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BLOG

Potential Impacts of New Chinese Opinions for Overseas Listings

JULY 30, 2021

On July 6, 2021, the General Office of the Central Committee of the Communist Party of China and the General Office of the State Council of the People's Republic of China jointly issued "*Opinions on Strictly Cracking Down on Illegal Securities Activities in accordance with the Law*" (**Opinions**) signaling that the country will step up its supervision of domestic firms listed both onshore and offshore. The Opinions purportedly intend to "improve regulation of cross-border data flows and security, crack down on illegal activity in the securities market and punish fraudulent securities issuance, market manipulation and insider trading." Additionally, China will "check sources of funding for securities investment and control leverage ratios." This follows an action in early 2019, when amendments were made to the Securities Law of the People's Republic of China that "include[d] penalizing overseas capital-markets activities that hurt investors in China."

In aggregate, these measures are an attempt to close the loophole that allowed Chinese tech companies to list overseas without the same scrutiny as would apply in a domestic listing process. As reported, "Chinese internet companies typically adopt a so-called variable interest entity structure that gives them flexibility to raise funds offshore" that is "usually registered in offshore tax havens[,] such as the Cayman Islands[,] that fall outside China's legal jurisdiction."

The head of the China Securities Regulatory Commission (CSRC) explained that the Opinions were spurred by "financial fraud, insider trading, market manipulation and other illegal activities of listed companies [that] are increasing," and "[t]he capital markets have such power that a slight change could affect everything else in financial operations." Some commentators argue that the scrutiny is targeted at Chinese companies that are going to list in the U.S., which adds pressure "not only on listed tech companies but also the valuation of pre-IPO companies."

The table below provides some potential impacts of the Opinions:

WHO COULD BE IMPACTED	POTENTIAL IMPACTS

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Global Investors	"[T]he Chinese government could exert its authority to block any deal at the last minute to ensure that companies' data on Chinese citizens doesn't slip into U.S. hands."
U.S. Capital Markets	"[T]he risk of additional scrutiny may now deter domestic [Chinese] firms from listing there [in the U.S.]," which could limit what had been a very strong pipeline of IPOs.
Chinese Companies	Stronger regulation could be imposed and other Chinese regulators could act.
	• The above Opinions noted that "stronger capital-market regulation should be combined with broader efforts to uphold national security and social stability." • The Chinese government noted in the Opinions that "regulators need to deepen cross-border cooperation over audit supervision and amend laws and regulations 'on data security, cross-border data flow and other confidential information management.'"

One company has already put a pause on its plan to list overseas: ByteDance Ltd., the Chinese owner of TikTok, paused its IPO plan indefinitely after the Chinese government "told the company to focus on addressing data-security risks." The company's founder, Zhang Yiming, decided that "the time wasn't right for an IPO because of the political and regulatory environment." This comes after DiDi, China's leading ride-hailing platform, went public in the U.S. late last month. Following its listing, the company had its app ordered removed from Chinese app stores, due to its collection and use of personal information in a seriously illegal way, and is now under a cybersecurity investigation. These measures caused the share price to fall by as much as 25% less than a week after the company went public.

The CSRC is currently "drafting rules that could require offshore registered companies to seek regulatory approval before selling shares in foreign markets, with the Cyberspace Administration of China (CAC) leading interagency scrutiny into IPO candidates to make sure their plans don't risk national security." Further, the CAC proposed amending its draft cybersecurity-review rules to require "internet companies with more than one million users [to] undergo a cybersecurity review if they are looking to list abroad."

Any company looking to merge with a Chinese company should consider the risks. Any new SPAC that is targeting Chinese companies should add a risk factor to its registration statement.

Capital Markets & Securities Law Watch will continue to monitor developments in Chinese rules and regulations and will provide updates to our readers as they become available.

Also authored by Christine Olivo.

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Authors

Michael J. Blankenship

John P. Niedzwiecki

Louis Savage

Ben D. Smolij

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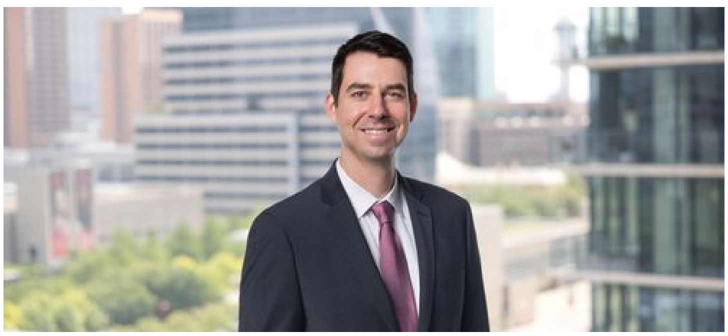

Ben D. Smolij

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