CSRC Publishes Final Rules for Overseas IPOs

On December 24, 2021, the China Securities Regulatory Commission (CSRC) published draft rules for the regulation of overseas offering and listing by Chinese companies for public consultation. The draft rules included two pieces of rules: the Management Regulations on Overseas Offering and Listing by Domestic Enterprises of the State Council, which provided for a general filing regulatory framework, and the Management Rules for the Filing Work of Overseas Offering and Listing by Domestic Enterprises of the CSRC, which set out more detailed terms and procedures of the filing requirements. After more than a year's anticipation and discussions, on February 17, 2023, the final rules are released. The final rules combine the above two pieces of rules into one regulation promulgated by the CSRC, and are supported by five interpretive guidelines. The final rules have retained the filing regulatory regime proposed by the consultation drafts and have included a number of welcomed changes in response to market feedbacks. The five interpretive guidelines, for which no consultation drafts were published, provide significant details on the regulatory requirements, on both substance and format, that the CSRC would apply to the filing procedure. As a coincidence (or not), February 17, 2023 also sees the publication of the final package of rules (a total of 165 pieces) that completes the registration-based system reform across all boards of the A share capital market, and is therefore destined to go down in history as a milestone day for the Chinese securities market. In this note, we attempt to set out an overview of the final rules on filing for overseas listings.

I. Establishing a unified filing system for all overseas listings by PRC-based companies

Consistent with the draft rules, the final rules cover both "direct" and "indirect" offering and listing overseas, and would apply to all overseas offering and listings by PRC-based companies, including:

a) overseas offering and listing by overseas companies controlled by PRC individuals with operations primarily in China, ie, the so called "***small red chip companies***";
b) overseas offering and listing by overseas companies controlled by PRC legal entities with operations primarily in China., ie, the so called "***big red chip companies***": offerings and listings by these companies have been subject to an ancient piece of rule published in 1997 (the so called "***97 Red Chip Guideline***") which requires provincial level approval and CSRC approval; the 97 Red Chip Guideline is to be repealed on March 31, 2023, the day when the final rules are to take effect; and
c) overseas offering and listing by PRC-incorporated companies, ie, the so called "***H share offerings***" (with "H" indicating Hong Kong, the primary market for such listings over the past two decades).

(a) and (b) above are referred to as "indirect" offering and listing while (c) is referred to as the "direct" offering and listing.

In the context of "indirect" offering and listing, only when the issuer reaches the prescribed ratio of "China constitutes" will it be subject to the regulation. During the consultation period, the definition of "China constitutes" was naturally a focus of market discussions, and the CSRC has responded to market comments and provided helpful clarification in the final rules. According to the final rules, a company that satisfies BOTH of the following would be captured by the filing requirement:

a) where the contribution by domestic entities to revenue, total profit, total asset or net asset (any one of the four) of the past accounting year exceeds 50%; and
b) the principle elements of operations are conducted within or the main places of operations are within the PRC, OR the majority of senior management are PRC citizens or reside regularly in China.

Overall, the filing rules represent a step-up in regulation for small red chip companies, but a relaxation of regulation for big red chip companies and H share companies. Big red chip companies no longer need to obtain CSRC approval or provincial government approval. For H share companies, the final rules also brought about further reforms: the "full-circulation" of H shares, ie., the conversion of existing pre-IPO shares and listing them on the overseas market, no longer requires CSRC approval but just needs a filing; the mandatory provisions for articles of H share companies, which were promulgated in 1994 and have caused quite some headaches in implementation, are repealed, and companies are now referred to the Company Law and the Guidance for Articles of Association for Listed Companies, thereby becoming on par with A share companies; and companies are permitted to raise Renminbi in their overseas offerings.

II. Pre-requisites for overseas listing

Under the rules for A share IPOs, companies applying to offer and list in A share market are required to satisfy a series of offering pre-requisites in relation to their compliance, governance and etc., as well as financial standards prescribed by different boards that they choose to list on. In the context of overseas listing, the CSRC has relinquished substantially all these requirements, and has prescribed just a few negative requirements that would prevent a PRC-based company from listing overseas, all of which relate to matters that would have a fundamental impact on the order of the market and national policies. The financial standards are a complete matter of overseas laws of the place of listing. According to the final rules, companies that are not permitted to list overseas include:

a) where listing is specifically prohibited by laws, administrative regulations or relevant state requirements;
b) where there is a national security risk; the final rules clarified that the national security review procedure should be completed before application to offshore exchanges or regulators are submitted;

c) where the domestic companies, their controlling shareholders and actual controllers have committed economic criminal offences in the past 3 years;
d) where the domestic companies are being subject to investigation by judiciary bodies for suspected criminal offences and where no definitive conclusions are available yet; and
e) where there are material disputes over the title of the shares held by the controlling shareholder/actual controller. This is significantly narrower compared with the consultation draft which also required that there was no material dispute over main assets and core technologies.

In an applaudable gesture, the final rules do not include a "catch all" item that reserves further discretion for the regulator, which is a practice prevalent in Chinese regulations. In addition, one of the associated rules, Guideline No. 1, prescribes further detailed guidance on the interpretation of each of the five items above, injecting further transparency into the regulatory procedure.

Needless to say, as the PRC-based companies conduct their operations substantially within China, and are expected to circle back a large portion, if not all, of the proceeds raised back to China to fund their operations, they need to comply with PRC laws with respect to their operations, including without limitation laws and regulations on foreign investment restrictions, state owned assets, overseas investments, national security, foreign exchange, and etc. This has been re-affirmed as a general principle in the filing rules.

III. Filing procedures applicable to different types of transactions

The final rules clarified some perplexities surrounding different requirements for different types of transactions that existed in the consultation drafts. According to the final rules, for different transactions, the filing is to be initiated at different time as summarized in the table below:

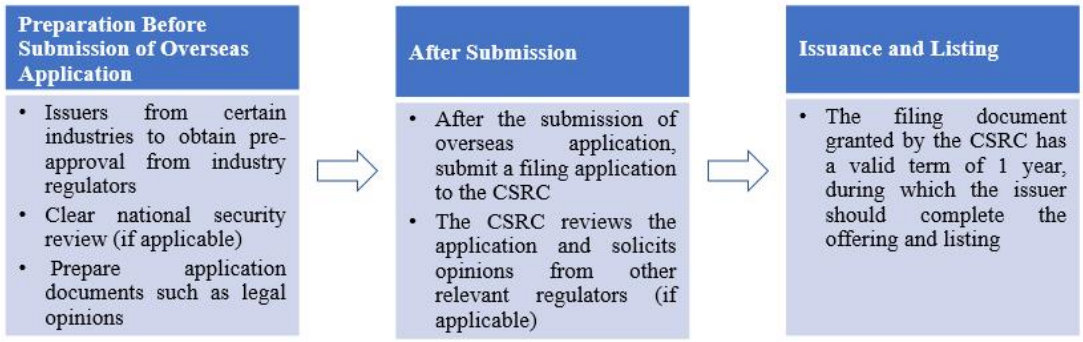
	Types of Transactions	Note on Application	Timing for Filing
1	Overseas initial public offering and listing	/	➢ 3 work days after submission of overseas IPO application
2	Follow-up offering on the market after overseas IPO	➢ Including issuances of convertible bonds, exchangeable bonds and preferred shares ➢ Excluding issuances of securities for the purpose of implementing stock incentives, conversion of reserved funds into share capital, distribution of bonus shares and share split	➢ 3 work days after completion of offering
3	Offering and listing on a different market after overseas IPO	➢ Including secondary listing and primary listing ➢ Switch of listing status (such as from	➢ 3 work days after submission of overseas IPO

	Types of Transactions	Note on Application	Timing for Filing
		secondary listing to dual primary listing) or switch of boards that does not involve an issuance of shares does not require a filing but requires submission of report 3 work days after the occurrence of the event and public announcement	application
4	The direct/indirect listing of domestic enterprise assets overseas achieved via one or more acquisitions, share swaps, transfers and other transaction arrangements	➢ Applicable scenario one: the overseas listed company falls within the scope of filing before transaction, and the transaction constitutes reverse merger/backdoor listing pursuant to the rules of the place of the listing ➢ Applicable scenario two: the overseas listed company does not fall within the scope of filing before the transaction but does after the transaction	➢ 3 work days after submission of overseas application ➢ Where no submission of overseas application is involved, 3 work days after first announcement of the detailed transaction arrangement
5	New overseas IPO after delisting from overseas stock exchange	➢ Delisting includes delisting and transferring to OTC market	➢ Depending on the methods of new overseas IPO

The filing rules also include mechanisms that bridge certain special overseas practices: with respect to shelf registrations, the final rules provide that the filing is to be conducted within 3 work days after completion of the first offering, while a summary report on the offerings is to be submitted after all remaining shares have been offered; and in connection with the practice of confidential filing permitted under the overseas regulatory framework, the final rules permit the issuers to apply for a defer of public disclosure.

The CSRC is to complete the filing review within 20 work days after it has received all application documents that satisfy the requirements, and the filing result will be made public on the CSRC website. Time needed for supplementing application documents and consultation with other regulators however does not count towards this time limit.

Working within the timeframe of overseas listing, we expect the CSRC filing procedure would work as follows:



IV. Detailed guidelines published

The final rules come with five guidelines, numbered 1 to 5, on the interpretation and application of the filing requirements and procedures.

Guideline No. 1 provides for interpretations on certain key issues, including the negative list conditions for overseas listing, application of the filing procedure to different types of transactions, circumstances under which qualified domestic investors may participate in overseas offerings, certain special requirements relating to backdoor listing or otherwise listing of domestic assets via restructurings, the definition of "control" and the ascertaining of controlling shareholders, and corporate governance requirements applicable to direct overseas listing companies.

Guideline No. 2 is the guidelines for the contents and formats of filing application documents. It further includes three appendixes, namely the list of application documents, a model for application report, and a guideline on the contents of the PRC legal opinion.

Guideline No. 3 is the guideline for the reports to be submitted after completion of the overseas IPOs or follow-up offerings and listings, covering reports re the result of offering and listing, reports on change of control, and reports of other material matters.

Guideline No. 4 is the guideline on filing communications, which sets forth a mechanism for the issuers and their intermediaries to communicate with the CSRC before and during the filing procedure. The CSRC will set up a filing management system whereby the issuers and their intermediaries may submit requests for communication and relevant materials. Communications can be done in writing, via telephone, video conference and on-site meetings. However, no communication can be had during the period between CSRC's receipt of applications and its first request for supplemental documents, which is defined as the "quiet period". Most helpfully, the guideline provides that matters such as industry regulatory policy and "control structure", which we believe relate to the VIE structure, and whether a particular issuer falls within the scope of filing regulation, both of which are topics where the market would need the most regulatory guidance, are matters that can be discussed by taking advantage of this communication mechanism.

Guideline No. 5 is the guideline for filing by overseas securities firms and includes a template of the filing form to be filled in by the overseas securities firms. The guideline clarifies that the initial filing, which is to be conducted within 10 work days after the signing of the first business engagement agreement, only needs to be filed once for each firm, and is not required for each project. The form also only requires information relating to the firm (focusing on penalties that the firm has been subject to overseas, responsible persons and a few other limited key information) but not project specific information.

V. Certain key issues and observations

a) VIE

Perhaps no topic has attracted more market attention than the VIE structure in relation to overseas listings by PRC-based companies. As a clever structure that has allowed many PRC companies to raise funds overseas, its legal status within China has always been in a "grey" area, with PRC regulators making no expressive objection or giving only implicit nodding of head at the most. Now that red chip offerings are to be officially subject to domestic regulation, the market has long worried that its legality may be wiped out in its entirety. In response to this, the CSRC, in its press release, reassured that the VIE structure will continue to be permitted, that the CSRC will continue to support companies to utilize domestic and overseas markets and resources for development, and that the CSRC will grant filings to companies which use VIE structure that comply with relevant requirements, after consulting other relevant regulators.

b) Provision of information overseas

On August 26, 2022, the US Public Company Accounting Oversight Board (PCAOB) signed a Statement of Protocol with the CSRC and the PRC Ministry of Finance, taking the first step toward opening access for the PCAOB to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong. Subsequently on December 15, 2022, the PCAOB announced that it was able, in 2022, to inspect and investigate completely issuer audit engagements of PCAOB-registered public accounting firms headquartered in mainland China and Hong Kong. This indicates that roadblock for PRC-based companies to continue offering shares and listing in the US market has been successfully removed after lengthy negotiations and discussions between the regulators of the two countries. PRC-based issuers however are still bound by PRC laws with respect to safeguard of state secrecy and protection of personal information and critical data. In April 2022, the CSRC, together with the Ministry of Finance, the State Secrecy Administration and the State Archives Administration published a consultation draft rule on "strengthening confidentiality and archives administration" in association with overseas listings, which sets out a detailed mechanism whereby sensitive information is to be protected during the overseas IPO process. It is worth noting when this piece of regulation is to be formally adopted.

c) Scrutiny over shareholders and shareholding structure

In A share market, shareholders, in particular controlling and major shareholders and shareholders who rush to invest shortly before IPOs, the overall shareholding structure and its stability and clarity have always been a focus of regulatory scrutiny. As shown by Guidelines No. 1-3, a significant part of this has now been carried over to the filing rules for overseas IPOs. Issuers are now required to define its controlling shareholders and actual controllers (unless under limited circumstances where the issuer can prove that its shareholding structure is so diverse that there is no controlling shareholder), who need to satisfy additional requirements and bear additional obligations; terms and circumstances of shareholders who "rush to invest", ie., invest within 12 months before IPO application, are to be further looked into and disclosed in the filing report; intermediaries are required to conduct a "look-through" exercise on major shareholders to trace up the shareholders at all levels up to the "ultimate" level such as SOEs and individuals; shareholding by entrustment is to be looked into to rule out potential non-compliances and disputes; and ESOPs adopted by issuers, including their participants, pricing, internal approval procedures and etc., are also to be looked into and specifically opined on by PRC counsels, whether they are implemented before or to be implemented after listing. Needless to say, all these will translate into additional workload, and issuers and their intermediaries should budget sufficient time for the work to be completed.

d) PRC lawyers to shoulder larger responsibility

In the A share market, securities firms acting as sponsors and underwriters bear overarching responsibilities in ensuring the quality of disclosure and the quality of listed companies. In the context of overseas listing, however, sponsors (if any) and underwriters are overseas securities firms qualified to practice in the place of listing, and even under the filing rules the CSRC only exercise limited supervision over them. While the underwriters are still held liable for the truthfulness, accuracy and completeness of the relevant documents, the responsibility of ensuring compliance with PRC laws and national policies naturally rests on the shoulders of the PRC lawyers. For example, a lot of the work in relation to the scrutiny over shareholders and shareholding structure as described would be conducted by the PRC lawyers. For another, in relation to the VIE structure, PRC lawyers are also expected to investigate into matters such as how the overseas investors participate in the operation of the issuer, whether there are rules prohibiting the use of VIE over particular business, license or qualifications, and whether the domestic entity is subject to foreign investment related national security review or falls within areas restricted or prohibited for foreign investments. In addition, a key application document to be submitted is a comprehensive PRC legal opinion covering the incorporation and history of the issuer (or the domestic subsidiaries in the case of an indirect overseas listing), its shareholders, business, material contracts and debts, investments and material assets, corporate governance, material litigations and penalties, and etc. The responsibilities and workload of PRC lawyers are therefore significantly increased.

VI. Transition arrangements

The final rules provide for considerate transition arrangements for ongoing projects, depending on the progress of the projects as of March 31, 2023, the date when the final rules are to take effect:

a) companies that have already completed overseas listing do not need to file until when they conduct a further follow-up offering;
b) companies that have already obtained consents from overseas regulators (such as passing the hearing in Hong Kong, or completed the registration in the US) are granted 6 months to complete the offering without having to file with the CSRC;
c) companies that have already submitted applications overseas but have not yet obtained the consent from overseas regulators are permitted to conduct its filing with the CSRC under a "reasonable arrangement" but in any event before the completion of the offering; and
d) companies that seek a direct overseas listing and have already obtained CSRC approval can continue to complete the filing within the valid term of the CSRC approval.

VII. Conclusion

The filing rules for overseas listings have been in the brewing for over a year, and the release of the final rules is much awaited and injects certainty into the market at a time when it is needed most. The rules represent a remarkable endeavor by the regulators to seek a balance between permitting Chinese companies to continue overseas listing and fundraising in a smooth manner, and the safeguarding of fundamental national interests and implementation of state policies. We expect that under the new rules Chinese companies will continue to leverage overseas capital market for their growth and development, and to further contribute to the prosperity of economy in China.

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