Non-tradable Share Reform in China’s Capital Markets

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Agenda

1. Chinese Capital Markets
2. Non-tradable Share Reform
3. Parallel Reforms of Chinese Capital Markets
4. Challenges and Initiatives
1. Chinese Capital Markets

1990 - Shanghai Stock Exchange opened
1991 - Shenzhen Stock Exchange opened
1992 - The first B shares were issued to foreign investors
1992 - CSRC was established
1993 - The first H-share company (Tsingtao Brewery) was listed in HK
1993 - Company Law was promulgated
1998 - The first securities investment fund was launched
1998 - Securities Law was passed by the Congress
2001 - Domestic investors were allowed to invest in B shares
2002 - QFII scheme started off
2003 - Securities Investment Fund Law was promulgated
2004 - State Council's Instructions Regarding Advancing Reform, Opening and Stable Development of Capital Markets released
2004 - The Small & Medium Enterprises Board was launched
2005 - Notices about Questions Related to the Listing of Non-tradable Shares was issued by the CSRC
2005 - Revised Securities Law and Company Law were passed by the Congress

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Overview of the Markets

Number of Listed Companies

- **Number of Listed Companies**
  - A, B Share
  - B Share

Years: 1994 to 2006

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Overview of the Markets

A-share Market: Full Spectrum of Chinese Economy

- Finance: 38%
- Manufacture: 28%
- Electricity: 9%
- Information Technology: 7%
- Real Estate: 6%
- Commerce: 5%
- Transportaton: 4%
- Public: 9%
- Others: 12%
- Mining: 9%
- Manufacture: 28%
- Transportaton: 7%
- Electricity: 4%
- Information Technology: 3%
- Real Estate: 3%
- Commerce: 3%
- Transportaton: 28%
- Finance: 38%
2. Non-tradable Share Reform

- Background
- Problems Caused by the Issue
- Principles and Strategies of the Reform
- Progress
The Origin of Non-tradable Share Issue

- Transition from planning economy to market economy
- Concerns on state-asset reduction
- Attempt to maintain state control over listed companies
- A holding-off approach: shares owned by the state and legal persons not allowed to trade tentatively (Non-tradable share issue)
- Non-tradable shares accounted for 64% of total shares (12/2004)
Problems Caused by Non-tradable Share Issue

- Distortion of pricing mechanism of the capital markets
- Provide no common interest for public and non-tradable shareholders (corporate governance)
- Failed to evaluate and manage state asset on a market basis
- Created great uncertainties for the market
- Deviated from international practices
- Failed attempts (1999 and 2002)
Non-tradable Share Reform in Chinese Capital markets

Principles

- Follow the market rules: win-win situation
- Maintain market stability
- Protect the legitimate interests of investors, especially the public investors
- No non-tradable share issue for new IPO’s
- Take the reform as an opportunity to promote the capital market in a national level and initiate a series of reforms
Implementing uniform rules, customizing individual solutions: the pricing of the “trading right” not decided by regulatory authority, but to be decided by negotiation between and among tradable and non-tradable shareholders, and endorsed by 2/3 of the public investors (on average: 3/10)

Pilot program to be followed by other companies

Other supporting measures and policies: lock-up period and trading restrictions on the selling of non-tradable shares after the conversion

Balanced Initiatives: pace of the non-tradable share reform, market stability, other coordinated reforms
Progress

- 29 April 2005, 1st batch of 4 companies participated in the pilot program
- June 2005, 2nd batch of 42 companies joined the reform
- Nov. 2005, 35 large state-owned companies joined the reform
- As of Dec. 2006, 96% of the listed companies completed the reform
3. Parallel Reforms in Chinese Capital Markets

- Reform of IPO process (ICBC IPO)
- Establishment of incentive structure for listed companies
- Development of institution investors
- Introduction of QFII/QDII
- Change of investment philosophy
Non-tradable Share Reform in Chinese Capital Markets

- Incentive structure
- 50% of companies reformed
- IPO resumed
- BOC IPO
- QFII rules revision
- IPO rule revision
- PetroChina joined the reform
- ICBC IPO (A+H)
- Adopted international accounting standard
- ChinaLife IPO
Outcomes of the Reforms

- Market cap grew from RMB 3 trn. To 9 trn.
- IPO’s (BOC, ICBC), newly raised fund RMB 280 bn
- Securities Companies walked out of shadow
- Institutional Investors: 30% of total market cap.
- More diversified structure of listed companies, representing Chinese economy
- Impact on Chinese economy and society
4. Challenges and Initiatives

Data Source: China Annual Report on Financial and Futures Markets
Initiatives

- Deepening Liberalization Reform
  - Reform of non-tradable shares; IPO reform
  - M&A, delisting of public companies

- Improving Regulatory System
  - Establishment of multi-layer regulatory system
  - Fine balance to allow financial innovation

- Improvement of Legal Structure
  - Legal framework (revised Securities Law & Companies Law)
  - Improvement of enforcement

- Fostering Healthy “Capital Market Culture”
  - Respect for shareholders; fiduciary trust; professionalism; investor education
US vs. China

Non-tradable Share Reform in Chinese Capital markets

$trillion

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<td>Market Cap</td>
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Thank You

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