Property Rights Exchanges in China

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I. Introduction

China's property rights exchanges[1] are markets specifically for trading property rights. The country now has more than 200 such exchanges. In October 2003 the Third Plenary Session of the 16th Central Committee of the Communist Party of China announced its *Decision on Some Issues Concerning the Improvement of the Socialist Market Economy*. This defines "property rights" as including "rights over things, creditor's rights, stockholder's rights, and intellectual property rights." This important document deals with financial reforms and capital market reforms in general, and paved the way for the later reforms to China's capital markets.

When these exchanges were first established in the late 1980s, their role was to facilitate the transfer of state-owned assets as part of the process of reforming China's state-owned enterprises. In this regard, they can be compared to the stock markets established in 1990, whose role was to provide finance for state-owned enterprises. In recent years, however, more attention has been paid to ensuring that, like China's capital markets, which are being reformed, the property rights exchanges have a properly functioning market mechanism. We also expect these exchanges to attract growing interest from private equity investors as well as on account of the role they can play in creating multilayer capital markets, which the China Securities Regulatory Commission (CSRC) has been trying to establish as part of the process of reforming the capital markets.

II. The development of property rights exchanges thus far

First, we review the development of property rights exchanges thus far. These exchanges came into being during China's transition from a planned economy to a market economy. Their role was to enable the transfer of state-owned property rights in restructuring local state-owned enterprises or injecting private capital into them as part of the reform of state-owned enterprises. As a result, the public sector was closely involved in the creation of these exchanges.

1 Property rights exchanges are sometimes called "equity exchanges" or "asset and equity exchanges."

The first property rights exchange was established in Wuhan in 1988. In the following 12 months, 25 such exchanges were established all over China. At this stage, the government was still responsible for deciding the price and other terms of the sale of state-owned property rights. It was only during the period of economic development that followed Deng Xiaoping's famous speech during his tour of south China in early 1992 that these exchanges came into their own as markets. More than 200 were established all over China. However, the rapid increase in the number of exchanges led to a lack of control over how property rights were traded and to the stripping of state-owned assets. The State Council (China's Cabinet) therefore suspended the trading of property rights in April 1994.

Although the exchanges were allowed to reopen in 1995-96 after the State Council strengthened supervision of the sale of state-owned property rights and their registration, more stripping of state-owned assets occurred, this time on a massive scale, as a result of trading in the shares of unlisted companies[2]. In 1998, the State Council closed the exchanges concerned on the grounds that they had been involved in illegal over-the-counter trading. This affected the development of the remaining property rights exchanges[3].

The subsequent decision by the CSRC to require the property rights exchanges to observe the three principles of "non-divisibility," "non-continuity," and "non-standardization" prohibited the exchanges from dividing up state-owned assets, packaging them as standardized products, and trading these products continuously. As well as preventing the stripping of state-owned assets, this drew a distinction between property rights exchanges and normal capital markets that still exists today.

Following the restructuring of 1998 and partly as a result of the government's policy of fostering the development of high-tech companies, technological property rights exchanges were established in many locations. After 2002, partly as a result of China's accession to the World Trade Organization, economic reform and the restructuring of state-owned enterprises gathered momentum, bringing with them more restructuring and M&A activity. This, in turn, led to a revival of the property rights exchanges. In 2002, seven property rights exchanges, including those in Beijing and Tianjin, set up a regional market for property rights transactions, the North United Assets and Equities Market (NUAEM)[4].

In 2003, following the restructuring of government departments, the State-owned Assets Supervision and Administration Commission (of the State Council) (SASAC) was formed. This addressed the issue of how to supervise and administer state-owned assets such as state-owned enterprises by concentrating the responsibility for this in

2 In China, strictly speaking, a distinction is made between "shares" in a joint stock company and "equity" in a limited liability company. In this report, however, the two are normally referred to as "shares."

3 This and the preceding paragraph are based on *Shanghai Guozi* (2008) and Liu and Wei (2007).

4 See Ma, Gao, Zhang, and Chen (2003), and Ren (2008).

SASACs at both central and local government level[5]. During the same year, a series of rules and regulations was issued which governed the separation of state-owned enterprises' core and peripheral activities, the appraisal of those responsible for managing central state-owned enterprises, and the reform of state-owned enterprises (e.g., by means of restructuring, mergers, transformation to a joint stock company, and increasing the nonstate sector's ownership ratio by selling shares in and increasing the capital of state-owned enterprises). Moreover, in October 2003, the Third Plenary Session of the 16th Central Committee of the Communist Party of China defined "property rights" as including "rights over things, creditor's rights, stockholder's rights, and intellectual property rights." These developments accelerated the reform of state-owned enterprises and made it easier to trade property rights.

In December 2003, SASAC and the Ministry of Finance jointly issued the *Provisional Rules on the Administration of the Transfer of State-owned Property Rights in Enterprises* with effect from 1 February 2004 (see below for further details). These rules, which lay down a standard procedure for transferring state-owned property rights and are still in force, have played an important role in the development of property rights trading in China. In August 2004, SASAC issued a circular entitled *Issues Relevant to the Transfer of State-owned Property Rights in Enterprises*, clarifying these rules.

Since then, the property rights exchanges have grown rapidly, with trading more or less doubling in value from around RMB100 billion in 2003 to around RMB200 billion in 2004, and rising further to around RMB360 billion in 2007. As well as growing in size, the exchanges have also become more diversified. Local governments throughout China have begun to do more to encourage venture capital and high-tech investment. One example of this is the creation of the Zhongguancun Technological Property Rights Exchange in Beijing in 2003.

Further examples are the creation of the China Beijing Environment Exchange and the Shanghai Environment and Energy Exchange in August 2008, and that of the Tianjin Climate Exchange in September 2008[6].

III. Current state of property rights exchanges and the rules governing them

1. Current state of property rights exchanges

China now has more than 200 property rights exchanges. Of these, the Shanghai United Assets and Equity Exchange, the China Beijing Equity Exchange, the Tianjin

5 Although state-owned assets are owned by the state, responsibility for this has been divided among a number of government departments. Therefore, in order to improve the way these assets are managed, responsibility was concentrated in central and local SASACs. See Jingu and Ri (2003).

6 The China Beijing Equity Exchange has a stake in the China Beijing Environment Exchange , while the Chicago Climate Exchange and the Tianjin Property Rights Exchange etc. have a stake in the Tianjin Climate Exchange .

Property Rights Exchange, and the Chongqing United Assets and Equity Exchange are recognized by SASAC as “central-level” exchanges and permitted to trade the property rights of central state-owned enterprises (i.e., those supervised by the central government). In addition to these there are 65 “province-level” exchanges selected by the SASACs of each province, autonomous region and municipality, while the rest are referred to as “prefecture-level” exchanges[7]. In recent years there has been a move towards integrating exchanges, with exchanges belonging to the same regional market sharing information, for example. There are four such regional markets: the Yangtze River Basin Regional Property Rights Common Market, centered on the Shanghai United Assets and Equity Exchange; North United Assets and Equities, centered on the Tianjin Property Rights Exchange; the Huang He River Basin Regional Property Rights Market, centered on the Qingdao Property Rights Exchange; and the Western Regional Property Rights Market, centered on the Western Assets Exchange[8].

The total number of transactions conducted on China’s property rights exchanges in 2007 was 35,958 (compared with 33,541 in 2006), while the total value of these transactions was RMB358.2 billion in 2007 (compared with RMB319.3 billion in 2006) (Figure 1). In this connection, it is perhaps worth pointing out that the total value of transactions on China’s A share markets was RMB45,477.1 billion in 2007 (partly as a result of an overheated market) and RMB8,921.7 billion in 2006. As we will see, property rights transactions tend to be one-offs, so it is also worth pointing out that RMB772.3 billion of funds was raised on the A share markets by means of IPOs and capital increases in 2007 and RMB246.4 billion in 2006. The property rights exchanges derive their income from membership fees and trading commission[9].

Figure1: Transactions on China's property rights exchanges (2007)

(number of transactions, RMB100mn)

	Number of transactions	Share (%)	Value of transactions	Share (%)
Yangzi River Basin Regional Property Rights Common	20,821	57.9	1,766.6	49.3
North United Assets and Equities Market (NUAEM)	9,097	25.3	1,429.6	39.9
Other	6,040	16.8	385.8	10.8
Total	35,958	100.0	3,582.0	100.0

Source: Nomura Institute of Capital Markets Research, based on *Zhongguo Chanquan Shichang Nianjian 2008*.

7 Chinese local government operates at four different levels. In descending order, these are the provinces, the prefecture-level cities, the county-level cities and counties, and the townships.

8 See the China Beijing Equity Exchange's website at http://www.cbex.com.cn/

9 In the case of the China Beijing Equity Exchange, the commission on a transaction worth RMB10 million or less is 0.2%; on a transaction worth more than RMB10 million but not more than RMB100 million it is 0.1%; and on a transaction worth more than RMB100 million it is 0.05%. Both parties to a transaction have to pay commission.

A geographical breakdown reveals that 57.9% of transactions in terms of number and 49.3% in terms of value are accounted for by the Yangtze River Basin Regional Property Rights Common Market, while 25.3% in terms of number and 39.9% in terms of value are accounted for by the North United Assets and Equities Market (Figure 1). Furthermore, a breakdown of each of the property rights exchanges by trading value reveals that the top five exchanges account for three quarters of the total, with the Shanghai United Assets and Equity Exchange accounting for RMB95,690 million, the China Beijing Equity Exchange for RMB64,370 million, the Wuhan Optics Valley United Property Rights Exchange for RMB34,690 million, Guangzhou Enterprises Mergers & Acquisitions Services for RMB34,670 million, and the Tianjin Property Rights Exchange for RMB34,000 million (Figure 2).

Figure2: Top five property rights exchanges in terms of transaction value (2007)

(RMB100mn)

Exchange	Transaction	Share (%)
Shanghai United Assets and Equity Exchange	956.9	26.7
China Beijing Equity Exchange	643.7	18.0
Wuhan Optics Valley United Property Rights Exchange	346.9	9.7
Guangzhou Enterprises Mergers & Acquisitions Services	346.7	9.7
Tianjin Property Rights Exchange	340.0	9.5
Top five (subtotal)	2,634.2	73.5
Total	3,582.0	100.0

Source: Nomura Institute of Capital Markets Research, based on *Zhongguo Chanquan Shichang Nianjian 2008*.

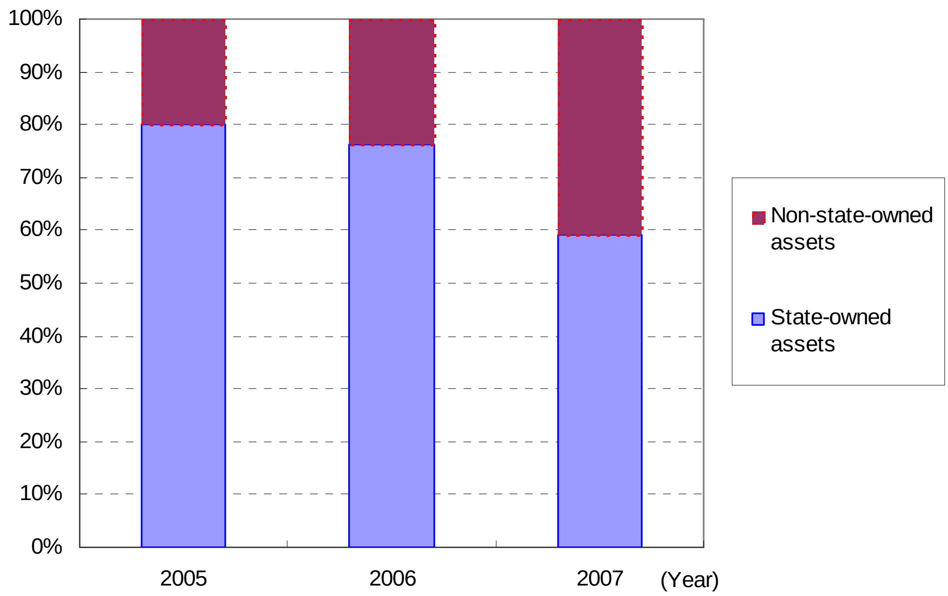
Actual transactions (taking the China Beijing Equity Exchange as an example) include the transfer by auction of state-owned enterprises that have failed, the transfer of shares held by asset management companies as a result of debt-equity swaps (AMCs acquired shares in a corporate borrower in exchange for nonperforming loans which they had purchased from banks), the agreed transfer of some of a state-owned enterprise's operations (e.g., a subsidiary) to enable it to concentrate its resources on its main business, and the transfer by auction of equity in a wholly state-owned enterprise to foreign investors in order to diversify its shareholder structure. They are used in this way with state-owned enterprises to deal with failures, the disposal of bad debts, restructuring (e.g., of subsidiaries), and changes in ownership structures. They are also used to transfer shares in private companies, for example[10].

As a percentage of trading value, trading in state-owned property rights has declined from 80.04% in 2005 to 76.26% in 2006 and 59.08% in 2007 (Figure 3). It is reckoned that over the next 3-5 years at least a third of the central government's state-owned assets will have to be restructured in some way (e.g., to enable state-owned enterprises to concentrate their resources) and that this constitutes approximately

10 In the case of the China Beijing Equity Exchange.

RMB2 trillion in latent demand for such transactions[11]. In the longer term, however, trading in state-owned property rights is expected to decline as the reform of state-owned enterprises progresses.

Figure3: Breakdown of transaction value of property rights exchanges by type of asset



Source: Nomura Institute of Capital Markets Research, based on *Zhongguo Chanquan Shichang Nianjian 2008*.

2. Rules and procedures

We now consider the rules governing property rights exchanges. As we have seen, the *Provisional Rules on the Administration of the Transfer of State-owned Property Rights in Enterprises* are an important piece of legislation specifically governing the trading of property rights. As the name indicates, these rules lay down a standard procedure for the transfer and trading of state-owned property rights, and are intended to ensure that they are regulated more stringently. They do not cover non-state-owned property rights. As a result, the rules governing the transfer of non-state-owned property rights vary from exchange to exchange.

These rules apply to the activities of SASACs or enterprises having state-owned assets in transferring state-owned assets they hold to domestic and foreign juridical persons, natural persons or other organizations ("transferees") with compensation (Article 2). However, the transfer of state-owned assets of financial enterprises and

11 See Xinlang Property Rights Exchange Channel et al., *Zhongguo Chanquan Shichang 2007niandu Baogao* (2008).

state equities in publicly listed firms has to be handled in line with the related regulations of the state (Article 2).

In these rules "state-owned assets of enterprises" refers to interests formed as a result of input by the state in enterprises in various forms, interests to be shared by the state as formed by various investments made by state-owned enterprises and enterprises over which the state has control, and other interests recognized, according to laws, to belong to the state (Article 2). The transfer of state-owned assets of enterprises has to be conducted openly on property rights exchanges set up in accordance with the law (Article 4).

The responsibility for formulating the supervision system and methods of trading of state-owned assets of enterprises in line with the provisions of the related laws or administrative regulations of the state lies with the SASAC (Article 8-1). The SASAC is also responsible for making decisions on or approving matters related to the transfer of state-owned assets of enterprises to which the state has contributed capital (Article 8-2). Here "enterprises to which the state has contributed capital" are state-owned enterprises in which the SASAC has taken responsibility as a shareholder instead of and with the approval of the central or local government.

Next, we consider the procedures governing the transfer of state-owned assets. First, the transferor enterprise needs to review the transfer in line with the procedures of internal decision making. In cases where lawful interests of workers are involved, opinions of the workers' general meeting of the enterprise whose property rights are to be transferred have to be solicited, and matters related to the re-employment and redeployment of workers have to be discussed and adopted by the workers' general meeting (Article 11).

After the matters related to the transfer have been decided, the transferor has to verify the assets and capital, compile a balance sheet and list of assets to be transferred, and entrust accounting firms to conduct an audit (Article 12). After the audit, the transferor has to appoint an asset evaluation agency to carry out an asset evaluation. The evaluation report serves as a reference for the transfer price. If, in the course of trading the property rights, the trading price is less than 90% of the evaluation result, trading is suspended and does not resume until the consent of the related authorities has been obtained (Article 13).

Next, the transferor has to entrust the property rights exchange to publish the bulletin of the transfer of property rights in economic or financial newspapers issued publicly above the province level and on the websites of property rights exchanges and solicit transferees in an extensive manner. The period for publishing the bulletin of the transfer of property rights is 20 working days (Article 14). When soliciting transferees, the transferor may require transferees to meet certain conditions regarding qualifications, business reputation, operational conditions, etc (Article 15). In cases where the transferee is a juridical person, natural person or other organization from foreign countries, Hong Kong, Macao, or Taiwan, the transferee has to conform to the provisions of the *Regulations on the Directions of Foreign Investment* released by the State Council and other related regulations (Article 16).

In cases where two or more transferees are identified from the public solicitation, the transferor consults with the property rights exchange on this and chooses auction or tendering in consideration of the actual situation of the property rights to be transferred (Article 17). Transfer by negotiation or negotiated transfer may be used in cases where only one transferee is identified through public solicitation or where approval from the SASAC has been obtained in line with the related regulations (Article 18). Whichever type of transfer is used, the transferor and transferee have to sign a contract of property rights transfer once the transaction is complete. As well as the names and addresses of both parties and basic information about the property rights being transferred, the contract has to include a plan for re-employing or redeploying workers affected by the transfer. In 2007, 52.3% of property rights transfers were negotiated transfers, 23.5% auctions, and 7.0% tenders, with other types accounting for the remaining 17.2%[12].

These are the rules governing state-owned property rights. As we have seen, the rules governing the trading of non-state-owned property rights vary from place to place. In Beijing, for example, the *Rules Governing the Administration of Trading in Property Rights in Beijing City* (in force since January 2002 and amended in June 2005) cover such things as transfer procedures, auditing and asset evaluation, types of transfer (auction, tender and negotiated transfer), and the contents of transfer contracts.

As we have seen, the transfer of state-owned assets of financial enterprises is governed by central government rules, with the Ministry of Finance publishing draft *Provisional Measures on the Transfer of State-owned Property Rights in Financial Enterprises* in 2007. "The transfer of state-owned property rights in financial enterprises" is the transfer of state-owned equity in institutions such as state-owned banks, securities houses, and insurance companies. According to the draft, the transfer of property rights in unlisted state-owned financial institutions has to take place on a property rights exchange, with proper information disclosure, solicitation of transferees, and auctions or tenders[13].

IV. Remaining challenges and future developments

1. Remaining challenges

Finally, we consider the remaining challenges facing property rights exchanges and likely developments.

As far as the challenges that face property rights exchanges are concerned, one key question is whether they are able to allocate resources efficiently. In this regard, we need to remember first of all the role played by local governments. As we have mentioned, government has been closely involved with property rights exchanges ever

12 See Yangzi River Basin Regional Property Rights Common Market et al., *Zhongguo Chanquan Shichang Nianjian 2008*.
13 Based on media reports.

since they were established. Most exchanges have close ties with their local finance and technology departments, and their senior officials also tend to come from local government or state-owned enterprises[14]. Hence the continuing pernicious influence of local government on the property rights exchanges' operations.

And the need to improve the situation by, for example, fully implementing the *Provisional Rules on the Administration of the Transfer of State-owned Property Rights in Enterprises* to strengthen the exchanges' market mechanism. One way of strengthening the exchanges' market mechanism and eliminating their dependence on the public purse would be to convert them to joint stock companies.

Next, there is the problem that not all the exchanges are regulated by the same regulator or governed by the same set of rules. As of 2007, 55% of the exchanges were regulated by a SASAC, 22% by a local finance department, and the remaining 23% by some other body[15]. And, even in the majority of cases (i.e., where an exchange is regulated by a SASAC), the regulator is not responsible for regulating the 40% of transactions that do not involve state-owned property rights. As we have seen, there are no standard regulations for non-state-owned property rights comparable to the *Provisional Rules on the Administration of the Transfer of State-owned Property Rights in Enterprises*. It has therefore been proposed that the exchanges should set up their own association and that this should act as a self-regulating body[16]. Nonetheless, we suspect that local governments will have a vested interest no matter what approach is adopted. Therefore a lasting solution is unlikely to be found soon.

Third, the fact that property rights exchanges are located all over the country means that the market is divided. Although, as we have seen, there are more than 200 exchanges, most of the trading takes place on a minority of regional markets and property rights exchanges. On most of these exchanges trading is for small amounts. We therefore think that many are likely to disappear in one way or another.

However, there is little cooperation among those regional markets where most of the trading takes place. As a result, the market is divided on a regional basis. In this connection, it is perhaps worth pointing out that 79.1% of property rights transactions in 2007 were within the regions where property rights exchanges are located[17]. Another point worth mentioning is that restricting trading in the property rights of central-level state-owned enterprises to only four designated exchanges inhibits free competition among the exchanges[18].

This may have reduced the efficiency of China's property rights exchanges as a whole. We therefore think the exchanges need to be reorganized. At the moment, the Chinese authorities appear not to have decided whether this reorganization should be instigated by themselves or driven by market forces. One measure that was announced in February 2008 was that the four designated property rights exchanges that trade the property rights of central-level state-owned enterprises would be required to disclose

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14 See *Zhongguo Chanquan Shichang 2007niandu Baogao*.
15 See *Zhongguo Chanquan Shichang Nianjian 2008*.
16 See *Zhongguo Chanquan Shichang 2007niandu Baogao*.
17 See *Zhongguo Chanquan Shichang Nianjian 2008*.
18 See *Zhongguo Chanquan Shichang 2007niandu Baogao*.

information on the transfer of property rights in central-level enterprises simultaneously. This should reduce the inefficiency caused by the regional division of the property rights market.

Fourth, liquidity has been affected by some of the trading rules. Under the rules of 1998, property rights exchanges are not allowed to trade standardized products on a continuous basis. Similarly, it is difficult to sell property rights at below their valuation price. These shortcomings will have to be addressed if the property rights exchanges are incorporated in multi-level capital markets.

Fifth, illegal practices can still be observed. In some cases, state-owned assets are sold for less than they are worth to associates of the transferors by not following the proper procedure for valuing assets or by not disclosing information properly. In other cases, property rights are actually sold outside an exchange by negotiation even though the formal procedures for selling them on a property rights exchange have been followed. This happens because transferors can offer terms that exclude other bidders by taking advantage of the fore-mentioned rule that permits them to require transferees to meet certain conditions[19]. Such practices need to be banned as they not only prevent resources from being allocated optimally but reduce fiscal revenue.

2. Future developments

Next, we consider the direction in which China's property rights exchanges are likely to develop. The first likely development, in our view, is a widening of the range of products they are allowed to trade. As we have already seen, trading in state-owned property rights is likely to account for an increasingly small proportion of their business. The exchanges will therefore have to create other business opportunities if they are to have a long-term future.

Two such possible opportunities are (1) trading in carbon emission credits, forestry rights and mining rights, and (2) small business finance. As we have already mentioned the establishment of emissions trading exchanges in China, we now consider the possibility that China's property rights exchanges might become involved in small business finance.

Like Japan, China has had to contend for many years with the problem that small businesses have only a limited access to capital. It will therefore be interesting to see whether China's property rights markets will be able to function as a financing platform for such businesses.

Companies have two ways of raising capital on property rights exchanges: by either (1) increasing their capital or (2) selling property rights. In 2004-07 they raised RMB70.0 billion using the former method and RMB800.0 billion using the latter method. In this connection, it is perhaps worth mentioning that this is roughly 70% of the RMB1,136.1 billion that companies raised on the A share markets by means of

[19] Based on interviews with market participants.

IPOs and capital increases during this period[20]. We think that the property rights exchanges will probably become more closely involved with both private equity firms and the diversification of capital markets in raising capital.

Private equity firms currently face the problems of gathering information and of exiting their investments[21]. However, property rights exchanges enable them to (1) find suitable investments (by providing them with information about enterprises that are trying to sell property rights) and to (2) sell rights in companies they have invested in. Similarly, property rights exchanges enable enterprises that wish to sell properties to attract strategic investors and raise capital at the same time. As it happens, the Shanghai United Assets and Equity Exchange now plays an important role in mergers and acquisitions as well as in restructuring Chinese industries and financing small businesses[22]. The property rights exchanges therefore have the makings of successful private equity markets.

Next, we consider the role that the property rights exchanges could play in creating multi-layer capital markets. In fact, the bulk of the trading on a number of property rights exchanges has already shifted from real assets such as plant and equipment to corporate equity. As a result, these exchanges now share some of the features of capital markets[23]. Judging by comments from the CSRC, however, the Chinese authorities have yet to include the property rights exchanges in their plans to create a multi-layer capital market. The chairman of the CSRC, Dr Shang Fulin, has been reported as saying that this multi-layer securities market will comprise (1) a main board, (2) a secondary board (for small and medium-sized companies), (3) a (still to be established) Growth Enterprise Board (for start-ups), and (4) an over-the-counter market. He did not mention the property rights exchanges, although that may be partly because the CSRC is not responsible for regulating them.

At the moment, there is a considerable gap between China’s capital markets and its property rights markets. Although both developed as a result of the reforms to China’s state-owned enterprises, the property rights exchanges are still largely regionally based whereas the capital markets operate at a national level. The capital markets are regulated mainly by the CSRC whereas the property rights exchanges are regulated mainly by the SASACs. Also, as we have already seen, there is a clear demarcation line between the capital markets, which trade equities and bonds, and the property rights markets, which do not trade standardized packaged products and do not normally trade on a continuous basis.

Therefore, if the property rights exchanges are to be incorporated in a multi-layer capital market, some regulatory adjustment will probably be required as well as solutions to the aforementioned challenges.

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[20] See Xu (2008).

[21] See Jingu and Kamiyama (2008).

[22] See Cai, Minyong, *Simu Guquan Touzi Yu Zhongguo Chanquan Shichang de Xinjiyu* (Private Equity Funds and New Opportunities for China's Property Rights Market), China Beijing Equity Exchange.

[23] See Xu (2008).

That said, some of the property rights exchanges have already begun to trade high-tech stocks. A State Council document on the development of China's high-tech industry mentions the role of the property rights exchanges in the trading of unlisted high-tech companies and suggests to us that the trading of unlisted and privately issued stocks in government approved high-tech parks has a certain legal basis[24]. Also, we think that a number of property rights exchanges would like to use this trading of high-tech stocks as a springboard for engaging more closely with the capital markets[25].

One recent development was the establishment in September 2008 of the Tianjin Equity Exchange Center for trading in unlisted stocks. Another, as we have seen, was the establishment in 2003 of the Zhongguancun Technological Property Rights Exchange in Beijing. Thus far, these exchanges have avoided falling foul of the law by restricting their equity trading to noncontinuous trading in shares in companies with no more than 200 shareholders (i.e., privately placed shares)[26]. Furthermore, some of the exchanges now offer record-keeping services such as acting as a transfer agent[27].

We need to compare the trading of unlisted shares on the property rights exchanges with that on other markets. Stocks that are delisted from the Shanghai and Shenzhen stock exchanges are traded on an over-the-counter share transfer system established in 2001 and commonly known as the "Third Board." In other words, unlisted and publicly issued stocks are traded on the Third Board. The New Third Board market established in the Zhongguancun Science Park in 2006 is an over-the-counter market for unlisted and privately issued high-growth high-tech stocks. In other words, the New Third Board markets trade unlisted and privately issued stocks, although the method of trading is different from that on the property rights exchanges. To that extent, the functions of the property rights exchanges (e.g., the Tianjin Equity Exchange Center) and the New Third Board markets overlap.

We therefore need to consider not only the main board, a secondary board for small businesses, a (still to be established) Growth Enterprise Board, and an over-the-counter market but also (some of the functions of) the property rights exchanges when it comes to creating a multi-layer capital market in China. The issue as far as unlisted stocks are concerned will be how to demarcate between the over-the-counter market and the property rights exchanges, whether to combine the two, or whether to create a new market. However, the situation is already quite complicated, with opinion and

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24 According to China's amended Securities Law (Article 10), "publicly issued securities" are either (1) securities issued to an unspecified group of investors, (2) securities issued to a specified group of more than 200 investors, or (3) securities issued in some other way as specified in laws and administrative regulations.

25 See *Zhongguo Chanquan Shichang 2007niandu Baogao*.

26 The Tianjin Property Rights Exchange is a shareholder of the Tianjin Equity Exchange Center. Also, we understand from interviews with market participants that the shares traded on the Zhongguancun Technological Property Rights Exchange cannot be divided into very small amounts and that transactions are ultimately negotiated by buyers and sellers. This suggests to us that trading complies with the three principles of "non-divisibility," "non-continuity," and "non-standardization."

27 See *Zhongguo Chanquan Shichang 2007niandu Baogao*.

regulatory powers divided among those involved. We expect a clearer sense of direction will emerge as time passes.

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