.S. -listed companies, such issuers will be required to provide evidence that the company is not controlled by a foreign government, as well as audit papers. In March 2021, the final amendment to the Holding Foreign Companies Accountable Act stipulated that Chinese companies would face forced delisting if they failed to submit financial documents for three consecutive years [1]. Most Chinese companies listed in the US use variable interest entity (VIE) structure, which is also seen by the market as a potential regulatory risk. In August 2021, the US Securities and Exchange Commission announced that it would stop mainland Chinese companies from conducting initial public offerings in the US through the VIE structure. In the future, the regulation of VIE structure in the United States is likely to be further increased to the level of regulatory policy constraints.

So far, there are about 250 Chinese companies listed in the US, and 139 Chinese companies have been placed on the SEC's ‘pre-delisted’ list. Chinese concept shares are under pressure to return back.

2. Institutional Optimization for Chinese Concept Shares: A-Share and H-share Have Issued a Series of Policies

In recent years, both A-share and H-share have implemented a series of institutional reforms, adjusting the listing mechanism, providing diversified listing channels, and allowing unprofitable, one share but different vote, Red-chip Architecture, issuance of depositary receipts, etc., creating more friendly conditions for the return of Chinese concept shares.

Table 1: The listing policies of A-share and H-share [4]

	A-share	Dual listing of H-share	Secondary listing of H-share
Time to market	Mainboard: The approval time is about 9 months STAR Market: 4 months from the acceptance of the application to the effective registration	3 months from submission of application to listing	Same process, faster time
Disclosure documents	There is no mutual recognition of Chinese and American laws and documents	Financial reports required to comply with HKEX accounting standards	Financial statements that can be prepared directly using American accounting standards
Weighted voting rights	The Main-Board Market does not allow it, but the STAR Market and Second-board Market are allowed after meeting a certain market value. Companies with weighted voting rights in Beijing stock exchange needs to run smoothly for at least one full accounting year.	Allow. The market value requirement must be met.	
Unprofitable	The Main-Board Market does not allow it, but the STAR Market and Beijing stock exchange allow unprofitable companies to appear on the market.	Allow. Should subject to market capitalization and working capital requirements.	
VIE structure	After receiving the application, the CSRC will solicit opinions from the competent industry departments under the State Council, the National Development and Reform Commission and the Ministry of Commerce where the domestic entity of the enterprise with Red-chip architecture actually conducts business.	Preserve the VIE architecture	The retention of the VIE structure indicates that the VIE structure complies with the laws, rules and regulations of China and the disclosure requirements in the listing decision of the Stock Exchange of Hong Kong.
Depositary receipts	Allow qualified enterprises with Red-chip architecture in high-tech or strategic emerging industries such as the Internet, artificial intelligence and biomedicine will be allowed to issue depositary receipts for listing.	Allow. The market value requirement must be met	
Market capitalization requirements	Secondary or dual listing requires company to have a market capitalisation of no less than RMB200bn; or market capitalisation of more than RMB20bn, and has independently developed international leading technology, strong scientific and innovation ability, and has relatively advantageous position in the industry competition.	Main-Board Market: Market capitalisation of no less than HK $500 million; meet one of the terms including earnings test, market value/revenue test, market value/revenue/cash flow test. Second-board Market: Market capitalisation of no less than HK $150 million.	Equal share with equal rights: Market capitalisation of at least HK $3 billion (good regulatory compliance record after 5 full fiscal years of listing) or more than HK $10 billion (regulatory compliance record after 2 full fiscal years of listing). Equal share with different rights: Innovative industry company with a market capitalisation of at least HK $40 billion, or company with a market capitalisation of at least HK $10 billion and audited revenue of at least HK $1 billion in the most recent fiscal year.
Case	Winner Medical	Beigene	Alibaba

Hong Kong has implemented measures in January 2022 to further facilitate secondary or primary listing of China-concept-shares in Hong Kong. For example, it relax the requirements for secondary listing in Hong Kong for Greater China issuers without different voting rights structures, remove the condition of belonging to an innovative industry and reducing the market capitalisation requirement. Moreover, a secondary listed issuer is deemed to be primarily listed in Hong Kong if it is delisted in overseas markets; Exempted Greater China issuers with different voting rights or variable interest entity structures may apply directly for a dual primary listing if they meet the secondary listing requirements [2]. The above measures will facilitate the return of high-quality 'Chinese concept shares' to Hong Kong to meet the financing needs of mainland enterprises.

China's mainland market has also introduced a series of policies to optimize the system. On the one hand, with the continuous deepening of the A-share registration system reform, some listing conditions have also been relaxed. In March 2018, the China Securities Regulatory Commission (CSRC) issued 'A number of opinions on the pilot of domestic issuance of shares or depositary Receipts by innovative enterprises', which proposed solutions for financing of unprofitable companies, companies with different rights to the same share, and companies with Red-chip Architecture [2]. In April 2020, the China Securities Regulatory Commission issued 'The Announcement on Innovative Pilot Arrangements for the Domestic Listing of Enterprises with Red-chip Architecture, which lower the threshold for the return of Chinese concept shares with Red-chip Architecture to A shares market. Also, the registration based approval system will be extended to the main board of the Shenzhen Stock Exchange and the SME Board. In addition, the Beijing Stock Exchange has also introduced a system to encourage small and medium-sized enterprises to go public, allowing enterprises with different rights in the same share, non-profitable enterprises to go public [3]. It provides the possibility for the return of 'specialized, refined, distinctive and new' Chinese concept companies with small market value. Table 1 compares the listing policies of A-shares and H-shares.

3. The Return of Chinese Concept Shares to Hong Kong: Going Well

Compared to A-share Market, currently it is more convenient for Chinese concept share to return to H-share market. Hong Kong has optimised financial reporting and disclosure requirements for Chinese concept shares listed back in Hong Kong, allowed companies to have Weighted Voting Rights (WVR), and allowed companies to retain VIE structures. If the company is listed in a way of Secondary Listing, it can directly adopt the financial statements prepared by the accounting standards of the United States, and there is no need to re-prepare the financial statements according to the accounting standards of Hong Kong or international standards [4]. In addition, H-share market has a lower market capitalization threshold for listed companies than A-share Market. For companies with Red-chip Architecture, the market capitalization requirement for secondary listing in A-share Market is higher than H-share market. For secondary listing in H-share market, the market capitalization should be no less than HK $40 billion, or the market capitalization is no less than HK $10 billion and the revenue is no less than HK $1 billion. In addition, the listing process in Hong Kong and the US is more consistent and the international investor base is well laid out in Hong Kong.

As shown in Table 2, at present, many companies have returned to H-share market through dual listing and secondary listing, and the demand for dual main listing has increased. The main ways to be listed in Hong Kong are secondary listing and dual primary listing. So far, 20 chinese concept issuers have returned to Hong Kong through secondary or dual primary listings, with a total market capitalisation of HK $5.4 trillion, taking up 77 per cent of all Chinese concept issuers. Among them, most of the grandfathered companies choose the second listing in H-share market first, and then turn to the primary listing. Non-grandfathered companies are more flexible in listing options, with some opting for dual listing or secondary listing, and a third of them preparing for the green channel of listing in Hong Kong.

Table 2: Dual primary listing and second listing in H-share market

	2018	2019	2020	2021	2022
Dual primary listing	Beigene raised HK $7.1 billion	—	—	—	Have raised HK $800 million. And there are 11 other companies leaning towards dual primary listings.
Second listing	—	Have raised HK $101.2 billion	Have raised HK $131.3 billion	Have raised HK $66.5 billion	Several companies with a market capitalisation of HK $40bn are preparing for second listings

Due to the faster process, low cost, simple subsequent disclosure requirements, and exemptions for WVR or VIE structure, more companies raise capital through secondary listing. However, dual listing is more inclusive for the Shanghai-Hong Kong Stock Connect Program (Currently, companies using secondary listings cannot be included in the scope of Shanghai-Hong Kong Stock Connect Program). In addition, if Chinese companies are forced to delist in the United States market, the listing status of secondary listed companies may be affected. In order to hedge the delisting risk in the United States, more and more companies plan to raise capital through dual primary listing in Hong Kong.

Bilibili, for example, announced plans in March 2022 to convert its secondary listing status in Hong Kong into a dual primary listing statuswhile retaining its listing status in Nasdaq Global Select Market. Bilibili could be included in the Shanghai-Hong Kong Stock Connect program on the date of the switch, based on communications with mainland regulators. With Bilibili as a guide, a number of issuers have also embarked on this quest. However, some issuers also need to consider whether the primary listing requirements can be met. For example, in order to get primary listings status in Hong Kong, companies need to adjust the WVR/VIE structure [5], obtain licenses from mainland regulators, make information disclosure and revoke exemptions (provisions on executive compensation and shareholder voting rights, etc.), continuous related-party transaction requirements applicable to contractual arrangements, reconciliation between US accounting standards and IFRS, etc.

Some issuers are continuing to convert ADRs into Hong Kong ordinary shares. Currently, the delisting risk of ADRs is also a key factor for investors and issuers to shift liquidity to Hong Kong [6]. A number of companies have already accelerated the conversion of ADRs, notably JD.com and Alibaba, with the proportion of freely traded shares in Hong Kong grown up 44% and 39% compared to the number on the IPO day. This is shown in Table 3.

Table 3: Issuers continuously switch ADRs to ordinary shares in Hong Kong

Stock Name	Market value (HK $billion)	Listing Date in Hong Kong	The proportion of freely traded shares in Hong Kong* (IPO day)	The proportion of freely traded shares in Hong Kong(March 2022)
JD.com	730	18/06/2020	5.0%	49.0%
Alibaba	2431	26/11/2019	2.7%	41.3%
Netease	482	11/06/2020	5.8%	33.0%
Bilibili	84	29/03/2021	7.5%	24.5%
GDS	61	21/10/2020	10.9%	21.5%

*The shares freely traded in Hong Kong/Globally issued shares

According to the market value, it can be seen that most of the Chinese concept shares can be accepted by the Hong Kong capital market. CICC forecasts that the average scale of newly returned Chinese concept companies is HK $29 billion over the next three years. This value is equivalent to 9% of the annual IPO financing volume of H-share market in 2021, so the H-share market does not have too much pressure to undertake returned Chinese concept companies. Some companies (15% of total market capitalization) have not yet met the requirements for secondary listing, such as the market capitalization requirements for secondary listing, the differential voting rights of the company, etc., which can be undertaken after some changes. Hong Kong may also further optimize the listing requirements. There may be some small and weak companies that are not expected to return to the mainland or Hong Kong capital markets. They can only choose to go private if delisting in the United States [6].

4. Hedge the Risk of Capital Decoupling Between China and the United States, Open China's Capital Market to the Outside World at a Higher Level

Based on the objective needs of Chinese enterprises for global financing, even in the face of a potential conflict, Chinese enterprises still need to grasp the opportunities in American capital market, to further explore the mechanism for opening the capital market to the outside world, at the same time grasp the advantages of Hong Kong as an international financial centre, connecting the mainland and overseas capital market.

First, it is important to actively negotiate and communicate with the US to keep the channels for overseas listing open. At present, China's capital market is not fully opened to the outside world, and foreign funds mainly circulate through the Hong Kong market. The United States, the United Kingdom and Hong Kong are the three major sources of investors in the H-share market, accounting for 72% of the total holdings in Hong Kong. Among them, American investors account for 39%, making them the largest group of shareholders. China has yet to wean itself off the US in areas such as high-end manufacturing. Since 2020, the number of Chinese companies listed in the US capital market and the amount of financing have maintained rapid growth. China still needs to tap the world's largest capital market to develop new economy businesses, so taking steps to circumvent the risks posed by US sanctions is necessary. Continuing to strengthen ties with the US market and nurture startups with the US capital market is still important. On the other hand, Chinese concept companies have many overseas investors as shareholders, and their listing in the US is easier for investors to exit. Delisting could also force some foreign investors to sell down their holdings. A complete decoupling of China from the United States would have an negative impact on China's industrial upgrading and external cooperation. Therefore, it is still necessary to continue to support domestic enterprises to go public in the US, and to strengthen communication with the US regulatory agencies, and actively coordinate the policy on audit. As far as possible, we should maintain financial ties to avoid decoupling and achieve win-win cooperation between China and US [7].

Second, China should cooperate with overseas securities regulators on cross-border audit supervision to properly address regulatory differences [7]. The SFC has been in advanced talks with the PCAOB to address market concerns about a negative outcome for Chinese concept stocks. On March 16, The State Council says that regulators of China and US have maintained good communication and made positive progress, and are working on concrete cooperation plans. The Chinese government continues to support all types of companies to list overseas. The secrecy rules recently issued by the CSRC also provide the possibility for the follow-up cooperation between China and the United States on audit supervision. At the same time, the Chinese regulator says it will prudently promote and complete the rectification work of large platform companies as soon as possible [8].

Third, it is necessary to promote financing arrangements in overseas capital markets through multiple channels and establish a sound regulatory mechanism [9]. Chinese government can encourage domestic enterprises to raise funds through the Shanghai-London Stock Connect program and Global Depositary Receipt (GDR) channels, and promote China Depositary Receipt (CDR) overseas so that foreign investors can invest in mainland-listed enterprises. At the same time, it is necessary to actively expand London, Singapore and other overseas markets, accelerate the enterprise's global layout, to meet the financing needs of the real economy [10].

Fourth, the risks brought by VIE architecture should be properly addressed. At the end of 2021, the ‘Measures for the Management of Overseas Securities Issuance and Listing of Domestic Enterprises (Draft)’ was issued, which clarified that on the premise of complying with domestic laws and regulations, enterprises with VIE structure can go public overseas after filing if they meet the compliance requirements [11]. Currently the policy about the overseas listing of enterprises with VIE structure remains to be further verification in practice. The CSRC shall further consummate the share with VIE in the framework of information disclosure mechanism, then guide the relevant enterprises to timely disclose possible financial impact of regulators attitude adjustment, profits shift and taxes arrangement, protocol control and equity control, etc.. Due to the uncertainty of external regulation, arrangements for the VIE structure can be actively negotiated with overseas regulators [12].

Fifth, Hong Kong should give full play to its advantages as an international financial center and global financing platform. Hong Kong should make institutional optimization and preparations for the return of Chinese concept shares, and at the same time give full play to Hong Kong's unique advantages in connecting Chinese mainland and the world market, attracting more international investors to Hong Kong [13].

In the current global economic and political environment, The risk faced by Chinese concept shares poses a challenge to China to continue bilateral opening of capital market. Therefore, the return of Chinese concept shares should be properly handled to avoid the negative impact of the concentrated return of Chinese concept shares on the H-share market and the mainland market. It should also avoid the depreciation pressure on the Renminbi [14].

5. Conclusion

This paper summarizes the current situation and possible ways of the return pressure of Chinese concept stocks under the Sino-US trade friction. This paper puts forward the following suggestions, based on the principle that the regression of Chinese concept shares should be needed and well-selected, the reasonable regression of high-quality Chinese concept shares should be supported. On the one hand, China should try to retain the listing channel in the US capital market. On the other hand, China can turn eyes to the global market and actively expand new financing channels, in order to hedge the risk of friction between the Chinese and US capital markets, and promote the positive interaction between the internal and external circulation of financial resources.[15]The weakness of this paper is that it does not analyze the specific cases of Chinese concept shares regression. In the next step, this paper will try to analyze the specific cases of Chinese concept shares regression and summarize the characteristics of Chinese concept shares suitable for this treatment.

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