CLIFFORD CHANCE

# SHANGHAI-LONDON STOCK CONNECT: WHAT DO CHINESE COMPANIES NEED TO CONSIDER?

– THOUGHT LEADERSHIP

JUNE 2019

# SHANGHAI-LONDON STOCK CONNECT: WHAT DO CHINESE COMPANIES NEED TO CONSIDER?

Shanghai-London Stock Connect – a stock exchange trading link – will allow investors to more easily trade depositary receipts representing shares cross-border and is a signal that the Chinese government is keen to increase foreign access to its financial markets.

Here our experts provide a short introduction for Chinese companies to Global Depositary Receipts (GDRs) and explain the benefits and issues for Shanghai-listed companies considering seeking admission of GDRs representing their A shares to listing on the UK Official List and to trading on the Shanghai-London Stock Connect segment of the Main Market of the London Stock Exchange.

## What are GDRs?

GDRs are transferable securities issued by a depositary, typically an investment bank. GDRs represent a proportion of underlying shares in a company incorporated outside of the United Kingdom. In the case of a Chinese company seeking admission of GDRs to the Shanghai-London Stock Connect segment, these would be A shares of the company listed on the Shanghai Stock Exchange. Prior to issuing GDRs, the company will deposit the relevant A shares with the depositary in a specially created GDR facility.

GDRs provide investors with many of the economic and other benefits of holding shares, including voting rights and claims to dividends. GDRs therefore offer international investors a means of enjoying the benefits of holding shares in an overseas company, while avoiding some of the barriers faced by non-residents.

The shares to be represented by the GDRs will be held by a custodian in China on behalf of the depositary and will be held on trust for the investors to ensure that they are ring-fenced from the assets of the depositary should the depositary become insolvent. The custodian will be experienced in dealing with shares held by it locally.

GDRs listed in London are typically denominated in US dollars and are cleared and settled through international clearing systems, such as Euroclear, Clearstream and DTC. Whilst the GDRs and underlying shares are separate securities and therefore can be traded at different prices, generally there will be strong correlation between the GDR price and the share price. The exchange rate risk resulting from the GDRs being denominated in US dollars and the shares being denominated in Renminbi rests with the investors.

## What is different about Shanghai-London Stock Connect?

Shanghai-London Stock Connect is unusual as it involves a mechanism that connects the capital pools that exist in Shanghai and London via a two-way depositary receipt programme. As well as allowing Chinese Shanghai-listed companies to obtain a listing of GDRs in London (the focus of this note), it also allows London premium listed companies to obtain a listing of Chinese depositary receipts in Shanghai.

The scheme represents the culmination of three years of work by the relevant stock exchanges and regulators. It seeks to deepen financial cooperation between China and the UK and further opens up China's capital markets. There is therefore significant political will to ensure the scheme is a success.

What is particularly innovative about the scheme is that fungibility across both markets is facilitated by the role of designated brokers who operate in each market and provide a bridge (allowing holders to sell their securities in either market). Four designated brokers have been confirmed to date, and more are expected to be confirmed in due course.

When buying GDRs, an investor may: (i) buy GDRs on the London Stock Exchange or (ii) request a designated broker to buy A shares on the Shanghai Stock Exchange and instruct the depositary to create GDRs representing such A shares. When selling GDRs, an investor may: (i) sell the GDRs on the London Stock Exchange or (ii) request a designated broker to redeem the GDRs and sell the underlying A shares on the Shanghai Stock Exchange. Accordingly, investors have access to both capital pools. The designated brokers may also hold an inventory of A shares to facilitate settlement.

This level of connectivity and fungibility is fundamentally different to other platforms and structures such as Hong Kong "H" share listings, Frankfurt "D" share listings and the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect platforms.

## What are the benefits to a Chinese company obtaining a listing of GDRs on the London Stock Exchange?

There are barriers to foreign investors being able to purchase shares in Chinese companies solely listed in China, which may reduce the international demand for shares of such companies. For example, investors will generally need to qualify as a Qualified Foreign Institutional Investor (QFII) or Renminbi Qualified Foreign Institutional Investor (RQFII) to invest directly in A shares.

International institutional investors investing in London are familiar with GDRs and, as such, a listing of GDRs in London allows a Chinese company to access foreign capital markets and unlocks a very large pool of potential additional investors, which may also be a benefit for existing shareholders looking to transfer their holdings. In particular, London-listed GDRs can be sold to qualified institutional buyers in the United States (as well as institutional investors outside of the United States).

In addition, a London GDR listing can expand a Chinese company's global presence by raising its public profile and can attract international research analysts and media coverage.

## What are the eligibility requirements for a London GDR listing?

There are various criteria which a Chinese company will need to satisfy in order to be eligible for GDRs representing its shares to be eligible for admission to the UK Official List and the Shanghai-London Stock Connect segment of the Main Market of the London Stock Exchange.

The company must have an A share listing on the Shanghai Stock Exchange and a minimum market capitalisation requirement of RMB20 billion (approximately USD2.9 billion). In addition, the company must have a sufficient financial track record. Generally, there must also be a free float of 25 per cent. of the GDRs (but not the underlying shares) held in public hands by unconnected public investors in one or more European Economic Area member states, to ensure that there is sufficient liquidity in the GDRs, subject to any derogation granted by the UK Financial Conduct Authority (UK FCA).

## What is the process and typical timeline for listing GDRs in London?

A London GDR listing is typically obtained alongside a wider transaction, such as a capital raising by the company or a sale of shares by an existing significant shareholder, or a combination of both. Whilst obtaining a London GDR listing is a well-trodden path, it can be a relatively involved process. Typically, such a transaction will take around four to six months from start to finish (although can be completed more quickly). An illustrative timetable is included in the appendix to this briefing note.

The first step in the process is usually the appointment of professional advisers and counterparties. In addition to the depositary and custodian, the key parties generally include: (i) one or more investment banks to act as global coordinators and bookrunners who are independent from the depositary, (ii) legal advisers to the company, the global co-ordinators and bookrunners and the depositary, (iii) reporting accountants and (iv) public relations advisors. Key elements of the process involve the preparation of a prospectus and registration document, due diligence, marketing, and negotiating the legal documentation.

## Prospectus/Registration Document

The most involved aspect of the process is the preparation of the prospectus and registration document. The prospectus is typically the primary document used to market the securities to investors and is required to be published to obtain a London GDR listing.

The prospectus is an extensive document that is intended to provide investors with all the information they require to make an informed investment decision. The prospectus will include risk factors, information about the company's business and industry and detailed financial information. The financial information must be prepared in accordance with IFRS as adopted in the EU or its equivalent. As Chinese GAAP is considered equivalent to IFRS as adopted in the EU, Chinese companies will generally be permitted to use their existing financial statements.

Specific content requirements for the prospectus are governed by the UK Prospectus Rules and Listing Rules. As such, the prospectus will follow a standard format. However, companies with existing listings are often able to leverage their existing public disclosure to assist with the drafting process.

The requirement to publish a registration document is a relatively new development in the UK market, which came into force in 2018 following a consultation process by the UK FCA on the listing process and is relevant where the investment banks mandated on the transaction wish to publish research on the company (see below). The registration document will be published at the start of the public phase of the process. The registration document will generally contain the same information about the company as the prospectus, but will only contain limited information about the GDRs or the proposed listing.

The prospectus and registration document will be primarily reviewed and approved by the UK FCA, who will also consider the company's eligibility for listing. The prospectus will also need to be reviewed by the China Securities Regulatory Commission (CSRC).

The legal advisers to the company are usually responsible for preparing the prospectus and registration document, although the preparation of both documents and the other legal documentation will require involvement from all parties, including attendance at drafting meetings by management.

## Due diligence

Alongside preparation of the prospectus and registration document, a due diligence process will be carried out by the investment banks and legal advisers, the purpose of which is to identify any material issues which may need to be reflected in the prospectus and registration document. It is vital that all material information is included in the prospectus and registration document and that they are accurate, complete and not misleading. Due diligence typically involves meetings with management, the preparation and review of a virtual data room and enquiries of the reporting accountants and occasionally other third parties (such as key customers or suppliers).

## Research

International research coverage on Chinese companies listed only in China (and which, for example, do not also have H share listings in Hong Kong) is likely to be limited. Accordingly, there is likely to be a desire on the part of the global coordinators and bookrunners mandated on the listing to initiate research coverage on the company.

Typically, a detailed presentation will be prepared, containing all the material information about the company, which is then presented by key members of management to research analysts connected to the syndicate banks. The connected analysts will then prepare draft research reports, which are reviewed by the company and its advisors for factual accuracy. The connected research is published at the time of the company's "intention to list" announcement (see the illustrative timetable in the appendix), following which the analysts will carry out investor education.

Under the recent reforms to the UK IPO process referred to above, research analysts unconnected to the syndicate banks must also be given an opportunity to write research on the company. They can be briefed either at the same time as connected analysts, or more usually, shortly following publication of the registration document. Unconnected analysts must be provided with all material information as provided to connected analysts. However, there is no requirement for management to brief unconnected analysts in person (although there may be benefit in doing so) or review their research reports.

## Marketing

Marketing efforts will be organised by the global coordinators and bookrunners. Typically, management of the company would meet with potential investors at various stages of the process, in order to present the strengths and future growth strategy of the business in order to generate demand and obtain valuation feedback. Preparation for such meetings involves the drafting of marketing presentations and rehearsals.

## Legal documentation

Various agreements will need to be negotiated in connection with a London GDR listing. In particular, the company will need to enter into a deposit agreement with the depositary under which the GDR facility is established, a custody agreement with the custodian, an underwriting agreement with the global coordinators and bookrunners and engagement letters with the reporting accountants and other advisers. Such legal documentation will typically be governed by English law.

## What continuing obligations will apply following a GDR listing?

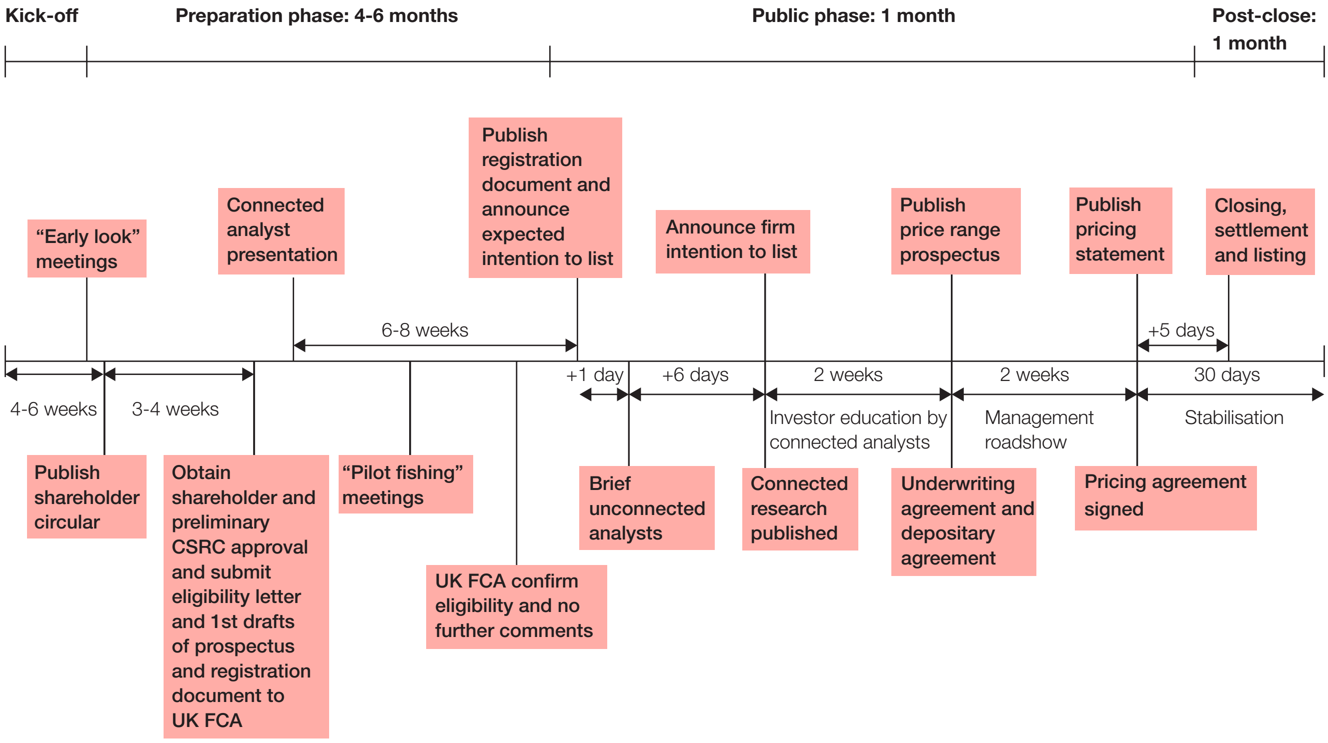
Companies with a London GDR listing will need to comply with various continuing obligations, in particular under the UK Listing Rules, the UK Disclosure Guidance and Transparency Rules and the EU Market Abuse Regulation.

The most important continuing obligation is that the company must disclose inside information to the market. An important consideration for Chinese companies will be coordinating disclosure of inside information and providing other information across the two markets, given the large time difference between China and the United Kingdom, and the different regulatory requirements, particularly in relation to whether such disclosures can be made in or outside of trading hours. In the United Kingdom, the requirement is to disclose as soon as possible after the information arises (i.e. regardless of trading hours), whereas in China generally inside information is disclosed after markets close. In order to facilitate disclosures, trading on the Shanghai-London Stock Connect segment of the London Stock Exchange will start at 9.00 a.m. (rather than 8.00 a.m.), thus providing a window between the end of trading in Shanghai and the start of trading in London when disclosures can be made.

Other key continuing obligations include a requirement on the company to publish an audited annual report within four months of the end of its financial year. Directors and managers of a company with a London GDR listing must also comply with certain restrictions on dealing in securities to avoid insider trading.

# Appendix

## Illustrative GDR listing timetable




**Our GDR experience includes advising:**

- **Huatai Securities,** a leading Chinese technology-enabled securities group, on its London GDR listing – the first transaction to be conducted under the Shanghai-London Stock Connect scheme.
- **Nova Ljubljanska Bank,** Slovenia's largest bank, on its privatisation by the Slovenian state by way of an IPO and London GDR listing.
- **Zenith Bank,** one of Nigeria's largest banks, on its IPO and London GDR listing.
- **TCS Group Holding,** the sole shareholder of Tinkoff Credit Systems Bank, on its IPO and London GDR listing.
- The underwriters on the IPO and London GDR listing of **Romgaz,** the largest natural gas producer in Central and Eastern Europe. The first London listing of a Romanian state-owned company.
- The selling shareholders on the IPO and London GDR listing of **TBC Bank,** a leading Georgian bank.
- **NOMOS Bank,** Russia's eighth largest banking group, on its IPO and London GDR listing.
- **OMV Petrom,** an integrated oil company which is the largest corporation in Romania, on its secondary London GDR listing.
- A depositary bank on the IPO and London GDR listing of **MegaFon.** Equity deal of the year 2013, IFLR Europe Awards.
- **PhosAgro,** a Russian fertiliser producer, on its London GDR listing

# CONTACTS

## London

Maggie Zhao
Partner
London
T: +44 20 7006 2939
E: maggie.zhao@cliffordchance.com

Paget Dare Bryan
Partner
London
T: +44 20 7006 2461
E: paget.darebryan@cliffordchance.com

Adrian Cartwright
Global Practice Area Leader for Capital Markets
London
T: +44 20 7006 2774
E: adrian.cartwright@cliffordchance.com

Iain Hunter
Partner
London
T: +44 20 7006 1892
E: iain.hunter@cliffordchance.com

Simon Thomas
Partner
London
T: +44 20 7006 2926
E: simon.thomas@cliffordchance.com

Bruce Kahl
Partner
London
T: +44 20 7006 2419
E: bruce.kahl@cliffordchance.com

Christopher Roe
Senior Associate
London
T: +44 20 7006 4609
E: christopher.roe@cliffordchance.com

James Spencer
Senior Associate
London
T: +44 20 7006 1329
E: james.spencer@cliffordchance.com

## Hong Kong

Terry Yang
Partner
Hong Kong
T: +852 2825 8863
E: terry.yang@cliffordchance.com

Francis Edwards
Partner
Hong Kong
T: +852 2826 3453
E: francis.edwards@cliffordchance.com

Liu Fang
Partner
Hong Kong
T: +852 2825 8919
E: fang.liu@cliffordchance.com

Connie Heng
Partner
Hong Kong
T: +852 2826 2457
E: connie.heng@cliffordchance.com

Amy Lo
Partner
Hong Kong
T: +852 2826 3420
E: amy.lo@cliffordchance.com

Virginia Lee
Partner
Hong Kong
T: +852 2826 3451
E: virginia.lee@cliffordchance.com

## Beijing and Shanghai

Tim Wang
Co-Managing Partner
Shanghai
T: +86 10 6535 2266
E: tim.wang@cliffordchance.com

Terence Foo
Co-Managing Partner
Beijing
T: +86 10 6535 2299
E: terence.foo@cliffordchance.com

Glen Ma
Head of Corporate, China
Shanghai
T: +86 21 2320 7217
E: glen.ma@cliffordchance.com

Jean Thio
Partner
Singapore
T: +65 6506 1956
E: jean.thio@cliffordchance.com

C L I F F O R D

C H A N C E