

### Panda Bond Market Review and Outlook

#### Overview

Since International Finance Corporation (IFC) and Asian Development Bank (ADB) made their first forays into Chinese bond market in 2005, the Panda Bond market experienced a decade of sluggish growth. Starting from 2015, regulatory policies geared toward financial market liberalization and RMB internationalization. As a result, the Panda Bond market entered a stage of rapid development. In 2016~2018, the issuance scale of the market went on a bumpy route, exhibiting rapid expansion followed by sharp tightening, and then rallied to a relatively stable level. By the end of 2018, the existing volume of Panda Bond reached 272.33 billion Yuan, accounting for 0.32% of the total in China's bond market. In recent years, accelerated pace of opening-up and market infrastructure improvements have introduced standards and liberty into the Chinese bond market. Panda Bond market benefited and gradually matured along with the trend. Panda Bond issuers continue the route of diversification in terms of industry and qualifications. In addition, the advance of the "Belt and Road" initiative and the burgeoning undertakings of foreign companies in China have driven more issuers with real long-term demand of RMB to enter the market. At the same time, the progress of Panda Bond market boosted communications of Chinese bond market with its international counterparts and further accelerated the pace of globalization for China's bond market. In September 2018, China's interbank market witnessed its first systematic regulation regarding Panda Bond issuance. The setup of a unified regulatory framework offered relatively user-friendly and operable guidelines for different kinds of issuers, especially foreign institutions with various funding motives and demands. Accelerated legal standards laid a solid foundation for the development of Panda Bond market. After a year and a half of pilot run, "Bond Connect" greatly prompted foreign investors to participate in the Chinese bond market. Investment group are diversifying and their activities further enriched. However, as a pilot program of the opening up process of Chinese bond market, in many ways, Panda Bond market is still in its early age:

market size stays relatively small, “Real Panda” issuers’<sup>1</sup> participation remains lukewarm, and bond issuance and approval guidelines still require refining and detailed specifications.

As an important observer and participant in the Panda Bond market, China Chengxin International Credit Rating Co., Ltd. (“CCXI”) not only enjoys a dominant role in the field of Panda Bond ratings, but also has accumulated years of experience and expertise in research and practice. In 2016, CCXI, together with ASIFMA, King & Wood Mallesons and Standard Chartered Bank, released the first special report on Panda Bond -- *RMB Series: Panda Bonds – On the Cusp*. Since then, CCXI has been constantly monitoring this market and has published *Panda Bond Market Review and Outlook* annually. Year 2018 proved to be of great significance: China’s bond market became much more open and mature, and Panda Bond market saw the generation of its first systematic regulation since the 2005 debut. In this report, we give a detailed review on the Panda Bond market, with a focus on year 2016 to 2018. The report aims to review the trend and analyze key factors affecting this market, thus to offer insights for various participants in their decision-making process.

### Part I. Market Review

The Panda Bond market has gone through several major stages. From 2005 to 2014, Panda Bond issuers were limited to development financial institutions, with the total issuance scale of 6.0 billion Yuan. Subsequently, the regulations over fund-raising and use of proceeds had been gradually loosened. Starting from 2015, there are no longer limits set on the type of issuers. The Panda Bond market entered a phase of rapid development, with the annual issuance scale amounting to 13.0 billion Yuan, surpassing the sum of the past decade. From 2015 to 2018, with the fluctuation of onshore and offshore interest rates and exchange rates and the adjustment of regulatory policies, Panda Bond market entered a fast track, revealing an increasingly diversified trend of issuers and a gradual increase of long-term bonds issuance made by overseas institutions, which is more aligned with the original intention of the market. Undoubtedly, the Panda Bond market is still in its pilot phase. The introduction of *Interim Administrative Measures for the Issuance of Bonds by Overseas Institutions on the National*

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<sup>1</sup> Panda Bond issuers whose business operations are mainly based outside of mainland China.

*Interbank Bond Market* (hereinafter referred to as the “Measures”) in September 2018 heralds the beginning of a new stage. The introduction of a comprehensive regulatory framework and the establishment of guideline bode well for a market that is standardized and well-developed. Taking the past three years as the observation interval, the Panda Bond market renders the following features:

**(I) The Panda Bond market entered a relatively stable stage in 2017-18 after the issuance tide of red-chip real estate enterprises<sup>2</sup> receded.**

From 2016 to 2018, the Panda Bond market experienced rapid expansion, significant tightening in terms of issuance scale and gradually recovered to a relatively stable stage. In 2016, the Panda Bond market expanded rapidly underpinned by favorable policies and lower issuance costs, with a total of 66 tranches and an issuance scale amounting to 130.4 billion Yuan, which is 10.0 times of that in 2015. The change in market conditions for onshore and offshore markets drove the return of those Hong Kong enterprises as well as red-chip companies that issued Dim Sum bonds as the financing channel. Meanwhile, the optimism about domestic real estate market and the establishment of non-public issuance of exchange market recording system also played an important role. In 2017, due to the rising domestic interest rate, and the tightening policy set on the use of proceeds and domestic financing of real estate enterprises, the issuance scale of Panda Bond market dropped significantly. In 2017, the number of Panda Bond issuance was 35, and the issuance scale was 71.9 billion Yuan, 44.7% less than that of 2016. In 2018, the decline in issuance costs coupled with the gradual improvement of the regulatory policies led to a revival of the Panda Bond market, with a total issuance of 58 tranches and a scale of 95.59 billion Yuan, representing a 33.0% increase compared with 2017.

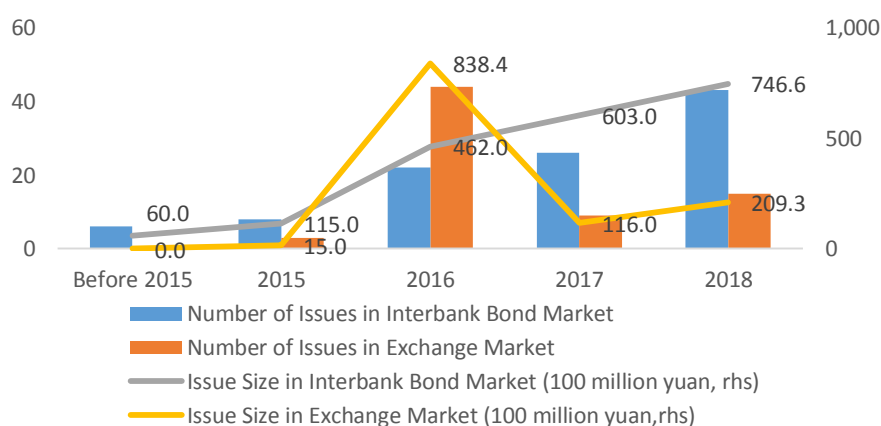
In terms of issuing market of Panda Bonds, the interbank market still plays a dominant role. The interbank market sustained stable growth of issuance scale, with a growth rate of 30.5% and 23.8% in 2017 and 2018, respectively. While the exchange market saw dramatic fluctuations due to the change of issuance volume of real estate enterprises. Tracing the reasons, in 2016, the change in onshore and offshore market conditions coupled with the optimism about

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<sup>2</sup> Red-chip enterprises refer to Chinese-funded enterprises that are incorporated overseas.

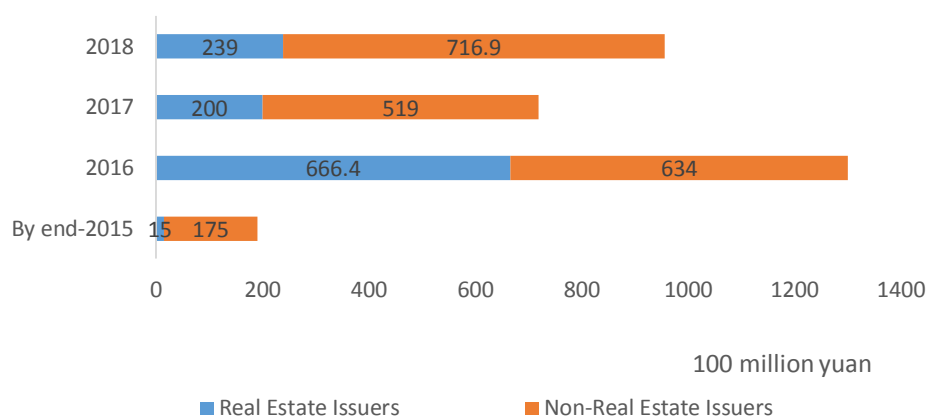
domestic real estate market and the establishment of non-public issuance of exchange market recording system led to the rapid expansion of the Panda Bond market. The Chinese-funded real estate enterprises tend to raise funds in China, which brought the issuance surge in the exchange market. In 2016, the Panda Bond issuance scale of real estate enterprises reached 66.64 billion Yuan, 44.4 times that of the previous year. However, since October 2016, the financing policy of real estate enterprises has been tightened dramatically. The Panda Bond issuance plans of several Hong Kong-listed real estate enterprises, such as Country Garden and Agile, were terminated and the issuance cost increased substantially. Against this backdrop, red-chip real estate enterprises turned to financing channels such as dollar bonds and asset securitization, which led to a significant decline of Panda Bond issuance in the exchange market from 2017 to 2018. After the 2016 issuance peak of red-chip real estate enterprises faded, the Panda Bond market revealed a more stable development trend.

**Figure 1. Panda Bond issuances in interbank bond market and exchange market**



Source: public information, edited by CCXI

**Figure 2. Panda Bond issuance scale (Real estate issuers vs. Non- real estate issuers)**



Source: public information, edited by CCXI

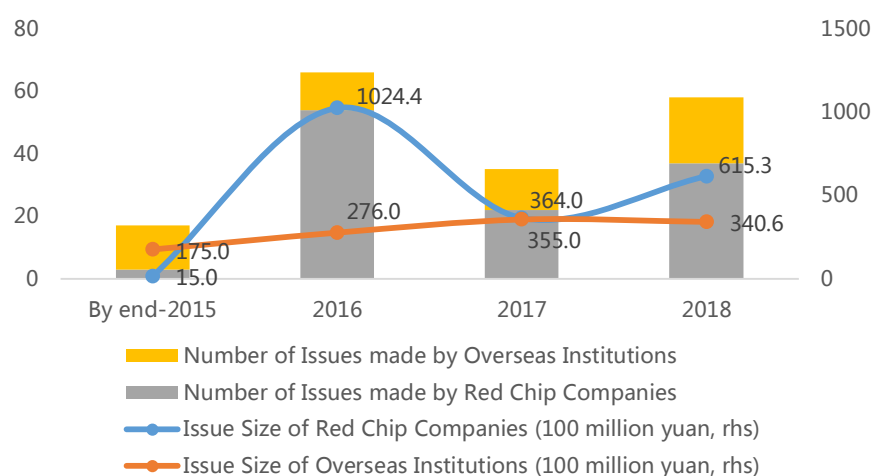
## (II) “Real Panda” issuers have increased, but the market participation rate is still less than 50%.

Started from the second half of 2018, the number of “Real Panda” issuers has shown an increasing trend, which is consistent with the original intention of supervision. But the proportion of “Real Panda” issuers in the market is still relatively low, and their participation needs to be further improved. From 2016 to 2018, there were 10, 8, and 12 “Real Panda” issuers, with 12, 13, and 21 Panda Bonds issued, respectively. It is worth noting that in 2018, the number of “Real Panda” issuers accounted for 46.7% of new issuers, marking a phased high from 2016 to 2018. Market environment, especially regulatory environment, is the key factor influencing “Real Panda” issuers entering the market. Since the second half of 2015, the PBOC has repeatedly relaxed the requirements for foreign institutions to participate in the interbank bond market, and the use of proceeds could be more flexible, significantly lowering the threshold for foreign entities to issue bonds in Chinese market. In addition, the continuous depreciation of RMB exchange rate in 2016 provided a favorable market condition for foreign issuers. Driven by those positive factors, “Real Panda” issuers actively poured in the market, with the number of newly entered foreign issuers reaching a historical high of eight. From 2017 to 2018, driven by the development of business in China and the financing demand of projects

along the “Belt and Road”, “Real Panda Bonds” issuance volume increased somewhat, but due to factors such as uplifted overall interest rates in China, and the strict supervision of the use of proceeds, foreign entities’ issue willingness were suppressed, and the overall growth was slow.

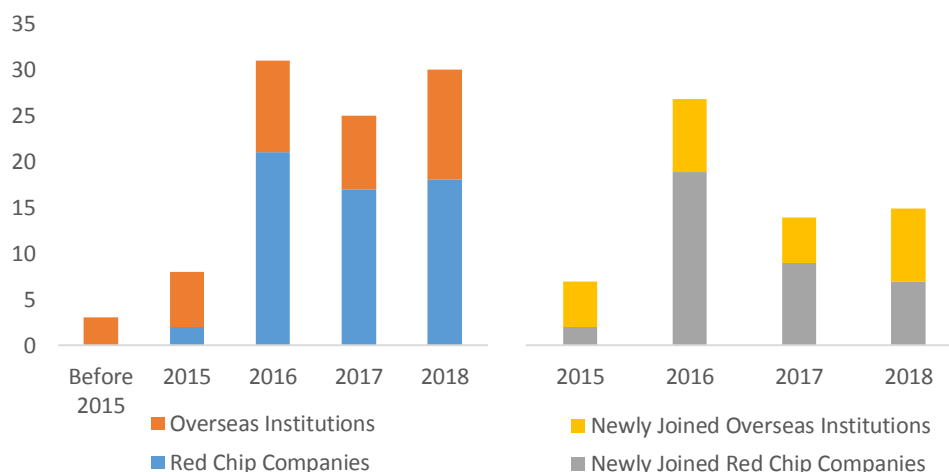
Compared with red-chip enterprises, foreign entities with sound credit quality are long-term financiers in the global market, and they tend to carry more market-oriented motives for bond issuance, and the comparison of overall issuance costs on a global scale is an important consideration. However, in the pilot stage of Panda Bond, the approval process for issuance remained a “case by case” state, and the convenience of issuance, the time cost and supervision-related cost of issuance were restricting the financing scale of foreign institutions. Even with the issuance approval, issuers will also set out the time window with proper market interest rates and exchange rates. The proportion of “Real Panda Bonds” issued in 2016-2018 was respectively 21.2%, 49.4% and 32.5% of the total volume, all of which were less than 50.0%. In medium to long term, the continuous improvement of China's bond market infrastructure will speed up the integration of domestic and international market. Considering more policies and regulatory documents will be introduced successively, the issuance costs of Panda Bond will be significantly reduced, and more “Real Panda” issuers are expected to enter the market.

**Figure 3. Panda Bond issuances of red-chip companies and overseas institutions**



Source: public information, edited by CCXI

**Figure 4. Distribution of Panda Bond issuers by type  
(red-chip companies and overseas institutions)**

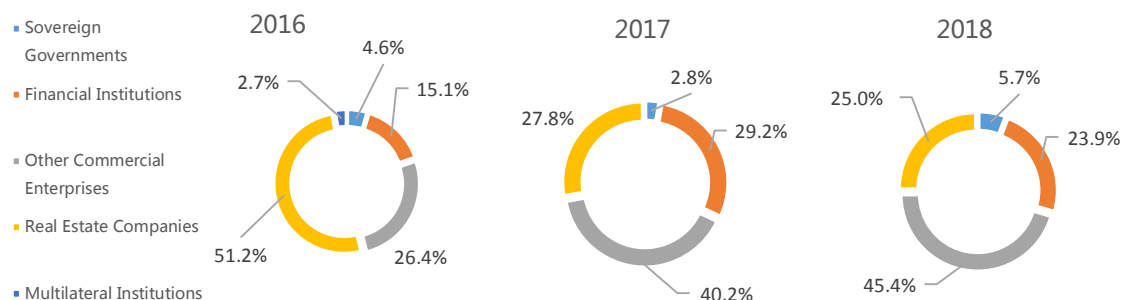


Source: public information, edited by CCXI

### **(III) Panda Bond issuers are becoming gradually diversified, with real estate enterprises and financial institutions being the major players.**

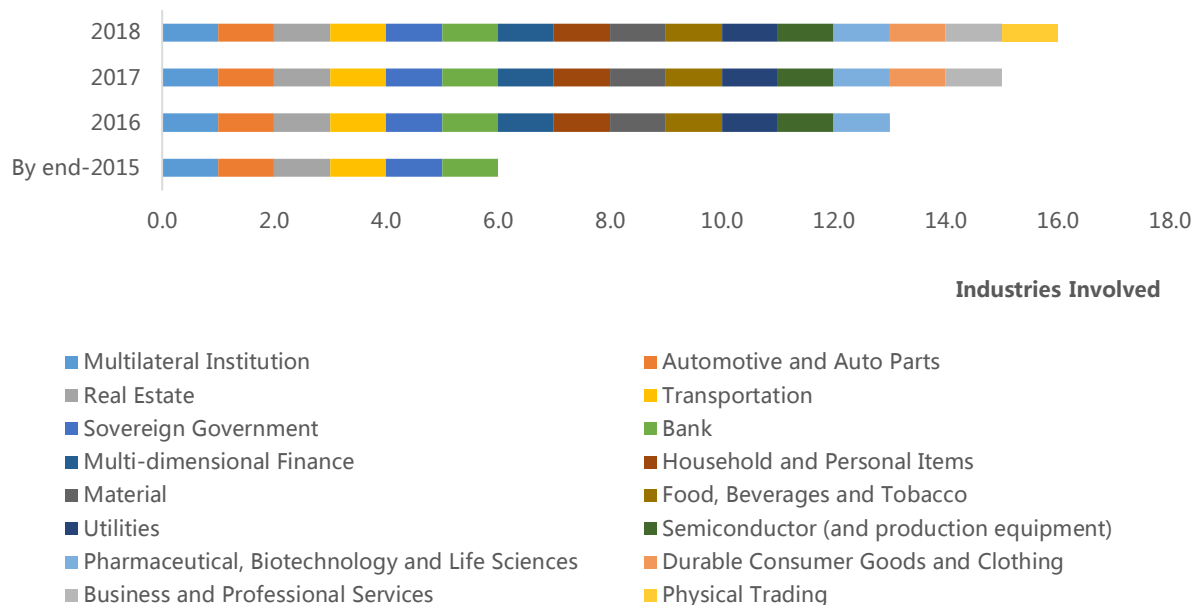
From 2016 to 2018, the main issuers of Panda Bonds are real estate enterprises and financial institutions. In the past three years, the total issuance volume of real estate Panda Bonds was 110.54 billion Yuan, accounting for 37.2% of the total, and that of financial institutions was 63.4 billion Yuan, accounting for 21.3%. In terms of industry breakdown, since the 2016 relaxation of policies, Panda Bond issuers are no longer limited to the scope of multilateral development institutions, sovereigns, financial institutions, and other traditional ones. The background of Panda Bond issuers is enriching with the entrance of issuers from consumer goods, service, pharmaceutical, public utilities and other industries, indicating that the Panda Bond market is becoming more mature and diversified.

**Figure 5. Distribution of Panda Bond issuers by type (according to issue size)**



Source: public information, edited by CCXI

**Figure 6. Industries involved by Panda Bond financing entities<sup>3</sup>**



Source: public information, edited by CCXI

**(IV) Panda Bonds maturities are concentrated in short to medium terms, but some enterprises became long-term issuers.**

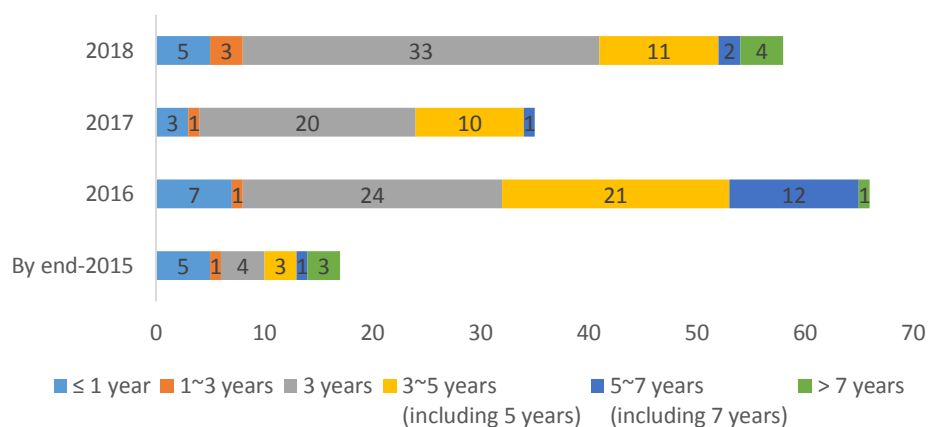
<sup>3</sup> Customers with new issuances and remaining Panda bonds in the corresponding year are all included.



The maturities of Panda Bonds are mainly short to medium terms. From 2016 to 2018, a total of 97 Panda Bonds with maturities less than three years (including three years) were issued, with a scale of 182.09 billion Yuan, accounting for 61.2% of the total, and the three-year bonds alone accounted for 46.3%, ranking the top of all kinds of maturities. Specifically, most pure foreign entities out of exchange risk considerations, tend to issue bonds within three years; in contrast, red-chip enterprises tend to issue long-term Panda Bonds. The proportion of Panda Bonds issued by pure foreign entities and red-chip enterprises within three years are 90.0% and 45.7% respectively, with the exception of Air Liquide Group Finance Company of France, the medium and long term overseas Panda Bond issuers are concentrated in multilateral development institutions. In recent years, with the expansion of business in China and the launch of large-scale infrastructure projects along the “Belt and Road”, more Panda Bonds with longer maturities have been issued. For example, in 2018, Air Liquide Finance issued a five-year PPN in the interbank market; China Merchants Port Holdings Limited issued a five-year "Belt and Road" Corporate Bond in the Shenzhen Stock Exchange, and its proceeds were used for the acquisition of Hambantota Port in southern Sri Lanka; Pross China Holdings Co., Ltd. issued four nine-year “Belt and Road” Corporate Bonds in the Shenzhen Stock Exchange, and the raised funds were mainly used for purchasing logistics infrastructure assets in the UK, Germany, France and the Netherlands.

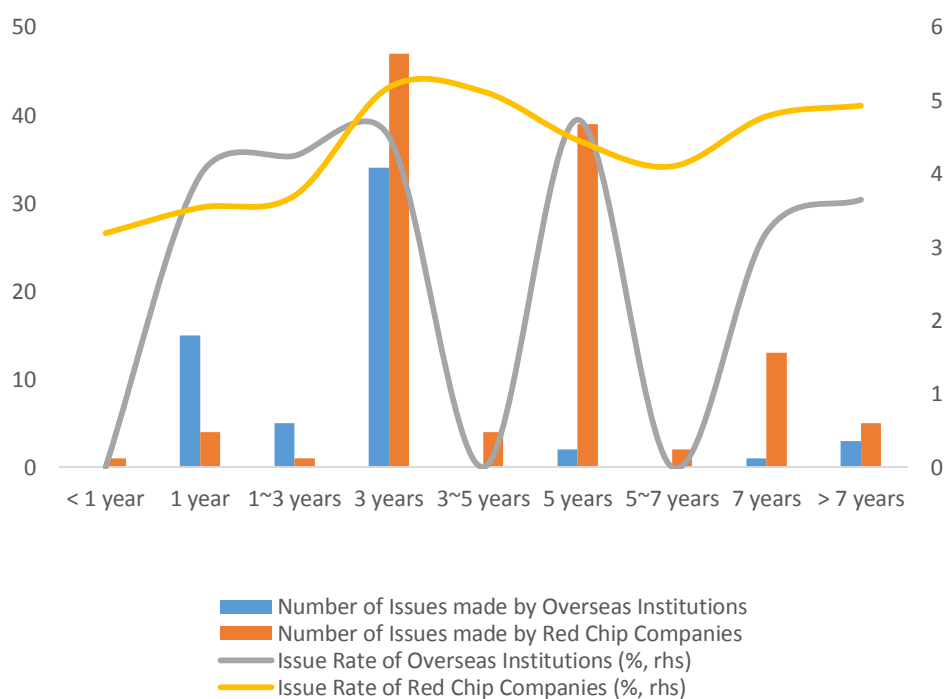
For issuers with long-term RMB financing needs, Panda Bonds have the advantages of longer maturities, unrestricted use of proceeds, and market-based interest rates compared with bank loans and other RMB financing channels. Looking back into the past three years, it can also be found that the issuance frequency and volume of existing Panda Bond issuers (both red-chip and pure foreign entities) were increasing, which in turn proving that the role of Panda Bond market as a long-term RMB financing channel is building up.

**Figure 7. Panda Bond issuance term structure**



Source: public information, edited by CCXI

**Figure 8. Panda Bond issuance periods of red-chip companies and overseas institutions**



Source: public information, edited by CCXI

### **(V) Panda Bond issuers became increasingly diversified in qualifications, and local Chinese rating agencies would help bridge the information asymmetry from regional differences.**

The Panda Bond market is positioned for highly qualified foreign institutions with real RMB financing needs. So far, the global scale ratings<sup>4</sup> of the issuers are above investment level, while the local scale ratings are concentrated in AAA. For local scale ratings, the interbank public offering market requires higher qualifications of Panda Bond issuers, with all of the issuers assigned AAA ratings. While the requirements on issuers' qualifications in the exchange public offering market have been relaxed. In 2017, China Auto Rental Ltd. and Skyworth Digital Holdings Co., Ltd., both rated AA+, successively issued Panda Bonds in the exchange market, marking a major breakthrough since 2016. In 2018, Beijing Enterprises Clean Energy Group Limited, another AA+ rating company, issued green renewable corporate bonds in the public offering exchange market. It follows that, with the expansion of the market in recent years, the concentration of global scale credit ratings of Panda Bond issuers has declined compared with the initial stage, revealing a more diversified trend. From 2017 to 2018, the number of issuers whose global scale ratings were below A- has increased significantly in the public offering market. In 2017, 81.8% of Panda Bond issuers were rated below A-, which is 11.8% higher than that of 2016. In 2018, the trend of diversification was strengthened as the proportion further rose to 90.9%. With the increasing demand for RMB financing from relevant countries and institutions, as well as the relaxation of access requirements on Panda Bond issuers, the participation of high-quality issuers from different industries and qualifications could help promote the expansion and diversification of the Panda Bond market.

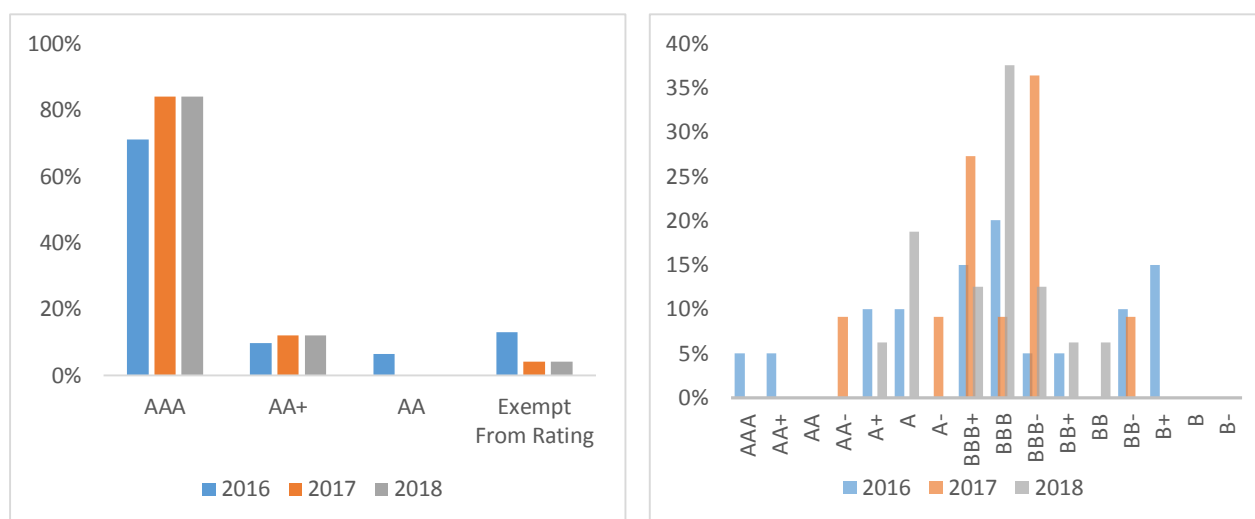
It is worth noting that the problem of information asymmetry is prominent due to the regional differences between issuers and investors in the Panda Bond market. With the increasing diversification of offshore issuers, domestic rating agencies are taking on a more irreplaceable role in evaluating credit risk of offshore entities. On the one hand, due to the limitation of sovereign ceilings, the different judgments on sovereign risks made by Chinese and foreign rating agencies may lead to underestimation of the enterprise strength and restrain the entity's

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<sup>4</sup> The credit ratings can be divided into "global scale" and "local scale" according to regional distributions of the rated entities.

willingness to issue RMB bonds, which is not conducive to the market development. On the other hand, it is necessary to make horizontal comparisons between foreign and Chinese issuers in the practice of Panda Bond issuance. With abundant rating samples, Chinese rating agencies can provide more accurate and effective benchmarks in the Panda Bond ratings. Therefore, Chinese rating agencies should make better alignment of the local and global scale credit rating methodologies, strengthen the risk disclosure of overseas issuers, and bridge the differences caused by information asymmetry at home and abroad.

**Figure 9. Credit rating of Panda Bond issuers**



2016~2018 Distribution of domestic credit ratings of Panda Bond issuers

2016~2018 Distribution of overseas credit ratings of Panda Bond issuers

Source: public information, edited by CCXI

**(VI) The Panda Bond supervision has been gradually improved with the “Measures” introduced to provide clear guidelines. The relaxation of accounting and auditing standards and the diversification of foreign investors could uplift the market prospect.**

In 2005, the *Interim Administrative Measures for the Issuance of RMB Bonds by International Development Institutions* made preliminary regulations on the threshold for the issuance of

RMB bonds by international development institutions in China<sup>5</sup>. From 2014 to 2016, several documents were issued successively, which gave instructions on fund remittance, bond issuance, trading or transfer and macro-prudential management of cross-border financing. Although restrictions on the qualifications and the use of proceeds were being relaxed, which gradually lays the foundation for the Panda Bond market, a unified regulatory framework remained absent. In September 2018, the People's Bank of China and the Ministry of Finance jointly issued the “Measures”, which further defined the accounting and auditing standards along with the use of proceeds for bond issuers. Clarification was made on the procedures of debt financing for overseas financial companies and the contents of registration and issuance documents, information disclosure, use of proceeds, etc., while the application scope got extended to non-financial companies in the supporting framework guidelines promulgated in February 2019. Remarkable relaxation on the accounting and auditing standards forms the main policy breakthrough made in the “Measures”. According to the “Measures”, if an overseas institution applying for public bond issuance is not using the Chinese accounting standards or the equivalent, it could disclose the accounting standards adopted and provide explanations for important differences as compared to Chinese ones while having audits conducted by an overseas accounting firm, a setting that greatly reduces the costs of financial standards conversion and audit. As the first general regulatory framework introduced since the launch of the Panda Bond, the “Measures” and the ensuing release of supportive document have made the relevant procedures of Panda Bond issuance in interbank bond market more complete and transparent.

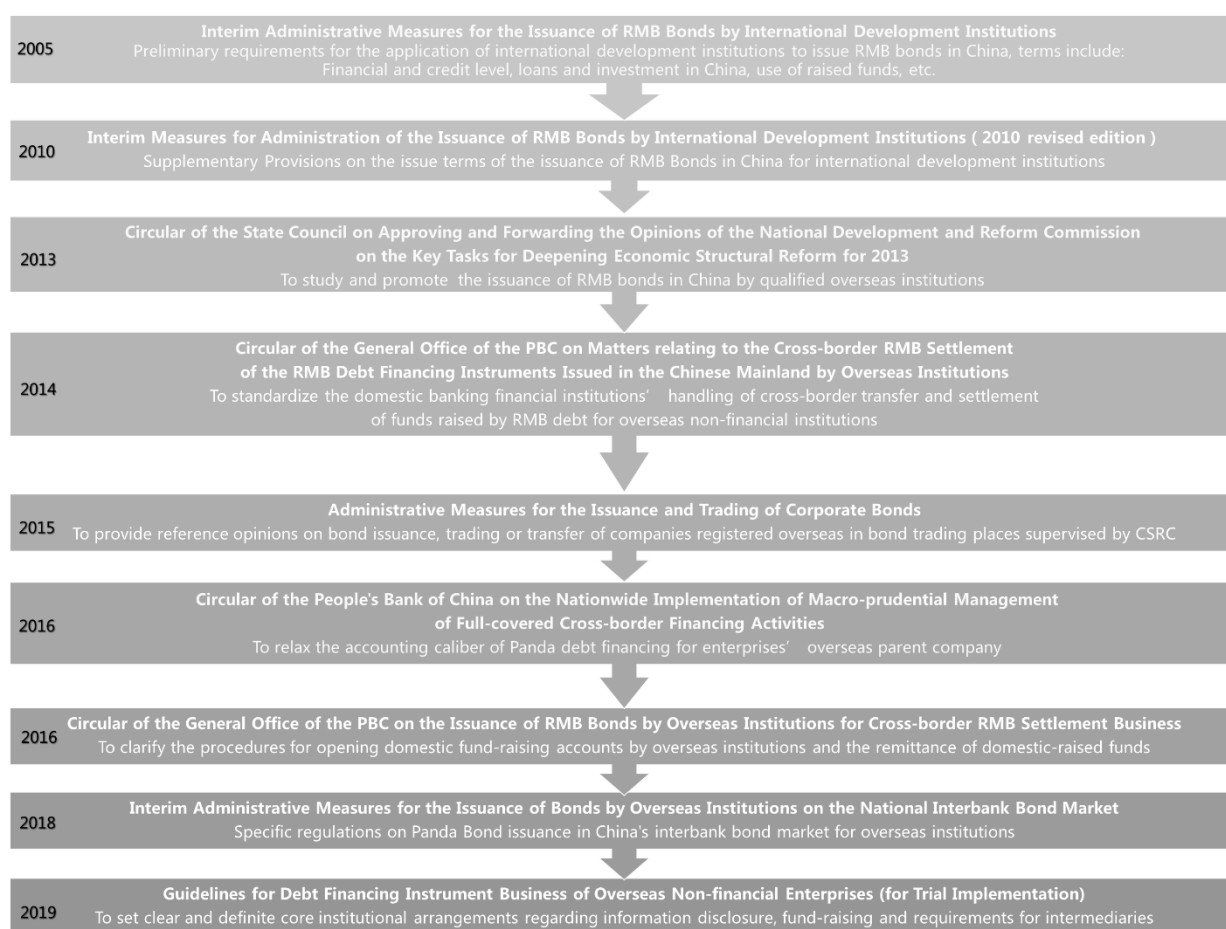
The significant expansion of overseas investors under the “Bond Connect” arrangement is another impetus to the Panda Bond market in recent years. By end-2018, a total of 503 overseas entities had entered the interbank bond market through “Bond Connect”, and the depth and breadth of overseas investors participating in the interbank bond market gradually increased. In this context, the Panda Bond are also appealing to medium- and long-term high-quality overseas investor. Take the sovereign Panda Bond issued by the Republic of the Philippines in March 2018 as an example, the proportion of foreign investors subscribed through “Bond

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<sup>5</sup> this document was revised in 2010

Connect” accounted for 88% of its total subscription. In 2018, the “Bond Connect” had been driving traffic, through both increasing the source of financing and enhancing the secondary market liquidity. Since 2018, the loosening of accounting and auditing standards and the opening of overseas investment in China's bond market could greatly promote the expansion of the Panda Bond market by reducing issuance cost, enriching participant group and prompting investment activity. Meanwhile, several old problems persist. First, current regulatory documents remain at the level of framework guidance, while relevant rules and supporting measures await further clarification. Second, the bond market infrastructure could use added improvement, while the convergence between domestic rules and international practices needs to accelerate.

**Figure 10. Policy Review**



Source: public information, edited by CCXI

In summary, despite the small scale, the Panda Bond market has been witnessing the trials and integration during the opening-up of China's bond market, and valuable experiences could be drawn from such pilot project. On the one hand, amid various motives of overseas entities, the patterns of Panda Bond market have been tilting towards the regulatory purposes that were originally set. This market is positioned as a channel for highly qualified foreign institutions to obtain long-term stable RMB financing, while in practice, due to the disparities in issuing motive and proceeds usage among overseas entities, its scale and structure have been fluctuating widely. So far, there gradually have manifested a more diversified issuer group and a larger proportion of long-term overseas issuers, which is more aligned with the original guideline of this market. On the other hand, the Panda Bond market illustrates the systematic connections amongst the Chinese and foreign bond markets, both at the technical and conceptual levels. The approval procedure of bond issuance has been standardized in terms of issuance instructions, information disclosure, use of proceeds, etc., as compared to the previous state of "case by case". The accounting and auditing standards that overseas entities once were subject to have also been liberalized officially. Likewise, the gap between Chinese and foreign ratings have been bridging inch by inch. From the perspective of rating arrangements introduced by the "Measures", the overall regulatory direction of the Panda Bond market heightens market-orientation - a feature of international practices, which bodes well for the globalization of China's bond market.

### Part II. 2019 Outlook

To help build a sound Panda Bond market and ensure its normalized development, several supportive elements are essential: the steady growth of the Chinese economy, the acceleration of RMB internationalization, and the opening-up and liberalization of the Chinese bond market. Under the superposition of global economic slowdown and contentious U.S.-China trade negotiations, an overall sense of uncertainty will continue to cloud the Panda Bond market. Yet, at the same time, accelerated pace of RMB internationalization and clearer regulatory emphasize on the opening-up and liberation of Chinese financial market indicate a promising future of the market. CCXI believes that, with lower issuance cost, the implementation of supportive regulatory policies and the improvement of bond market infrastructure, the Panda

bond market will continue to pick up in 2019.

**(I) Amid the global economic slowdown and the continuous fermentation of Sino-US trade disputes, the monetary policy is expected to maintain a relaxed tone and the domestic interest rate is on the downward track. Lower issuance costs would benefit foreign issuers with real needs for RMB financing.**

Fundamentally, the economy will face downward pressure in 2019. In order to sustain economic growth, China's monetary policy is expected to maintain marginal easing, and the policy interest rate and market interest rate are expected to decline slightly. In addition, although the monetary policy of the Federal Reserve tends to be conservative, increase in interest rates is still anticipated. The deviation of monetary policies in US and China leads to the differentiation of issuance costs, and the comparative advantages of Panda Bonds will be further revealed to potential issuers. Global economic slowdown and the continuous fermentation of Sino-US trade tensions pose challenges for exports. Concurrently, with the initiative to expand imports, the foreign trade surplus is expected to narrow further and interest rate spreads between China and the United States remain volatile, posing considerable depreciation pressure on of RMB. The exchange rate cost of Panda Bond issuance is also expected to decrease, thus reducing the exchange risk of overseas issuers. Lower issuance cost will provide a favorable window period for overseas enterprises with real needs for RMB financing, promoting the steady expansion of the Panda Bond market.

**(II) The promulgation of the Measures marks that the Panda Bond market will come under clear regulation, and the sequential implementation of more guidance documents in 2019 could further complement the policy framework.**

With regard to policy norms, in September 2018, the interbank bond market launched the first systematic management measure since the pilot issuance of Panda Bonds. The establishment of this unified regulatory framework could provide operable norms for various types of issuers, enabling overseas institutions to issue bonds via referring to a programmatic document of universal applicability. On February 1, 2019, the National Association of Financial Market Institutional Investors (the "NAFMII") announced the release of the Guidelines for Debt



Financing Instrument Business of Overseas Non-financial Enterprises<sup>6</sup> (hereinafter referred to as the “Guidelines”), which clarifies the core institutional arrangements for information disclosure, the use of proceeds and requirements for intermediaries of Panda Bond financing carried out by overseas non-financial enterprises. The “Measures” and “Guidelines” have brought forth a global-oriented operational management framework, which could help integrate rules and practices applied to cross-border bond market, improve procedure transparency, optimize operation mechanism, and prompt the system construction of interbank market to render a high-level open economy. In this way, such policies could help draw more high-quality foreign entities to participate in cross-border investment and RMB financing, thus further energizing the Panda Bond market. It is reported that in 2019, NAFMII would launch supporting product guidelines that apply to multilateral development institutions and foreign governments, which would further complete the Panda Bond institutional system and empower the market in a medium and long-term perspective.

**(III) In 2019, Panda Bond market is expected to attract more overseas participants thanks to the internationalization of bond market and the Belt and Road Forum.**

In early 2019, S&P became the first foreign credit rating agency to enter China’s interbank bond market, and Chinese bonds were confirmed to be added into the Bloomberg Barclays Global Composite Index. These movements add allure for RMB bonds in the eyes of overseas institutions. At the same time, improvements of bond market infrastructure, such as the amendment of “Bond Connect” related rules, will further improve capital allocation efficiency among market participants, and help attract more international participants to enter the Panda Bond market. In 2019, more measures will be implemented to accelerate the opening-up of China’s bond market – the SAFE, China’s currency regulator, is doing research on optimizing the arrangements for overseas investors to participate in foreign exchange hedging transactions. In the aspect of bond market connectivity, the PBOC is preparing to launch bond index products such as bond exchange traded funds (ETF), to promote interconnectivity among central depository institutions, and to extend the settlement cycle for bond trading. The PBOC will also

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<sup>6</sup> for trial implementation

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fully liberalize bond repurchase transactions at the right time and push hard with the utilization of the market for RMB derivatives. In addition, the second Belt and Road Forum is to be held in May 2019, which will tighten the bond between China and other BRI countries. The Panda Bond market, as the forefront of China's capital market opening-up to the outside world, is expected to attract more participants along the route.

In the medium to long term, the Panda Bond market could have broad prospects. By the end of 2018, the outstanding scale of Panda Bonds accounts for merely 0.32% of the overall volume in Chinese bond market, as compared to the much higher proportions of its counterparts in the global market. With the internationalization of RMB and further opening-up of China's capital market, a higher level of opening and diversification of China's bond market and dazzling progress of the Panda Bond market are on display in the foreseeable future.