COMMITTEE ON CAPITAL MARKETS REGULATION

Assessing the Future of U.S. Listings by Chinese Companies: A Call for Structured Dialogue

October 2021

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Assessing the Future of U.S. Listings by Chinese Companies

Call for a Structured U.S.-China Dialogue

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Executive Summary

The Committee on Capital Markets Regulation (the "**Committee**") is concerned with the potential impact on U.S. capital markets from recent policy developments in China and the United States indicating that Chinese companies may halt future listings on U.S. stock exchanges and that Chinese companies presently listed on U.S. stock exchanges may be delisted or will voluntarily delist in the near future.

The withdrawal of Chinese companies from U.S. stock exchanges would be a significant blow to the United States as an international financial center and could threaten the U.S. stock market's role as the world's deepest and most attractive capital market. The purpose of this report is to provide an overview of recent policy developments affecting U.S.-listed Chinese companies and call for a structured dialogue between U.S. and Chinese policymakers with the goal of avoiding a costly decoupling of Chinese companies from U.S. capital markets.

In **Part I** of this report, we describe the role of Chinese companies in U.S. capital markets. As of October 15, 2021, there were 247 Chinese companies listed in the United States with a total market capitalization of $1.6 trillion spanning a diverse range of business sectors. We then describe the unique legal structure—the variable interest entity ("**VIE**")—employed by the majority of Chinese companies listed in the United States.

In **Part II**, we review the four policy issues that threaten Chinese companies' ability to list or remain listed in the United States. First, we describe the Holding Foreign Companies Accountable Act (the "**HFCAA**") that requires the Securities and Exchange Commission (the "**SEC**") to delist Chinese companies from U.S. exchanges as soon as 2024 if Chinese officials continue to prevent U.S. regulators from reviewing the audits of U.S.-listed Chinese companies. Second, we describe U.S. Executive Orders issued by President Trump in 2020 and President Biden in 2021 banning trading by U.S. investors in firms with links to the Chinese military, including four large companies that have subsequently delisted from U.S. exchanges. And third, we review actions by Chinese regulators requiring that the Cyberspace Administration of China pre-approve foreign listings for certain Chinese companies. Finally, we examine recent indications that U.S. and Chinese regulators could restrict the ongoing use of the VIE structure.

In **Part III**, we briefly consider the market reaction to these policy developments. We find that the market valuation of U.S.-listed Chinese companies has fallen sharply suggesting that recent policy developments are materially harming U.S.-listed Chinese companies and their investors. We also note that the majority of Chinese companies listed in the United States by market capitalization have recently cross-listed in other jurisdictions to preserve their access to global pools of investment capital outside of China.

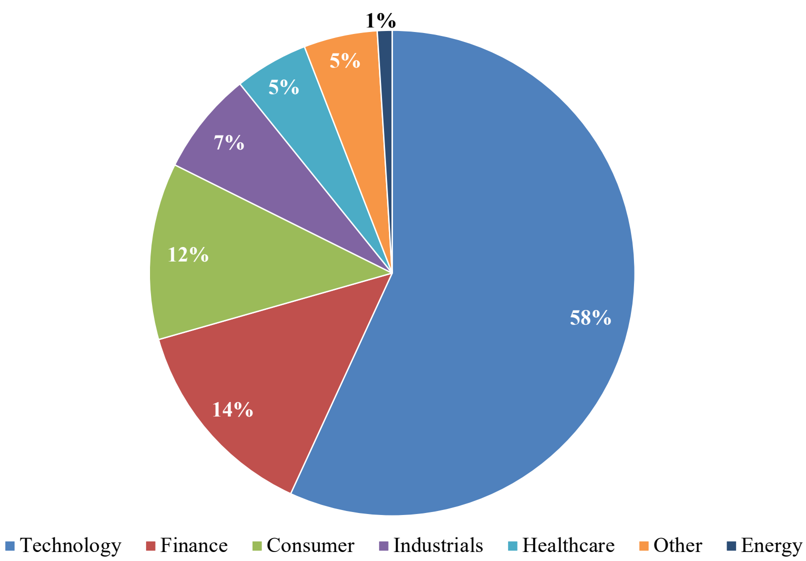
We recommend that U.S. and Chinese authorities form a high-level working group with participants from both sides, including the SEC and China Securities Regulatory Commission ("**CSRC**"), to systematically evaluate the full range of issues together and make joint recommendations for resolution. The goal should be to avoid a large-scale delisting of Chinese companies from U.S. stock exchanges that could lead to further restrictions on cross-border investment that would harm issuers and investors in both countries.

Part I. U.S. Listings by Chinese Companies

U.S. listings by Chinese companies are a relatively recent phenomenon: website operator China.com Corp began the trend when it went public on the Nasdaq in 1999 during the dotcom bubble, raising $84 million.[1] Since then, U.S. listings by Chinese companies have increased steadily over time. Over the past ten years, public offerings in the United States by Chinese companies raised $78 billion,[2] representing 8.4% of the capital raised by U.S. IPOs.[3]

As of October 15, 2021, there were 247 Chinese companies listed on U.S. stock exchanges with a total market capitalization of $1.6 trillion, representing approximately 4% of all U.S.-listed equities.[4] Chinese companies listed on U.S. exchanges include private-sector companies and state-owned enterprises ("**SOEs**") and represent a diverse range of sectors, including: technology, finance, consumer services, industrials and health care, among others. However, as demonstrated by **Figure 1**, technology companies such as Alibaba and JD.com constitute 58% of U.S.-listings by Chinese companies based on market capitalization.

Figure 1: U.S. Listed Chinese Companines by Industry



Source: Capital IQ data as of June 2021.

[1] Richard Frost and Sophia Horta e Costa, *China Signals End to $2 Trillion U.S. Listings Juggernaut*, BLOOMBERG (Jul. 19, 2021), https://www.bloomberg.com/news/articles/2021-07-18/china-signals-end-to-2-trillion-u-s-stock-listing-juggernaut. *See also* LOS ANGELES TIMES, *Price Raised for China.com IPO* (July 13, 1999), https://www.latimes.com/archives/la-xpm-1999-jul-13-fi-55411-story.html.

[2] Bloomberg data accessed July 20, 2021. Data restricted to IPOs (including SPACs) priced between January 1, 2011 and July 19, 2021 on U.S. exchanges that issued: ADRs; common stock; class A, B, or C shares; or units.

[3] *Ibid*.

[4] Bloomberg data accessed on October 18, 2021. "U.S.-listed Chinese company" is defined as a company domiciled in China listed on the NASDAQ, New York Stock Exchange, or NYSE American. *See also* U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION, *Research*: *Chinese Companies Listed on Major U.S. Stock Exchanges* (May 13, 2021), https://www.uscc.gov/research/chinese-companies-listed-major-us-stock-exchanges. Figures include: i) companies identified as based in China, ii) companies listing a Chinese address as their principal executive offices in SEC filings, and iii) companies with the majority of operations in China, including those structured offshore.

Variable Interest Entity Structure

More than 80% of Chinese companies listed on U.S. stock exchanges use a variable interest entity ("**VIE**") structure.[5] The VIE structure emerged in response to Chinese government restrictions on the foreign ownership of businesses that operate in certain sectors,[6] such as the internet and education sectors.[7] Major exceptions to the VIE structure include the eight SOEs listed on U.S. exchanges, including PetroChina and China Life Insurance Company.[8] The SOEs listed on U.S. exchanges were more readily able to obtain the regulatory and government permissions for raising foreign capital and therefore were not required to adopt a VIE structure. Instead, these large SOEs are listed in the United States in the same manner as other non-U.S. non-Chinese firms. They issued shares in their home stock market to a U.S. depositary institution, which in turn issued American Depository Receipts ("**ADRs**") on U.S. stock exchanges that are available to U.S. investors.[9]

As demonstrated on the next page by **Figure 2**, under the VIE structure, a Chinese business is separated into two parts: the parts of the business that are open to non-Chinese ownership (e.g., U.S. investors) are put into a foreign owned enterprise ("**FOE**") which is owned by an overseas parent entity ("**ParentCo**"). The ParentCo is usually incorporated in a tax-efficient jurisdiction like the Cayman Islands or the British Virgin Islands, and it lists in the United States using the ADR structure whereby U.S. depositary institutions purchase shares in the ParentCo and issue ADRs representing these shares to U.S. investors that are available to trade on U.S. exchanges. The parts of the business that are *not* available to foreign ownership (i.e., only available to Chinese investors) are in a separate Chinese company—the "**VIE**"—which enters into an equity-collateralized debt relationship with the FOE in order to transfer profits to the FOE. The obligation for the transfer is usually provided by a services agreement which establishes the FOE as the

[5] Jing Yang, *U.S. and Chinese Regulators Are in a Bind Over a Three-Letter Acronym*, WALL STREET JOURNAL (Sept. 30, 2021), https://www.wsj.com/articles/u-s-and-chinese-regulators-are-in-a-bind-over-a-three-letter-acronym-11632999033?st=bklnjwbs6qmpi9h&reflink=article_email_share.

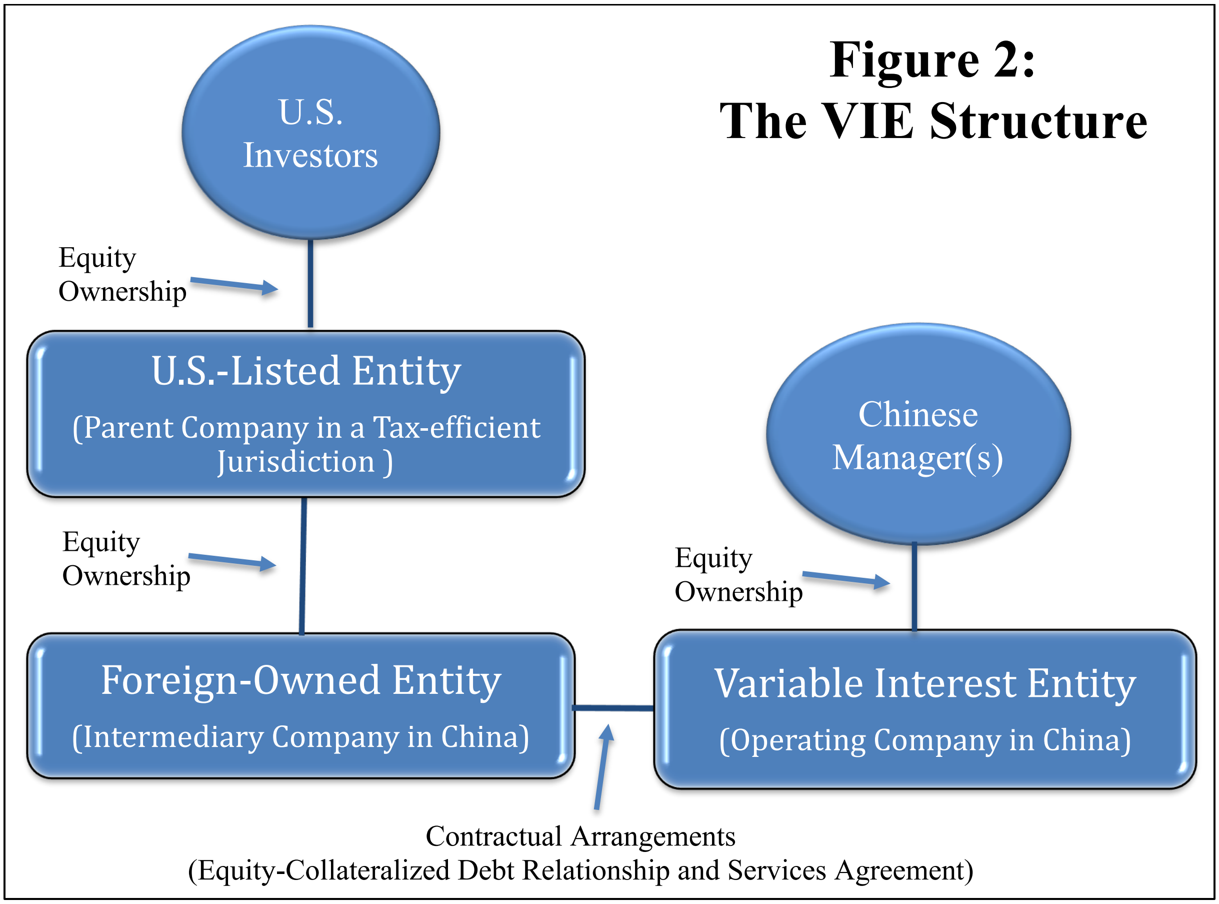
[6] Paul Gillis, *Variable Interest Entities in China*, GMT RESEARCH, 1-2 (Mar.13, 2019), https://www.chinaaccountingblog.com/weblog/2019-03-vie-gillis.pdf; Brandon Whitehill, *Buyer Beware: Chines Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS (Dec. 2017), https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf. *See also* JONES DAY, *China Further Opens its Market with New "Foreign Investment Law"* (Feb. 2020), https://www.jonesday.com/en/insights/2020/02/chinas-new-foreign-investment-law.

[7] DEAN, SHIRA & ASSOCIATES, *The Special Administrative Measures on Access to Foreign Investment (2020 ed.)* (July 2020), https://www.dezshira.com/library/legal/special-administrative-measures-access-foreign-investment-2020-edition-national-negative-list.html?1593598930#.

[8] PetroChina was established as a joint stock company under Chinese law on Nov. 5, 1999. The American Depositary Shares (ADS) and H shares of PetroChina were listed on the NYSE on Apr. 6, 2000 (stock code: PTR) and the Stock Exchange of Hong Kong Limited on April 7, 2000 (stock code: 857), respectively. It was listed on the Shanghai Stock Exchange on Nov. 5, 2007 (stock code: 601857). *See* http://www.petrochina.com.cn/ptr/gsjj/gsjs_common.shtml. China Life was established under Chinese law on Jun. 30, 2003. It was listed on the NYSE, the Hong Kong Stock Exchange and Shanghai Stock Exchange on Dec. 17 and 18, 2003, and Jan. 9, 2007, respectively. See https://www.e-chinalife.com/xxpl/gywm/gsjs/.

[9] *See, e.g.*, PETROCHINA COMPANY LIMITED, *Annual Report on Form 20-F for the fiscal year ended December 31, 2020* (April 29, 2021), https://www.sec.gov/Archives/edgar/data/0001108329/000119312521140226/d77520d20f.htm. *See* FIDELITY, *Understanding American Depositary Receipts* (2017), https://www.fidelity.com/learning-center/investment-products/stocks/understanding-american-depositary-receipts.

exclusive supplier of technical or consultancy services to the VIE.[10] The relationship between the FOE and the VIE is designed to establish the mutual interdependence of the two entities and thus the presumption that both their accounts should be consolidated into the accounts of the ParentCo.[11]



Risks for U.S. Investors from the VIE Structure

The VIE structure poses certain risks for U.S. investors. First, VIEs may not pay their earnings to the FOE and U.S. investors. According to a 2017 analysis by the Council of Institutional Investors ("**CII**"), "less than one fifth of U.S.-listed Chinese VIEs currently pay or intend to pay dividends to shareholders."[12] Similarly, according to a February 2021 report, a dozen U.S.-listed Chinese internet companies have not been remitting profits to their ParentCo as

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[10] Paul Gillis, *Variable Interest Entities in China*, GMT RESEARCH (Mar.13, 2019), https://www.chinaaccountingblog.com/weblog/2019-03-vie-gillis.pdf

[11] *Ibid*.

[12] Brandon Whitehill, *Buyer Beware: Chines Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS (Dec. 2017), https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf.

contemplated by the VIE structure.[13] According to the CII, "this arrangement potentially leaves investors to rely solely on the appreciation of the company's stock price for a return on their investment."[14]

Second, the VIE structure provides U.S. and other non-Chinese investors with limited ability to change or influence the operating company's management, because U.S. and other non-Chinese investors typically lack voting rights in the VIE. One high-profile dispute between Alibaba and Yahoo illustrates the risks associated with this absence of such rights.[15] In 2005, Yahoo invested in Alibaba by way of a VIE structure. Alibaba later successfully developed Alipay—a mobile and online payment platform—as a wholly-owned subsidiary.[16] However, in 2011, when Alibaba elected to spin out Alipay into a separate entity owned by Alibaba's Chinese founders, Yahoo was unable to prevent the transfer; and when the parties ultimately settled a dispute over the spinoff, Alibaba (and therefore its investors, including Yahoo) became entitled to a reduced share of Alipay's pre-tax income compared to the status quo ante, when Alipay was a wholly-owned subsidiary.[17]

Third, and perhaps most importantly, the various agreements binding the VIE to the FOE (and supporting the VIE's consolidation onto the ParentCo's balance sheet) have never been officially approved by a Chinese regulatory body,[18] and in the event of a dispute over the terms and validity of these agreements, there is no guarantee that a Chinese court would enforce them. If the underlying contracts binding the FOE and VIE were declared invalid by Chinese authorities, then investors would have no interest in the Chinese operating company in which they intended to invest.[19]

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[13] Jing Yang, *U.S. and Chinese Regulators Are in a Bind Over a Three-Letter Acronym*, WALL STREET JOURNAL (Sept. 30, 2021), https://www.wsj.com/articles/u-s-and-chinese-regulators-are-in-a-bind-over-a-three-letter-acronym-11632999033?st=bklnjwbs6qmpi9h&reflink=article_email_share.

[14] *Supra* at 13.

[15] *See* Kaitlyn Johnson, *Variable Interest Entities: Alibaba's Regulatory Work-Around to China's Foreign Investment Restrictions*, 12 LOY. U. CHI. INT'L L. REV. 249, 255-256 (2015), https://lawecommons.luc.edu/cgi/viewcontent.cgi?article=1181&context=lucilr.

[16] *See id.* at 255-256.

[17] *See* Kathrin Hille and Joseph Menn, *Alibaba settles Alipay dispute with Yahoo*, FINANCIAL TIMES (July 29, 2011), https://www.ft.com/content/40a66dd2-b9ec-11e0-8171-00144feabdc0. See also Stephen Foley and Nicole Bullock, *Alibaba defends payments unit split-off*, FINANCIAL TIMES (Sept. 11, 2014), https://www.ft.com/content/dba294ac-39cb-11e4-8aa2-00144feabdc0.

[18] Paul Gillis, *Variable Interest Entities in China*, GMT RESEARCH, 7 (Mar.13, 2019), https://www.chinaaccountingblog.com/weblog/2019-03-vie-gillis.pdf.

[19] *See, e.g.*, Gregory J. Millman, *Alibaba's IPO Puts VIE Structure in the Spotlight*, THE WALL STREET JOURNAL (Sept. 22, 2014), https://www.wsj.com/articles/BL-252B-5198. *See also*, ALIBABA GROUP HOLDING LIMITED, *Registration Statement on Form F-1*, 40-43 (May 6, 2014), https://www.sec.gov/Archives/edgar/data/1577552/000119312514184994/d709111df1.htm; USCC, *Chinese Companies Listed on Major U.S. Stock Exchanges,* 2 (May 5, 2021), https://www.uscc.gov/sites/default/files/2021-05/Chinese_Companies_on_US_Stock_Exchanges_5-2021.pdf.

Part II. Policy Issues Affecting Chinese Companies Listed in the United States

Several policy issues are threatening Chinese companies' ability to list or remain listed in the United States. These include longstanding issues with the ability of U.S. regulators to review the audits of U.S.-listed Chinese companies as well as more recent developments, including U.S. executive orders targeting firms with links to the Chinese military; Chinese authorities' enhanced scrutiny of strategic sectors such as technology; and potential regulatory challenges to the VIE structure. This section will address each issue in turn.

A. U.S. Regulators Lack Access to Audits of U.S.-Listed Chinese Companies

i. Background on Audit Requirements of U.S.-Listed Companies

The SEC requires U.S.-listed issuers to provide audited financial statements to investors.[20] In 2002, Congress passed the Sarbanes-Oxley Act ("**SOX**") strengthening these requirements in response to corporate and accounting scandals that shook confidence in U.S. capital markets.[21] Under SOX, accounting firms (whether located in the United States or abroad) that prepare or issue an audit opinion with respect to any U.S.-listed issuers are required to register with the Public Company Accounting Oversight Board (the "**PCAOB**"), submit to PCAOB inspection, and produce audit work papers upon request.[22] When the PCAOB inspects an accounting firm, it reviews specific audits that the firm has performed, which affords the PCAOB access to the underlying records about the accounting firm's issuer-clients. [23]

However, when the PCAOB inspects non-U.S.-based accounting firms and their audit work papers, foreign laws concerning data protection, privacy, confidentiality, bank secrecy, state secrecy, or national security can restrict access to the information reasonably necessary for the PCAOB to perform inspections.[24] For this reason, the SEC and PCAOB have entered into cooperative agreements with foreign regulators to facilitate the timely exchange of information related to audit inspections.[25] When negotiating agreements with foreign regulators, the PCAOB

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[20] U.S. Treasury Dept., *President's Working Group on Financial Markets: Report on Protecting United States Investors from Significant Risks from Chinese Companies*, 5 (July 24, 2020), https://home.treasury.gov/system/files/136/PWG-Report-on-Protecting-United-States-Investors-from-Significant-Risks-from-Chinese-Companies.pdf ["**PWG Report (2020)**"].

[21] Corporate Finance Institute, *What is the Sarbanes-Oxley Act?* (2021), https://corporatefinanceinstitute.com/resources/knowledge/other/sarbanes-oxley-act/.

[22] PWG Report (2020), supra note 20, at 2-3

[23] Public Company Accounting Oversight Board, *PCAOB Inspection Procedures: What Does the PCAOB Inspect and How Are Inspections Conducted?* (last accessed Feb. 5, 2021), https://pcaobus.org/oversight/inspections/inspection-procedures.

[24] Chairman Jay Clayton, Chief Accountant Wes Bricker, and PCAOB Chairman William D. Duhnke III, *Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China*, U.S. Sec. & Exch. Comm'n (Dec. 7, 2018) https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other ["**SEC Statement (2018)**"].

[25] SEC Statement (2018), supra note 24. *See also* U.S. Sec. & Exch. Comm'n, *International Enforcement Assistance* (May 31, 2021), https://www.sec.gov/about/offices/oia/oia_crossborder.shtml; PCAOB, *PCAOB Cooperative Arrangements with Non-U.S. Regulators* (last accessed April 1, 2021), https://pcaobus.org/oversight/international/regulatorycooperation.

prioritizes three principles of access: (i) the ability to conduct inspections and investigations consistent with its mandate; (ii) the ability to select the audit work and potential violations to be examined; and (iii) access to firm personnel, audit workpapers, and other information or documents deemed relevant by its team.[26]

ii. Lack of PCAOB Access to Audits of U.S.-Listed Chinese Companies & Past Initiatives Aimed at Resolution

Chinese accounting firms, including the Chinese affiliates of the four largest U.S. accounting firms that audit the overwhelming majority of U.S.-listed Chinese issuers,[27] are registered with the PCAOB. However, as of 2007, Chinese authorities have prevented Chinese accounting firms from sharing key records and information with the PCAOB, citing concerns about national security, state secrets, and sovereignty.[28] Therefore, for the past fourteen years, the PCAOB has been generally unable to inspect to its satisfaction the audit work papers and practices of PCAOB-registered accounting firms in China (including Hong Kong) with respect to their audit work for U.S.-listed Chinese companies.[29] The lack of audit inspection access raises concerns for the SEC and PCAOB as to the quality of financial statements by Chinese issuers listed in the United States.

U.S. and Chinese authorities have undertaken a number of initiatives to attempt to resolve the PCAOB's audit access concerns.[30] In August 2011, U.S. and Chinese securities regulators

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[26] PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, *Letter to the U.S. Department of the Treasury, U.S. Securities and Exchange Commission, Board of Governors of the Federal Reserve System, and U.S. Commodity Futures Trading Commission*, 20 (July 10, 2020), https://home.treasury.gov/system/files/136/PWG-Report-on-Protecting-United-States-Investors-from-Significant-Risks-from-Chinese-Companies.pdf ["**PCAOB Letter (2020)**"]

[27] PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, *Data About our China-Related Access Challenges* (June 30, 2021), https://pcaobus.org/oversight/international/china-related-access-challenges/data-about-our-china-related-access-challenges.

[28] SEC Statement (2018), supra note 24; PWG Report (2020), supra note 1, at 6-7; PCAOB Letter (2020), supra note 26, at 5; BLOOMBERG TAX AND ACCOUNTING, *Podcast: China Refuses US Audit Inspections. Why It Matters.* (last accessed Feb. 2, 2020), https://pro.bloombergtax.com/podcast-china-refuses-us-audit-inspections-why-it-matters/. See also Dawn Lim and Jing Yang, *Countdown Starts on Chinese Company Delistings After Long U.S.-China Audit Fight*, WALL STREET JOURNAL (Oct. 2, 2021), https://www.wsj.com/articles/countdown-starts-on-chinese-company-delistings-after-long-u-s-china-audit-fight-11633172403?st=4kzb3xo6v4pkajo&reflink=article_email_share.

[29] PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, *Letter to the U.S. Department of the Treasury, U.S. Securities and Exchange Commission, Board of Governors of the Federal Reserve System, and U.S. Commodity Futures Trading Commission*, 3 (July 10, 2020), https://home.treasury.gov/system/files/136/PWG-Report-on-Protecting-United-States-Investors-from-Significant-Risks-from-Chinese-Companies.pdf ("China's refusal to cooperate meaningfully with the PCAOB is not new. It dates back to 2007 when Chinese and Hong Kong audit firms first invoked Chinese restrictions to refuse us access to conduct inspections of audit work performed in China. Since that initial refusal in 2007, the PCAOB has engaged in numerous attempts to obtain access to conduct inspections and enforcement activities in China on terms consistent with the remainder of the world.").

[30] See, e.g., PCAOB Letter (2020), supra note 26, at 21; PCAOB, *Joint Press Release Chinese and U.S. Regulators Held Meeting in Beijing on Audit Oversight Cooperation* (Aug. 8, 2011), https://pcaobus.org/news-events/news-releases/news-release-detail/joint-press-release-chinese-and-u-s-regulators-held-meeting-in-beijing-on-audit-oversight-cooperation_346; CHINA SECURITIES REGULATORY COMMISSION, *Officials from relevant departments of the CSRC answered reporter questions* (April 27, 2020),

attended a "Sino-U.S. Symposium on Audit Oversight" where respective authorities briefed each other on their audit oversight processes in order to deepen mutual understanding and facilitate future cooperation on audit issues.[31] They also held recurring discussions on audit inspection issues at the U.S.-China Strategic and Economic Dialogue.[32] In 2013, the China Securities Regulatory Commission (the "**CSRC**") and PCAOB signed a non-binding memorandum of understanding on enforcement cooperation under which Chinese auditors shared with the PCAOB the working papers for the audits of four different Chinese companies listed in the U.S. that were under investigation by U.S. authorities.[33] Following this agreement, in 2015, U.S. and Chinese officials entered into discussions to establish a broader set of inspection protocols, but these talks failed to result in an agreement.[34] From 2016 to 2017, the PCAOB and CSRC conducted a pilot inspection of one PCAOB-registered Chinese accounting firm where, according to the CSRC, "the Chinese side facilitated PCAOB's inspection of the quality control system of the firm and the examination by PCAOB staff of audit working papers of three engagements by the firm."[35] More recently, in early 2020, the CSRC proposed a joint inspection framework whereby U.S. officials would conduct inspections under the supervision of Chinese officials,[36] but the PCAOB again reiterated its position that the Chinese proposal imposed "critical limitations" on its ability to conduct inspections, including the PCAOB's ability to select the target and scope of its inspections.[37]

While these efforts were ongoing, in 2012, the SEC brought an administrative proceeding against the China-based affiliates of Deloitte, Ernst & Young, KPMG, and PwC for refusing to produce audit work papers relating to Chinese companies listed in the United States under SEC

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http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/202004/t20200427_374553.html; REUTERS, *Timeline: U.S., HK regulators struggle to get China audit papers* (Dec. 20, 2017), https://www.reuters.com/article/china-audit-timeline/timeline-u-s-hk-regulators-struggle-to-get-china-audit-papers-idUSKBN1EE0HT; PCAOB, *PCAOB Enters into Enforcement Cooperation Agreement with Chinese Regulators* (May 24, 2013), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-enters-into-enforcement-cooperation-agreement-with-chinese-regulators_430; CHINA SECURITIES REGULATORY COMMISSION, *Officials from relevant departments of the CSRC answered reporter questions* (April 27, 2020), http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/202004/t20200427_374553.html.

[31] PCAOB, *Joint Press Release Chinese and U.S. Regulators Held Meeting in Beijing on Audit Oversight Cooperation* (Aug. 8, 2011), https://pcaobus.org/news-events/news-releases/news-release-detail/joint-press-release-chinese-and-u-s-regulators-held-meeting-in-beijing-on-audit-oversight-cooperation_346.

[32] PCAOB Letter (2020), supra note 26, at 21.

[33] CHINA SECURITIES REGULATORY COMMISSION, *Officials from relevant departments of the CSRC answered reporter questions* (April 27, 2020), http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/202004/t20200427_374553.html; REUTERS, *Timeline: U.S., HK regulators struggle to get China audit papers* (Dec. 20, 2017), https://www.reuters.com/article/china-audit-timeline/timeline-u-s-hk-regulators-struggle-to-get-china-audit-papers-idUSKBN1EE0HT; PCAOB, *PCAOB Enters into Enforcement Cooperation Agreement with Chinese Regulators* (May 24, 2013), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-enters-into-enforcement-cooperation-agreement-with-chinese-regulators_430.

[34] Dawn Lim and Jing Yang, *Countdown Starts on Chinese Company Delistings After Long U.S.-China Audit Fight*, WALL STREET JOURNAL (Oct. 2, 2021), https://www.wsj.com/articles/countdown-starts-on-chinese-company-delistings-after-long-u-s-china-audit-fight-11633172403?st=4kzb3xo6v4pkajo&reflink=article_email_share.

[35] CHINA SECURITIES REGULATORY COMMISSION, *Officials from relevant departments of the CSRC answered reporter questions* (April 27, 2020), http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/202004/t20200427_374553.html.

[36] Dawn Lim and Jing Yang, *Countdown Starts on Chinese Company Delistings After Long U.S.-China Audit Fight*, WALL STREET JOURNAL (Oct. 2, 2021), https://www.wsj.com/articles/countdown-starts-on-chinese-company-delistings-after-long-u-s-china-audit-fight-11633172403?st=4kzb3xo6v4pkajo&reflink=article_email_share.

[37] PCAOB Letter (2020), supra note 26, at 21-24.

investigation.[38] The firms argued that Chinese law prevented them from fulfilling these requests, and the SEC responded that this did not relieve them of their obligations under U.S. law.[39] In 2015, the SEC issued an order settling the proceedings that required each firm to pay $500,000 and perform specified steps to satisfy SEC requests for similar materials over the following four years.[40] Under the settlement order, the SEC agreed to coordinate its requests for information through the CSRC; the audit firms agreed to provide responsive information to the CSRC; and the SEC and CSRC would exchange documents and information directly.[41] The audit firms also agreed to produce a "withholding log" including all information withheld from the PCAOB due to Chinese legal restrictions.[42] If the audit firms failed to follow the terms of the order, then they would face an automatic six-month suspension from auditing U.S.-listed companies.[43] Although the order did not result in PCAOB access to the audits of U.S.-listed Chinese issuers, the settlement facilitated direct communications between the SEC and CSRC before it expired in February 2019.[44]

Notwithstanding all of these efforts, in 2020, the PCAOB asserted that "the Chinese side has never agreed to provide access consistent with PCAOB core principles,"[45] because Chinese authorities have imposed critical limitations on the PCAOB's ability to select the specific engagements, define the scope of its inspections, access documents, and investigate potential violations.[46]

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[38] U.S. SEC. & EXCH. COMM'N, *Press Release: SEC Charges China Affiliates of Big Four Accounting Firms with Violating U.S. Securities Laws in Refusing to Produce Documents* (Dec. 3, 2012), https://www.sec.gov/news/press-release/2012-2012-249htm; SIMPSON THATCHER, *Global Accounting Firms Caught in the Crossfire as SEC Fails to Reach Agreement with Chinese Regulators on Document Sharing* (Dec. 10, 2012), https://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1551.pdf.
[39] U.S. SEC. & EXCH. COMM'N, *Corrected Order on the Basis of Offers of Settlement of Certain Respondents Implementing Settlement*, File Nos. 3-14872, 3-15116, 6 (Feb. 6, 2015), https://www.sec.gov/litigation/admin/2015/34-74217.pdf.
[40] U.S. SEC. & EXCH. COMM'N, *Press Release: SEC Imposes Sanctions Against China-Based Members of Big Four Accounting Networks for Refusing to Produce Documents* (Feb. 6, 2015), https://www.sec.gov/news/pressrelease/2015-25.html. *See also* Gina Chon, *China auditors settle with SEC for $2m*, FINANCIAL TIMES (Feb. 6, 2015), https://www.ft.com/content/e1d13df2-ae1e-11e4-8d51-00144feab7de; Sarah N. Lynch, *'Big Four' auditors' Chinese units settle with U.S. SEC over document dispute*, REUTERS (Feb. 6, 2015), https://www.reuters.com/article/us-sec-china-bigfour/big-four-auditors-chinese-units-settle-with-u-s-sec-over-document-dispute-idUSKBN0LA1QD20150206.
[41] U.S. SEC. & EXCH. COMM'N, *Corrected Order on the Basis of Offers of Settlement of Certain Respondents Implementing Settlement*, File Nos. 3-14872, 3-15116, 21-23 (Feb. 6, 2015), https://www.sec.gov/litigation/admin/2015/34-74217.pdf.
[42] *See id.* at 22.
[43] *See id.* at 24.
[44] *See id.* at 28.
[45] PCAOB Letter (2020), supra note 26, at 21. *See also* WEAVER, *PCAOB Says Its Rules Override Chinese Regulations* (Feb. 27, 2017), https://weaver.com/blog/pcaob-says-its-rules-override-chinese-regulations.
[46] PWG Report (2020), supra note 1, at 22-23.

iii. The Holding Foreign Companies Accountable Act of 2020

In response to the longstanding U.S.-China audit inspection issue, Congress passed the Holding Foreign Companies Accountable Act (the "**HFCAA**") in December 2020.[47] The HFCAA introduces documentation and disclosure requirements as well as trading restrictions for certain public companies that have had a "non-inspection year." Under the HFCAA, a "non-inspection year" is a year for which the SEC determines that the PCAOB has been unable to carry out audit inspections or investigations adequately "because of a position taken by an authority in the foreign jurisdiction."[48]

According to the HFCAA, if an issuer has had a non-inspection year, then the SEC must require the issuer to submit documentation to the SEC establishing that the issuer is not "owned or controlled" by a governmental entity in the foreign jurisdiction.[49] A foreign issuer that has had a non-inspection year must also disclose in its annual report: (i) that, during the period covered by the relevant annual report, the auditor that prepared the audit report was not subject to PCAOB inspection; (ii) the percentage of shares owned by government entities; (iii) whether government entities have a controlling financial interest; (iv) whether the issuer's articles of incorporation contain any charter of the Chinese Communist Party; and (v) information related to board members who are also Chinese Communist Party members.[50] As with other disclosure requirements, the SEC has the authority to bring enforcement actions against issuers that fail to comply,[51] which can result in trading suspensions and delisting, among other sanctions.[52]

Critically, if the SEC determines that an issuer has experienced three consecutive non-inspection years, then the SEC must prohibit the issuer's securities from trading in the United States on national exchanges or through other methods within the SEC's jurisdiction (such as over-the-counter trading).[53] This requirement would effectively mandate the delisting of firms whose auditors are not subject to PCAOB inspection or investigation for three consecutive non-inspection years.

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[47] Pub. L. 116-222, *Holding Foreign Companies Accountable Act* (Dec. 18, 2020), https://www.congress.gov/bill/116th-congress/senate-bill/945 [the "**HFCAA**"]. *See also* Andrew Olmem, Christina Thomas, and Jason Elder of Mayer Brown LLP, *Congress Passes the "Holding Foreign Companies Accountable Act,"* HARVARD LAW SCHOOL (Jan. 10, 2021), https://corpgov.law.harvard.edu/2021/01/10/congress-passes-the-holding-foreign-companies-accountable-act/; SKADDEN, *Holding Foreign Companies Accountable Act Poised To Be Signed Into Law* (Dec. 3, 2020), https://www.skadden.com/insights/publications/2020/12/holding-foreign-companies-accountable.

[48] HFCAA §2(i)(1)(b).

[49] HFCAA §2.

[50] HFCAA §3; U.S. SEC. & EXCH. COMM'N, *SEC Issues Amendments, Seeks Public Comment on Holding Foreign Companies Accountable Act* (March 24, 2021), https://www.sec.gov/news/press-release/2021-53.

[51] *See, e.g.*, U.S. SEC. & EXCH. COMM'N, *Selected Provision from the U.S. Securities Exchange Act of 1934 Relating to the Authority and Discretion of the U.S. SEC to Investigate and Seek Sanctions Relating to Violations of the Securities Laws* (last accessed Sept. 2021), https://www.sec.gov/about/offices/oia/oia_enforce/selpro.pdf.

[52] *See, e.g.*, U.S. SEC. & EXCH. COMM'N, *Selected Division of Enforcement Accomplishments: December 2016 – December 2020* (Dec. 30, 2020), https://www.sec.gov/enforce/selected-division-enforcement-accomplishments-december-2016-december-2020; U.S. SEC. & EXCH. COMM'N, *Investor Bulletin: Trading Suspensions* (May 2012), https://www.sec.gov/files/tradingsuspensions.pdf; U.S. SEC. & EXCH. COMM'N – DIVISION OF ENFORCEMENT, *2020 Annual Report*, 10 (Nov. 2, 2020), https://www.sec.gov/files/enforcement-annual-report-2020.pdf.

[53] HFCAA §2(i)(3).

iv. Timing of Regulatory Implementation of the HFCAA

The HFCAA's requirements do not come into effect until the SEC and PCAOB finalize their rules for determining non-inspection years and identify firms as having non-inspection years.[54]

On March 24, 2021, the SEC adopted an interim final rule[55] addressing disclosure and submission requirements established by the HFCAA. The interim final rule indicated that the PCAOB was considering its process for determining whether it can sufficiently inspect or investigate an accounting firm for audits of U.S.-listed foreign companies due to positions taken by an authority in a foreign jurisdiction.[56] Following the PCAOB's establishment of this process, the SEC stated that it would use the PCAOB determination and information from issuers' annual reports to compile a list of issuers with non-inspection years.[57]

On May 13, the PCAOB proposed a rule that would establish a framework for making non-inspection determinations, including the factors that it will consider when assessing whether a determination is warranted.[58] These factors include: (i) the PCAOB's ability to select engagements, audit areas, and potential violations to be reviewed; (ii) the PCAOB's access to any documents, interviews, testimony, or information in the accounting firm's possession that the PCAOB considers relevant to its inspection; and (iii) the PCAOB's ability to conduct inspections and investigations in a manner consistent with applicable laws and regulations, as interpreted and applied by the PCAOB.[59] The PCAOB adopted the final rule on September 22, 2021 and filed it with the SEC for approval.[60] The SEC comment period remains open.[61]

Although no PCAOB determinations have been made, in September 2021, SEC Chairman Gary Gensler stated that he expects that the SEC will begin identifying non-compliant issuers in

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[54] HFCAA §2(i)(1)(b).

[55] U.S. SEC. & EXCH. COMM'N, *Holding Foreign Companies Accountable Act Disclosure*, Release No. 34-91364; IC-34227, 3-4 (March 24, 2021), https://www.sec.gov/rules/interim/2021/34-91364.pdf.

[56] U.S. SEC. & EXCH. COMM'N, *Holding Foreign Companies Accountable Act Disclosure*, Release No. 34-91364; IC-34227, 3-4 (March 24, 2021), https://www.sec.gov/rules/interim/2021/34-91364.pdf; Pub. L. 116-222, *Holding Foreign Companies Accountable Act*, § 2(i)(2)(B) (Dec. 18, 2020), https://www.congress.gov/bill/116th-congress/senate-bill/945.

[57] U.S. SEC. & EXCH. COMM'N, *Holding Foreign Companies Accountable Act Disclosure*, Release No. 34-91364; IC-34227, 5-6 (March 24, 2021), https://www.sec.gov/rules/interim/2021/34-91364.pdf.

[58] See *Public Company Accounting Oversight Board, News Release: PCAOB Proposes Rule to Create Framework for HFCAA Determinations* (May 13, 2021), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-proposes-rule-to-create-framework-for-hfcaa-determinations.

[59] PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, *Fact Sheet: Proposing Release for PCAOB Rule to Establish HFCAA Framework* (May 13, 2021), https://pcaobus.org/news-events/news-releases/fact-sheet-proposing-release-for-pcaob-rule-to-establish-hfcaa-framework.

[60] PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, *PCAOB Adopts Rule to Create Framework for HFCAA Determinations* (Sept. 22, 2021), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-adopts-rule-to-create-framework-for-hfcaa-determinations

[61] U.S. SEC. & EXCH. COMM'N, *Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule on Board Determinations Under the Holding Foreign Companies Accountable Act,* 86 FED. REG. 53699 (Sept. 28, 2021), https://www.federalregister.gov/documents/2021/09/28/2021-21056/public-company-accounting-oversight-board-notice-of-filing-of-proposed-rule-on-board-determinations.

early 2022, and that in 2024, the SEC will prohibit trading in the shares of companies that have been non-compliant for three years.[62]

[62] Gary Gensler, *SEC Chair: Chinese Firms Need to Open Their Books*, THE WALL STREET JOURNAL (Sept. 13, 2021), https://www.wsj.com/articles/china-accounting-standards-shell-company-vie-investment-sarbanes-oxley-sec-gensler-11631563524?st=hzlp98t37mtgxaw&reflink=article_email_share. *See also* Dawn Lim and Jing Yang, *Countdown Starts on Chinese Company Delistings After Long U.S.-China Audit Fight*, WALL STREET JOURNAL (Oct. 2, 2021), https://www.wsj.com/articles/countdown-starts-on-chinese-company-delistings-after-long-u-s-china-audit-fight-11633172403?st=4kzb3xo6v4pkajo&reflink=article_email_share.

B. U.S. Executive Orders Affecting Companies with Links to Chinese Military

Two Executive Orders—one signed by President Trump in November and one signed by President Biden in June—are also driving forward the process of decoupling between Chinese companies and U.S. capital markets by prohibiting the sale or purchase of certain publicly-traded Chinese securities by U.S. persons.

On November 12, 2020, President Trump issued Executive Order 13959 barring U.S. investors from investing in Chinese companies which, the Administration said, supply and/or support China's military, intelligence and security services—a company-specific determination.[63] The legal basis for the order was the International Emergency Economic Powers Act ("**IEEPA**"), which authorizes the President to regulate foreign economic transactions in order to deal with any unusual or extraordinary foreign threat to the national security or economy of the United States if the President declares a national emergency with respect to that threat,[64] and Section 1237 of the National Defense Authorization Act for Fiscal Year 1999, which broadens the President's authority under the IEEPA with respect to "Communist Chinese Military Companies" ("**CCMCs**") designated by the Secretary of Defense.[65] Executive Order 13959 was designed to prevent U.S. capital markets from financing Chinese military-industrial activities that threaten "the national security, foreign policy, and economy of the United States."[66]

The companies covered by Executive Order 13959 were initially identified by the Defense Department as CCMCs in June and August 2020[67] (the Defense Department then identified additional companies in December 2020 and January 2021).[68] Covered companies included, among others: China Mobile Communications Group, China Telecommunications Corp., and China United Network Communications Group Co Ltd. As a result, the NYSE began delisting proceedings against three listed affiliates before the end of 2020 and called a halt to trading of the securities on January 11, 2021. A subsequent appeal by the companies against the decision was

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[63] Executive Order 13959 of November 12, 2020 *Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies*, https://home.treasury.gov/system/files/126/13959.pdf. Later, amended by Executive Order 13974 of January 13, 2021, https://home.treasury.gov/system/files/126/13974.pdf.

[64] *International Emergency Economic Powers Act*, PUBLIC LAW NO: 95-223 (Dec. 28, 1977), https://www.congress.gov/bill/95th-congress/house-bill/7738.

[65] *Strom Thurmond National Defense Authorization Act for Fiscal Year 1999*, PUBLIC LAW NO: 105-261, §1237 (Oct. 17, 1998), https://www.congress.gov/bill/105th-congress/house-bill/3616?r=6. *See also* COVINGTON, *New Executive Order Revises Prohibition on Transactions Involving Publicly Traded Securities of Certain Chinese Companies* (June 7, 2021), https://www.cov.com/en/news-and-insights/insights/2021/06/new-executive-order-revises-prohibition-on-transactions-involving-publicly-traded-securities-of-certain-chinese-companies.

[66] Executive Order 13959 of November 12, 2020 *Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies*, https://home.treasury.gov/system/files/126/13959.pdf.

[67] See Gordon Lubold and Dawn Lim, *Trump Bars Americans From Investing in Firms That Help China's Military*, WALL STREET JOURNAL (Nov. 12, 2020), https://www.wsj.com/articles/trump-bars-americans-from-investing-in-firms-that-help-chinas-military-11605209431?mod=article_inline.

[68] U.S. DEFENSE DEPT., *DOD Releases List of Additional Companies, In Accordance With Section 1237 of FY99 NDAA* (DEC. 3, 2020), https://www.defense.gov/News/Releases/Release/Article/2434513/dod-releases-list-of-additional-companies-in-accordance-with-section-1237-of-fy/; U.S. DEFENSE DEPT., *DOD Releases List of Additional Companies, In Accordance with Section 1237 of FY99 NDAA* (Jan. 14, 2021), https://www.defense.gov/News/Releases/Release/Article/2472464/dod-releases-list-of-additional-companies-in-accordance-with-section-1237-of-fy/.

rejected in May 2021.[69] In addition, after CNOOC Limited was added to the list of CCMCs in January 2021, NYSE delisted the company in March,[70] but its appeal of the delisting decision remains pending.[71]

On June 3, 2021, President Biden issued Executive Order 14032 amending Executive Order 13959.[72] Like its predecessor, Executive Order 14032 prohibits U.S. persons from engaging in the purchase or sale of any publicly-traded securities of certain designated companies, referred to in implementing guidance as Chinese Military-Industrial Complex Companies ("**CMICs**").[73] Executive Order 14032 also tasks the Secretary of the Treasury, in consultation with the Secretary of State and, if deemed appropriate, the Secretary of Defense, with the responsibility of identifying future additions to the list.[74]

Under the terms of Executive Order 14032 and its predecessor, the clear intention is to prohibit the sale and purchase by U.S. persons of *any* securities issued by CMICs, whether domestic or foreign, and *any* financial instruments that offer synthetic exposure to such securities, whether traded on-exchange or over-the-counter. In that respect, the Executive Orders go beyond the HFCAA for the firms included in the list, because while the HFCAA would prohibit trading

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[69] *See* Chong Koh Ping, *Chinese Telecom Carriers Ask NYSE to Make Another U-Turn on Delisting*, WALL STREET JOURNAL (Jan. 21, 2021), https://www.wsj.com/articles/chinese-telecom-carriers-ask-nyse-to-make-another-u-turn-on-delisting-11611223140?mod=article_inline; Chong Koh Ping and Alexander Osipovich, *NYSE to Delist Chinese Telecom Carriers After Rejecting Appeals*, WALL STREET JOURNAL (May 7, 2021), https://www.wsj.com/articles/nyse-to-delist-chinese-telecoms-carriers-after-rejecting-appeals-11620394719.

[70] INTERCONTINENTAL EXCHANGE, *NYSE to Commence Delisting Proceedings Against CNOOC Limited (CEO) to Comply with Executive Order 13959* (Feb. 26, 2021), https://ir.theice.com/press/news-details/2021/NYSE-to-Commence-Delisting-Proceedings-Against-CNOOC-Limited-CEO-to-Comply-with-Executive-Order-13959/default.aspx. *See also* Alexander Osipovich, *NYSE Moves to Delist Chinese Oil Company*, WALL STREET JOURNAL (Feb. 26, 2021), https://www.wsj.com/articles/nyse-moves-to-delist-chinese-oil-company-11614383331.

[71] P.R. Venkat and Quentin Webb, *China's Cnooc Plans Big Share Sale at Home as U.S. Delisting Looms*, WALL STREET JOURNAL (Sept. 27, 2021), https://www.wsj.com/articles/chinas-cnooc-plans-big-share-sale-at-home-as-u-s-delisting-looms-11632722451.

[72] Executive Order 14032 *Addressing the Threat From Securities Investments That Finance Certain Companies of the People's Republic of China*. See the text here: https://www.whitehouse.gov/briefing-room/presidential-actions/2021/06/03/executive-order-on-addressing-the-threat-from-securities-investments-that-finance-certain-companies-of-the-peoples-republic-of-china/ *See also* JD SUPRA, *Biden Revises Ban on U.S. Investors Buying Certain Chinese Securities* (June 8, 2021), https://www.jdsupra.com/legalnews/biden-revises-ban-on-u-s-investors-9368419/.

[73] *See* U.S. DEPT. OF TREASURY, *Non-SDN Chinese Military-Industrial Complex Companies List (NS-CMIC List)* (last Updated: June 16, 2021), https://home.treasury.gov/policy-issues/financial-sanctions/consolidated-sanctions-list/ns-cmic-list; Kim Caine, Katie McDougall, and Jeffrey W. Cottle, *US expands sanctions targeting investments in securities of Chinese military companies*, NORTON ROSE FULBRIGHT (June 17, 2021), https://www.nortonrosefulbright.com/en-us/knowledge/publications/2d19bb99/us-expands-sanctions-targeting-investments-in-securities-of-chinese-military-companies.

[74] *Ibid*. and see The White House, *Fact Sheet: Executive Order Addressing the Threat from Securities Investments that Finance Certain Companies of the People's Republic of China* BRIEFING ROOM (Jun. 3, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/03/fact-sheet-executive-order-addressing-the-threat-from-securities-investments-that-finance-certain-companies-of-the-peoples-republic-of-china/; SKADDEN, *US Amends Sanctions Targeting Investments in Securities of Chinese Companies* (June 11, 2021), https://www.skadden.com/insights/publications/2021/06/us-amends-sanctions; Demetri Sevastopulo, *Washington to bar US investors from 59 Chinese companies*, FINANCIAL TIMES (June 4, 2021), https://www.ft.com/content/91e6fb2a-6385-49b3-83aa-8044374805c4.

through methods within the SEC's jurisdiction, the Executive Orders prohibit U.S. investors from trading *any* securities denominated in *any* currency that trade in *any* jurisdiction.[75]

In theory, so long as the President declares a "national emergency" and characterizes the "unusual and extraordinary threat… to the national security, foreign policy, or economy of the United States" in a manner that passes muster under the IEEPA, then the President could extend these trading prohibitions to any Chinese issuer.[76] However, there are no indications that any such policy is under consideration.

[75] SKADDEN, *US Amends Sanctions Targeting Investments in Securities of Chinese Companies* (June 11, 2021), https://www.skadden.com/insights/publications/2021/06/us-amends-sanctions.

[76] *International Emergency Economic Powers Act*, PUBLIC LAW NO: 95-223, § 202 (Dec. 28, 1977), https://www.congress.gov/bill/95th-congress/house-bill/7738.

C. Enhanced Chinese Regulatory Oversight of Key Sectors

Chinese authorities have recently announced new regulatory policies that apply to key sectors of the economy with a focus on technology firms. It is important to note that, although these initiatives have important implications for Chinese firms that are listed in the United States (including Alibaba and JD.com), they may not be specifically targeted at Chinese companies listed in the United States.[77]

The first major development was in November 2020, when Chinese regulators suspended Ant Group's dual-listing in Hong Kong and Shanghai,[78] later ordering the firm to separate its lending and payments businesses on antitrust grounds.[79] Then, in April 2021, Chinese market and internet regulators directed China's thirty-four leading tech companies, including Alibaba and Tencent, to curb "monopolistic practices" that prevent customers from freely migrating between platforms.[80] Next, in August, market regulators released new rules banning certain anticompetitive practices, such as exploiting user data to learn how customers behave and influencing them to avoid competitors' products.[81]

i. Didi Global's U.S. Listing

Chinese policies began to more directly affect U.S.-listings by Chinese issuers in July 2021, when Chinese authorities launched an investigation of Didi Global Inc. a few days after its U.S. IPO.[82] Didi had filed with the SEC in April 2021 for a listing on the NYSE and on Wednesday, June 30th it launched its IPO as planned, although at the time, there were reports that Didi was under investigation by Chinese authorities for antitrust concerns.[83] At first, the offering looked as though it had been successful, raising $4.4 billion, but a few days later, on Sunday, July 4th, the Cyberspace Administration of China ("**CAC**") announced a cybersecurity review of Didi's data

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[77] Christian Shepherd, Ryan McMorrow, Hudson Lockett, and Edward White, *China unveils five-year plan to strengthen control of economy*, FINANCIAL TIMES (Aug. 12, 2021), https://www.ft.com/content/bdcbbdf3-24dd-436d-9e0f-36db2348eadd?shareType=nongift. *See also*
Brooke Masters, *Investors in China should beware Beijing's unpredictability*, FINANCIAL TIMES (Aug. 11, 2021), https://www.ft.com/content/32b8a1c7-cd06-4628-b608-a29bd2de1eab?shareType=nongift.

[78] Ryan McMorrow and Hudson Lockett, *China halts $37bn Ant Group IPO, citing 'major issues'*, FINANCIAL TIMES (Nov. 3, 2020), https://www.ft.com/content/c1ee03d4-f22e-4514-af46-2f8423a6842e.

[79] Yuan Yang and Sun Yu, *Ant ordered to restructure by Chinese regulators*, FINANCIAL TIMES (April 12, 2021), https://www.ft.com/content/5c14c1d1-bd9e-4654-9a12-93c4ac46792d.

[80] Ryan McMorrow, *China tech groups given a month to fix antitrust practices*, FINANCIAL TIMES (April 13, 2021), https://www.ft.com/content/c26eaf88-f0c7-4e8a-9dca-d5669166226f. *See also* REUTERS, *China market regulator fines 12 firms for violating anti-monopoly law* (March 12, 2021), https://www.reuters.com/world/china/china-market-regulator-fines-12-firms-violating-anti-monopoly-law-2021-03-12/.

[81] Christian Shepherd, *China to tighten competition rules for internet groups*, FINANCIAL TIMES (Aug. 17, 2021), https://www.ft.com/content/7ccf409d-489b-411a-8b4f-4b5d8b8ed0b1?shareType=nongift.

[82] Yuan Yang, *China cracks down on Didi days after New York IPO*, FINANCIAL TIMES (July 4, 2021), https://www.ft.com/content/809b31e2-6b1e-42b6-8009-3ea78969d870.

[83] Michelle Toh, *Didi launches blockbuster U.S. IPO in quest to go 'truly global'*, CNN (Jul. 1, 2021), https://edition.cnn.com/2021/06/30/investing/didi-china-us-ipo-intl-hnk/index.html. See also Clay Chandler, Grady McGregor and Eamon Barrett, *How Didi's data debacle doomed China's love affair with Wall Street*, FORTUNE (Jul. 10, 2021), https://fortune.com/2021/07/09/didi-ipo-stock-data-crackdown-china-wall-street-investors/.

practices and banned Didi's app from app stores in China.[84] The announcement was made as part of an effort by Chinese authorities to more closely scrutinize the data security implications of domestic firms listing abroad.[85] This was followed by a brief announcement on July 16th that "seven departments, including the National Internet Information Office," had established a presence within Didi Chuxing to conduct cybersecurity reviews.[86] Didi lost over $17 billion of its market value in the week following its listing, including about $15 billion on July 6th alone, and the share price quickly fell to half of the offering price.[87] As of close on October 15, 2021, Didi was trading at $8.26, still nearly 50% below its initial trading price.[88]

ii. Cyberspace Administration of China Review Process for Foreign Listings

The following week, on July 10th, the CAC proposed new rules requiring "critical information infrastructure operators" and "data processors" holding the personal information of more than one million users to "report to the Cyber Security Review Office for a cyber security review" if applying to list outside of China.[89] Although the proposal appears to target Chinese tech companies, it could require the majority of Chinese companies that list overseas to undergo review, according to market reports.[90]

The CAC review will focus on protecting sensitive data and addressing the national security risks arising from foreign IPOs.[91] According to the CAC, the review "should generally be completed within three months" but can be extended where "the situation is complicated."[92] The cost, delay, and uncertainty created by this new review process is likely to discourage foreign IPOs by Chinese tech companies. Moreover, companies may interpret the new policy, together with the creation of a new Beijing Stock Exchange for technology-oriented small and medium-sized

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[84] *China Weighs Unprecedented Penalty for Didi After U.S., IPO* BLOOMBERG (Jul. 22, 2021), https://www.bloomberg.com/news/articles/2021-07-22/china-is-said-to-weigh-unprecedented-penalty-for-didi-after-ipo; Yuan Yang and Hudson Lockett, *Didi shares fall 20% as China tightens overseas listings rules*, FINANCIAL TIMES (July 6, 2021), https://www.ft.com/content/095eb7ac-09ea-4a5c-8253-d8ca2d945614; Yuan Yang, *China cracks down on Didi days after New York IPO*, FINANCIAL TIMES (July 4, 2021), https://www.ft.com/content/809b31e2-6b1e-42b6-8009-3ea78969d870.

[85] FINANCIAL TIMES, *Didi caught as China and US battle over data* (July 6, 2021), https://www.ft.com/content/00403ae5-7565-413e-907d-ad46549375ba.

[86] Cybersecurity Administration of China, *Notice: Seven departments including the National Internet Information Office stationed in Didi Chuxing Technology Co., Ltd. to conduct cybersecurity reviews* (Jul. 16, 2021), http://www.cac.gov.cn/2021-07/16/c_1628023601191804.htm.

[87] Filipe Pacheco and Matt Turner, *Didi Extends Drop to Fresh Lows as China Weighs Rule Changes*, BLOOMBERG (Jul. 7, 2021), https://www.bloomberg.com/news/articles/2021-07-07/didi-extends-drop-after-sliding-below-ipo-price-on-crackdown.

[88] Bloomberg data accessed on October 18, 2021.

[89] Cybersecurity Administration of China, *Notice: Public Consultation on the "Cyber Security Review Measures (Revised Draft for Solicitation of Comments)"* (Jul. 10, 2021). See draft article 6, http://www.cac.gov.cn/2021-07/10/c_1627503724456684.htm.

[90] BLOOMBERG, in THE ECONOMIC TIMES, *China tightens rules on foreign IPOs in new blow to tech firms* (July 10, 2021), https://economictimes.indiatimes.com/news/international/business/china-tightens-rules-on-foreign-ipos-in-new-blow-to-tech-firms/articleshow/84301041.cms.

[91] Cybersecurity Administration of China, *Notice: Public Consultation on the "Cyber Security Review Measures (Revised Draft for Solicitation of Comments)"*, Article 10 (Jul. 10, 2021). See draft article 6, http://www.cac.gov.cn/2021-07/10/c_1627503724456684.htm.

[92] *Ibid*, draft article 14.

enterprises,[93] as signals that Chinese authorities are discouraging going public in foreign markets. Indeed, following the announcement of the Didi probe and cybersecurity review process, there have been no U.S. IPOs by Chinese companies and several Chinese companies' have decided to defer or cancel their plans to go public in the United States, including: Daojia Ltd., a Chinese home service platform, and Xiaohongshu (Little Red Book), a social media and e-commerce platform.[94]

Reports have recently emerged that Chinese authorities intend to enact additional protections for consumer data. In August 2021, the Wall Street Journal reported that Chinese regulators plan to propose additional rules that would prevent *any* internet firms holding large amounts of sensitive consumer data from going public in the United States.[95]

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[93] James T. Areddy, *China to Launch Beijing Stock Exchange to Steer Investment Into Innovation*, WALL STREET JOURNAL (Sept. 2, 2021), https://www.wsj.com/articles/china-to-launch-beijing-stock-exchange-to-steer-investment-into-innovation-11630622825.

[94] *Daojia Joins Little Red Book in Pausing USU.S. IPO Plans* BLOOMBERG (Jul. 19, 2021), https://www.bloomberg.com/news/articles/2021-07-19/daojia-is-said-to-join-little-red-book-in-pausing-u-s-ipo-plans.

[95] Keith Zhai, *China Plans to Ban U.S. IPOs for Data-Heavy Tech Firms*, THE WALL STREET JOURNAL (Aug. 27, 2021), https://www.wsj.com/articles/china-plans-to-ban-u-s-ipos-for-data-heavy-tech-firms-11630045061?mod=hp_lead_pos1.

D. Potential U.S. and Chinese Reforms to the VIE Structure

In recent months, U.S. and Chinese policymakers have enhanced scrutiny of the VIE structure used by most U.S.-listed Chinese firms. The SEC has imposed additional risk disclosure requirements and Chinese regulators have also enacted new restrictions on the use of VIEs.

i. U.S. Securities and Exchange Commission Review of VIE Structure

On July 30, the SEC published a *Statement on Investor Protection Related to Recent Developments in China* by Chair Gary Gensler expressing concern that, for VIE structures, "average investors may not realize that they hold stock in a shell company rather than a China-based operating company," and announcing new risk disclosure requirements for VIE structures.[96] These disclosures include: (i) that investors are buying shares in a shell company issuer that maintains service agreements with the China-based operating company, clearly distinguishing between the two entities and their activities; (ii) that the company faces uncertainty about future action by the Chinese government that could significantly impact financial performance and the enforceability of contractual arrangements; and (iii) detailed financial information, including quantitative metrics, necessary to understand the relationship between the VIE and the issuer.[97] Additionally, all China-based operating companies seeking to register securities with the SEC, whether directly or through a VIE structure, will be required to disclose: (i) whether the issuer and associated operating company received permission from Chinese authorities to list on U.S. exchanges, and the risks that such permission may be denied or rescinded; and (ii) that the HFCAA may result in the issuer being delisted in the future.[98]

By August, Chinese issuers seeking to list in the United States began receiving more detailed instructions from the SEC staff with respect to these disclosure requirements as part of the registration statement review process.[99] These instructions included, among other things, that issuers "refrain from using terms such as 'we' or 'our' when describing activities or functions of a VIE,"[100] presumably in order to reduce the risk that shareholders mistakenly assume that the issuer and the VIE are the same legal entity. Moreover, in a September interview with the *Financial Times*, SEC Chair Gensler raised concerns about whether "any real money" was flowing from VIEs to their affiliates with U.S. investors, suggesting that the SEC may consider additional regulatory actions with respect to VIEs in the future.[101]

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[96] See U.S. SEC. & EXCH. COMM'N, *Statement on Investor Protection Related to Recent Developments in China* (Jul. 30, 2021), https://www.sec.gov/news/public-statement/gensler-2021-07-30.
[97] *Ibid.*
[98] *Ibid.*
[99] Echo Wang, *Exclusive: SEC gives Chinese companies new requirements for U.S. IPO disclosures*, REUTERS (Aug. 23, 2021), https://www.reuters.com/business/finance/exclusive-sec-gives-chinese-companies-new-requirements-us-ipo-disclosures-2021-08-23/.
[100] Echo Wang, *Exclusive: SEC gives Chinese companies new requirements for U.S. IPO disclosures*, REUTERS (Aug. 23, 2021), https://www.reuters.com/business/finance/exclusive-sec-gives-chinese-companies-new-requirements-us-ipo-disclosures-2021-08-23/.
[101] Gary Silverman and Kiran Stacey, *Crypto platforms need regulation to survive, says SEC boss*, FINANCIAL TIMES (Sept. 1, 2021), https://www.ft.com/content/fb126d79-2e60-4002-8aba-b08887fca609?shareType=nongift.

In response to the SEC's July statement, the CSRC has sought further talks, calling for mutual respect and collaboration on the issue.[102] According to the CSRC, "the CSRC has always been open to companies' choices to list their securities on international or domestic markets in compliance with relevant laws and regulations."[103]

ii. Potential Restrictions on VIE Structures by Chinese Regulators

In early July, when the CAC announced its new cybersecurity review for companies raising capital overseas, reports emerged that the CAC was working with other Chinese authorities to revise the regulation of VIEs.[104] Then, on July 24, the Central Committee of the Communist Party of China and the State Council issued joint *Opinions on Further Reducing the Burden of Compulsory Education Students' Homework and Off-campus Training*, which contemplated stronger regulation of "off-campus training institutions" and which provided, in respect of tutoring institutions, that "foreign capital shall not control or hold shares [these] institutions through mergers and acquisitions …*[or] use variable interest entities to hold or participate in [these] institutions*" (emphasis added).[105] The announcement heightened concerns that VIE structures were potentially vulnerable to regulatory curbs.[106]

Chinese authorities have also begun curtailing use of the VIE structure in other ways.[107] For example, when Chinese issuers establish a VIE structure for listing overseas, they commonly inject capital into the overseas ParentCo so that it can pay its listing and other expenses; and in order to make these capital injections overseas, Chinese issuers under the jurisdiction of the National Development and Reform Commission ("**NDRC**") must obtain its permission to do so. However, by September 2021, firms that approached the NDRC for permission had been advised

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[102] Edward White, *China calls for closer communication with U.S. over stock market controls*, FINANCIAL TIMES (Aug. 1, 2021), https://on.ft.com/2ViRSky; and see *China Seeks More Communication With U.S. on Overseas IPOs*, BLOOMBERG (Aug. 1, 2021), https://www.bloomberg.com/news/articles/2021-08-01/china-calls-for-more-communication-with-u-s-on-overseas-ipos.

[103] *Ibid*.

[104] Lingling Wei, *China's Cyber Watchdog to Police Chinese Overseas Listings*, WALL STREET JOURNAL (July 8, 2021), https://www.wsj.com/articles/chinas-cyber-watchdog-to-police-chinese-overseas-listings-11625742254; Hudson Lockett and Tabby Kinder, *China's crackdown on US listings threatens $2tn market*, FINANCIAL TIMES (July 7, 2021), https://www.ft.com/content/299ba00b-dfef-4c53-88a2-e6725d14025d.

[105] Ministry of Education of the People's Republic of China, *News Item: The General Office of the Central Committee of the Communist Party of China and the General Office of the State Council issued the "Opinions on Further Reducing the Work Burden of Students in Compulsory Education and the Burden of Off-campus Training"* (Jul. 24, 2021), http://www.moe.gov.cn/jyb_xwfb/gzdt_gzdt/s5987/202107/t20210724_546566.html. The text of the opinion is available at: http://www.moe.gov.cn/jyb_xxgk/moe_1777/moe_1778/202107/t20210724_546576.html. See also *China issues guidelines to ease burden of young students*, PEOPLE'S DAILY (Jul. 25, 2021), http://en.people.cn/n3/2021/0725/c90000-9876270.html; *China Considers Turning Tutoring Companies Into Non-Profits*, BLOOMBERG (Jul. 23, 2021), https://www.bloomberg.com/news/articles/2021-07-23/china-is-said-to-mull-turning-tutoring-firms-into-non-profits.

[106] Tabby Kinder, Hudson Lockett, Ryan McMorrow, Michael Mackenzie and Harriet Agnew, *Beijing's threat to VIEs triggers Wall Street angst over China stocks*, FINANCIAL TIMES (Jul. 28, 2021), https://on.ft.com/3iWxQ7G.

[107] *See* BLOOMBERG, *Shanghai Suspends Key Approval on Route to Offshore Listings* (Sept. 3, 2021), https://www.bloomberg.com/news/articles/2021-09-03/shanghai-suspends-key-approval-on-route-to-offshore-listings.

that "the process for outbound investment into VIE structures is being halted."[108] At the same time, the NDRC has also claimed that "it has not rejected requests for outbound direct investment by companies *because of their use of VIEs*" (emphasis added), leaving unclear the basis for the policy change.[109]

Reports have also recently emerged that Chinese authorities are planning to propose rules that would require companies to obtain formal approval from a cross-ministry committee in order to list overseas using a VIE structure.[110] However, it remains unclear when the new rules would come into effect and whether the new rules would affect companies that have already used the VIE structure to list in foreign markets.

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108 *See* BLOOMBERG, *Shanghai Suspends Key Approval on Route to Offshore Listings* (Sept. 3, 2021), https://www.bloomberg.com/news/articles/2021-09-03/shanghai-suspends-key-approval-on-route-to-offshore-listings.

109 *Id.*

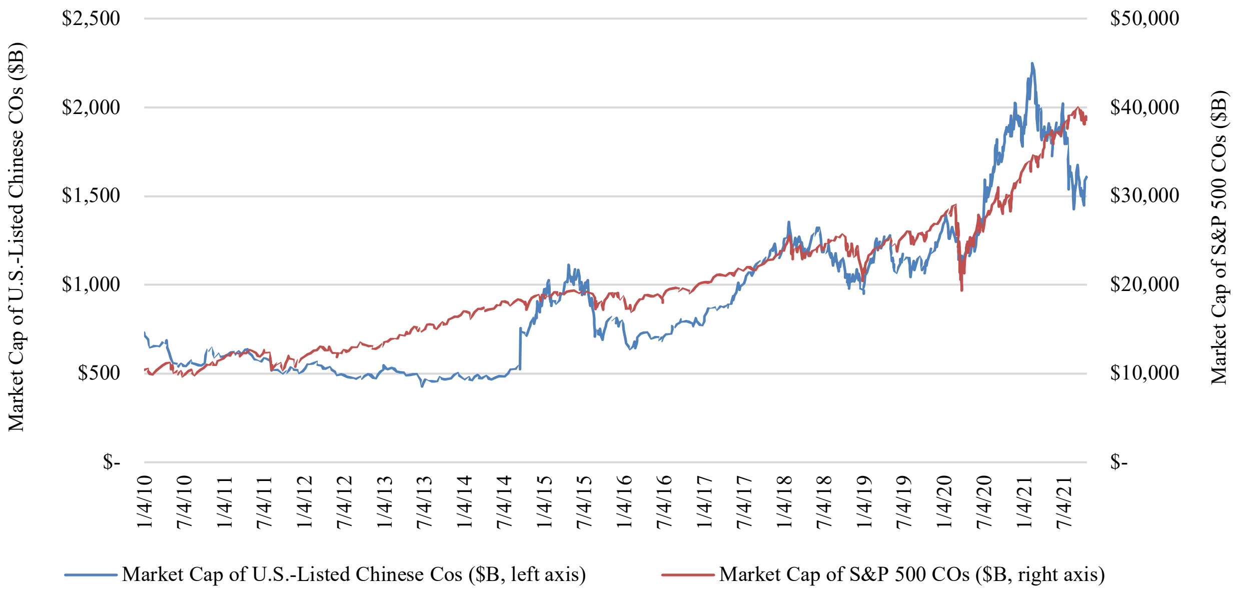
110 Keith Zhai, *China Plans to Ban U.S. IPOs for Data-Heavy Tech Firms*, THE WALL STREET JOURNAL (Aug. 27, 2021), https://www.wsj.com/articles/china-plans-to-ban-u-s-ipos-for-data-heavy-tech-firms-11630045061?mod=hp_lead_pos1.

Part III. Market Reaction to Regulatory Developments

Figure 3 displays the market capitalization of both Chinese companies listed on major U.S. exchanges (left axis) and the market capitalization of S&P 500 companies (right axis) from January 4, 2010 to October 15, 2021. Changes in the market capitalization of U.S.-listed Chinese companies largely mirrored the changes of S&P 500 companies prior to 2021. However, during Summer 2021, when several new regulatory initiatives were announced by U.S. and Chinese authorities, the two diverged. In the month of July alone, U.S.-listed Chinese companies lost approximately 20% of their value while S&P 500 companies gained 2%. Since the Shanghai Composite Index fell by a much more modest 5% over the same period, the sharper decline for U.S.-listed Chinese issuers suggests that this was not solely caused by a broader downturn in the Chinese economy.

U.S. listings by Chinese companies also rapidly dried up over the same period. Although 34 Chinese companies raised a record $12.4 billion from U.S. listings in the first half of 2021, an additional 50 Chinese companies that filed to list in the United States are now in "limbo," and there have been zero U.S. listings by Chinese companies since July.[111]

Figure 3: Market Cap of Chinese Companies Listed on Major U.S. Exchanges and S&P 500 Companies, Jan. 4 to Oct. 15, 2021 ($B)



Data note: "U.S.-listed Chinese company" is defiend as a company domiciled in China that has issued common stock or ADRs on the NASDAQ, New York Stock Exchange, or NYSE American exchanges.
Source: Bloomberg data accessed October, 18, 2021.

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[111] Bloomberg data, accessed October 18, 2021; and Tabby Kinder and Hudson Lockett, *Chinese start-ups caught in US listings limbo*, FINANCIAL TIMES (Aug. 17, 2021), https://www.ft.com/content/56a7dff0-cc63-40b0-ad96-7ce82780cce2?shareType=nongift.

Cross-Listings by U.S.-Listed Chinese Companies

Several Chinese companies that are listed in the United States have recently established cross-listings on other exchanges, with Hong Kong as the preferred venue.[112] Alibaba began the trend by listing in Hong Kong in November 2019. Since then, many other major Chinese technology companies including Baidu, JD.com, Bilibili, and NetEase have followed suit. By August 2021, of the 251 Chinese companies listed in the United States, 24 were cross-listed in Hong Kong, and these cross-listed firms represented 71% of the $1.8 trillion market capitalization of U.S.-listed Chinese companies.[113]

Cross-listing means that U.S. investors should be able to continue to obtain exposure to delisted Chinese companies by holding stocks directly on the foreign exchange or by investing indirectly via global investment funds (barring any applicable U.S. sanctions).[114] From the perspective of issuers, cross-listing enables Chinese companies that could be delisted in the United States to continue to access global pools of investment capital outside of China.

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[112] Rachael Johnson, U.S.-*listed Chinese companies gravitate to secondary listings in Hong Kong*, INTERNATIONAL BAR ASSOCIATION (2020), https://www.ibanet.org/article/fcf04a93-cff7-44ca-98c1-bcd5cb1a1d6c.

[113] Bloomberg data accessed on August 13, 2021. "U.S.-listed Chinese company" is defined as a company domiciled in China listed on the NASDAQ, New York Stock Exchange, or NYSE American.

[114] If stocks are delisted from U.S. exchanges for regulatory non-compliance in the ordinary course of market business they can still be advertised on the "Pink Sheets" (also known as "OTC Pink"), a service offered by OTC Markets Group. Since all dealers that trade on OTC Pink must be registered with the SEC, however, and trading is therefore within its regulatory reach, it seems virtually certain that the SEC will act, in due course, to prohibit the trading of securities issued by any issuers determined to have been Commission-identified issuers for three consecutive years in order to implement the terms of section 3 of the HFCAA.

Conclusion

Four key issues threaten the continued ability of Chinese companies to list or remain listed in the United States. First, U.S. and Chinese authorities have yet to resolve long-standing issues over U.S. regulators' access to audits of Chinese companies listed in the United States; second, Presidential Executive Orders have recently limited U.S. investor access to Chinese firms perceived as posing national security risks to the United States; third, in response to cybersecurity concerns, Chinese authorities have recently imposed a new regulatory review process for firms in key sectors (such as technology) seeking to list overseas; and fourth, regulators in the United States and China are directing greater scrutiny at the VIE structure that many Chinese firms use to list in the United States.

Taken together, these issues threaten to cause the large-scale delisting of Chinese issuers in the United States, which would potentially undermine the United States' role as the world's largest capital market. It could also cause U.S. investors to access these investments in overseas markets where they enjoy fewer protections than at home (assuming applicable sanctions do not prevent them from doing so). In addition, these issues increase the risk that the United States and China engage in tit-for-tat escalation by, for example, further restricting investment in each other's companies, which would segment global capital markets, undermine the efficient allocation of capital, and harm both sides. For instance, if policy disputes affecting U.S.-listed Chinese issuers remain unresolved, China may respond by reorienting its market opening away from U.S. issuers and investors and towards institutions from Europe and Japan.

The Committee recognizes that there are many social, geopolitical, and economic dimensions to the U.S.-China relationship. However, the Biden Administration has stressed "the responsibility of both nations to ensure competition does not veer into conflict,"[115] and authorities should keep in mind that decoupling U.S. and Chinese capital markets can have broader negative consequences for the bilateral relationship beyond business.

In our view, the audit, national security, cybersecurity, and exchange listing structure issues between U.S. and Chinese policymakers are likely too complex and intertwined to be effectively considered and resolved in isolation from one another. Consequently, the Committee recommends that U.S. and Chinese authorities form a high-level working group with participants from both sides, including the SEC and CSRC, to systematically evaluate the full range of issues together, consider potential solutions, and make recommendations. This working group should have a clear mandate setting forth the concerns it is expected to resolve, and it should be staffed by professionals from both sides that are familiar with the relevant issues.

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[115] THE U.S. WHITE HOUSE, *Readout of President Joseph R. Biden Jr. Call with President Xi Jinping of the People's Republic of China* (Sept. 9, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/09/readout-of-president-joseph-r-biden-jr-call-with-president-xi-jinping-of-the-peoples-republic-of-china/;

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