CHINA/US: New foreign IPO rules improve the outlook for US listings to resume

- Draft rules from China's securities regulator suggest that Beijing will continue to permit some foreign stock-market listings and that most already-listed companies will not be forced to de-list.
- But the rules grant regulators broad discretion to block foreign initial public offerings (IPOs) for a variety of reasons, including national security and data security.
- Separately, new guidance from the US Securities and Exchange Commission (SEC) paves the way for the agency to resume processing of IPO filings from Chinese companies, following a pause.

Penalties imposed on Didi Global in July following the company's New York IPO raised the prospect that Beijing intended to ban foreign listings entirely. Similarly, Didi's decision in December, under regulatory pressure, to de-list in New York and re-list in Hong Kong raised fears of other forced de-listings by Chinese companies. But draft rules published on 23 December by the China Securities Regulatory Commission (CSRC) appear to confirm our forecast that Beijing will continue to permit at least some foreign listings, albeit with greater oversight and new restrictions.

Our previous analysis also noted that foreign IPOs by Chinese companies would not resume until Chinese regulators provided clarity over the legality of variable-interest entities (VIEs). That clarity has now arrived. The official text of the CSRC draft rules does not address VIEs, but in an accompanying statement, the agency said that companies using the VIE structure are eligible to list abroad if they complete the filing process and are "complying with domestic laws and regulations."

IPOs: new restrictions but no ban

The CSRC's proposed rules, which are open for public comment until 23 January, establish a filing requirement for companies intending to list overseas; empower CSRC to ban an overseas IPO if the listing would threaten national security; and require that potential foreign IPO companies comply with existing rules on foreign investment, cybersecurity, and data security. In addition, the rules require foreign investment banks that underwrite IPOs on foreign exchanges to register with CSRC, which could subject these underwriters to as-yet-unspecified new compliance requirements.

Even as the proposed rules explicitly authorize foreign IPOs, the abovementioned provisions are vague, granting various regulatory agencies – not just CSRC – broad discretion to block such listings for various reasons. As a result, significant uncertainty remains about how the new regime will operate in practice and how many companies will successfully navigate the new filing requirement.

Our previous analysis noted the CSRC's earlier comments expressing continued support for foreign listings, despite the Didi fiasco, but we also noted the possibility that other agencies were less supportive. In Didi's case, CSRC reportedly supported the company's IPO, but the Cybersecurity Administration of China (CAC) objected. CSRC led the drafting process for the proposed rules, but importantly, the agency said the draft was formulated through an interagency process involving other "relevant departments" under the State Council, China's cabinet. This joint process suggests that at least in principle, non-CSRC agencies remain willing to permit foreign listings.

Still, CAC will likely play an important role in approving or rejecting foreign IPOs. As previously discussed, Beijing has greatly expanded its data security regime in recent years, including through two laws enacted last year, the Personal Information Protection Law and the Data Security Law, as well as new regulations under the 2017 Cybersecurity Law. Following the Didi fiasco, CAC also issued new rules requiring that companies holding data on more than 1mn users must undergo a security review before listing abroad. This requirement is separate from the CSRC filing process.

The Commerce Ministry and the National Development and Reform Commission (NDRC) will also play key roles. Those two agencies compile the annual foreign investment "negative list," which specifies industry sectors where foreign investment is restricted or banned. The latest annual version of the negative list, published on 27 December, contains a new provision specifying that companies listing abroad need special permission from regulators if the IPO will result in breaches of the negative list's limits on foreign investment. It adds that foreign listings should be subject to the same caps on foreign ownership that apply on mainland stock exchanges – 10% for any single foreign investor and 30% combined for all foreign investors.

De-listings unlikely

The CSRC also indicated that most existing overseas-listed Chinese companies will not share Didi's fate by being forced to de-list. CSRC said it will follow the "grandfathering principle" as it implements the new filing requirements and that companies already listed abroad "will be allowed sufficient transition period to complete their filing procedures." The agency also notes that the new filing requirement will not apply to follow-on share offerings.

As previously discussed, the bigger risk to New York-listed Chinese companies is the US Holding Foreign Companies Accountable Act (HFCA) and implementing regulations from the SEC. This law will require almost all Chinese companies to de-list in 2024 unless Washington and Beijing reach an agreement that enables Chinese companies to make the audit disclosures that this law requires.

Resumption of US IPOs?

Separate from the HFCA, however, other recent SEC actions raise the prospect that US IPOs by Chinese companies could resume this year. On 20 December, the SEC issued new guidance describing 15 areas where the agency "encourages" existing and future China-based listings to increase disclosures. In response to pressure from Congress, the SEC last year suspended processing of new IPO filings from China-based companies and promised to force increased disclosures about risks to investors related to state ownership, Chinese government interference, the VIE structure, and other issues.

With the SEC's increased disclosure guidance apparently complete, the agency may soon resume processing IPO filings from China, after suspending such processing in July. Moreover, recent precedent suggests that Chinese companies remain interested in New York IPOs, despite the threat of eventual de-listing under the HFCA. Before the Didi fiasco, some 31 Chinese companies listed in New York in 2021, even though HFCA was already enacted.

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Gabriel Wildau
Managing Director
+1 (347) 714-4962
gabriel.wildau@teneo.com