UOB Investment Insights
Quick Note

22 May 2020

Potential De-Listing of Chinese Companies in the US

- The US has threatened to de-list Chinese companies from their stock exchanges.
- If passed, there will likely be a transition period for companies to comply with the new rules. This allows time for companies and investors to react.
- US investors make up a relatively small portion of Chinese equity investors.
- There are alternate ways to invest in Chinese equities, such as through Hong Kong or the A-shares market.

The US Threatens To De-List Chinese Companies

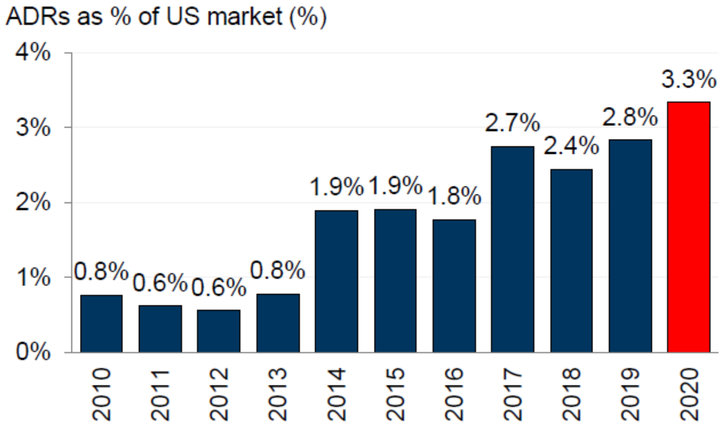
- On Wednesday (20 May 2020), the US Senate passed the Holding Foreign Companies Accountable Act. This proposed bill can potentially lead to the suspension or de-listing of foreign companies listed in the US that are unable to comply with audit requirements.
- Although the bill is not explicitly targeting China, it is specific to Chinese companies because China's regulations prohibit foreign regulators like the US' Securities and Exchange Commission (SEC) from examining the audit papers for overseas listed Chinese companies.
- The move is likely to be politically motivated and is one of the responses from the Trump administration to penalise China for the ongoing COVID-19 impact to the US. It could also be part of a wider US effort to undermine the rise of China.
- **Next steps:** The bill has to be passed by the House before it can be sent to President Trump to be signed into law. At the time of writing, it is unclear how long the process will take.

Quick Facts About US-Listed Chinese Companies

- Currently 233 Chinese companies are listed as American Depository Receipts (ADRs) in the US[1].
- ADRs
  - are denominated in US dollars, with the underlying security held by a US financial institution overseas.
  - can be listed on the New York Stock Exchange (NYSE), American Stock Exchange (AMEX), the NASDAQ, or sold over-the-counter (OTC).
  - allow investors to access foreign companies through US stock exchanges.
- Total listed market cap of US$ 1.03 trillion, which makes up 3.3% of US equity market cap and 8% of all-China market cap (Figure 1).

[1] Goldman Sachs Global Investment Research, 21 May 2020

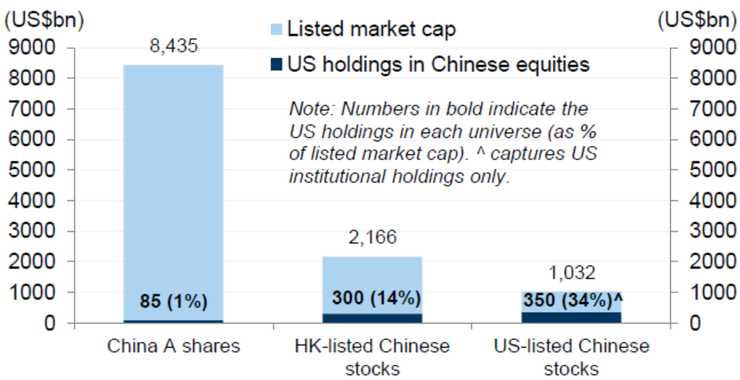
Figure 1: Chinese ADRs currently represent 3.3% of total US market cap



Source: Wind, FactSet, Goldman Sachs Global Investment Research.

- Chinese ADRs make up 6% of daily US trading volume (US$ 8.1 billion).
- US investors are estimated[2] to hold US$ 350 billion worth (roughly 1/3) of Chinese ADRs, which makes up approximately 50% of their Chinese equity holdings (Figure 2).

Figure 2: Approx. 50% of US investors' holdings in Chinese equities are in ADRs.



Source: Wind, CEIC, US Department of Treasury, Bloomberg, Goldman Sachs Global Investment Research.
Note: The US holdings of China A-shares and HK-listed stocks are estimated based on data disclosed by the US Treasury. The US ownership of US-listed Chinese stocks is calculated as the total US holdings divided by the total listed market based on stock-level data from Bloomberg.

[2] Goldman Sachs Global Investment Research, as at 21 May 2020

What Are The Possible Outcomes?

- If the Act is passed into law, there may be some **short term negative impact** on the Chinese ADRs, especially the smaller cap stocks, given their lower liquidity.
- Chinese companies will be likely given a **3-year window** to allow US regulators to examine their financial statements. This 3-year window may allow for potential negotiation between the regulators and the companies on the level and stringency of compliance.
- Non-compliance will most likely result in **forced de-listing**, which could result in price movements. However, the potential 3-year transition period will provide sufficient time for investors to react, thereby minimizing the negative impact.
- Alternatively, companies can choose to **voluntarily de-list** from the US and re-list elsewhere. In this scenario, the most likely market to benefit will be Hong Kong. Many of these companies are already dual-listed in Hong Kong, thus reducing any possible disruption.

What should investors do?

- **Do not rush to react.** While initial market sentiment to this news may be negative, there will likely be a 3-year transition period. This allows time for investors to react to any developments.
- **Invest in China as a long-term Megatrend.** The US' actions should not derail the long-term drivers for China's growth: rising domestic consumption and its growing leadership in technology developments and deployment. While it may deter some fund flows into Chinese equities, most investors (retail or institutional) are still able to access Chinese equities via Hong Kong or the A-shares market either directly or through a fund.
- If you are invested in Chinese equities through:
    - **a mutual fund or unit trust**, the fund manager will likely make the necessary changes to their portfolios ahead of any deadlines to minimise disruption. Both Hong Kong and the A-shares market are easily accessible to fund managers. The fund managers we have spoken to have indicated there should not be any long-term impact to their portfolios. There should not be any action required from you.
    - **a structured product**, there may be a possibility that one or more underlying companies may voluntarily de-list in the US and re-list elsewhere in the interim. We will contact you should this happen to provide further details and possible courses of action from the note issuer. In the meantime, the structured product will continue as intended. You should also consider this possibility when you invest in structured products in future.
    - **direct equities**, you may want to consider gradually shifting to shares of the same company listed elsewhere where available and within a reasonable timeframe, when the price differentials and currency differences may be in your favour.
- Please speak to your UOB Advisor to determine whether there are any actions you need to take in your investment portfolio.

**All data are sourced from Bloomberg unless otherwise stated.*

RIGHT BY YOU