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Bipartisan Bill to Delist Chinese Companies Signed Into Law

Summary

On Friday, December 18, President Trump signed into law Senate Bill 945, the Holding Foreign Companies Accountable Act (Act). As analyzed in our initial client alert, Delisting from Exchanges, the core of the Act paves the way for delisting Chinese companies from US indexes if the audits of those companies remain shielded from the Public Company Accounting Oversight Board (PCAOB), a situation primarily caused by the conflict between US securities regulations requiring audit visibility and Chinese laws prohibiting the export of such information. Our subsequent publication, Report on Protecting United States Investors, discussed that, while delisting these companies could achieve the goal of leveling the playing field of equities trading in the US (and potentially other international exchanges), such a move could also facilitate China's long-standing goal of enticing more companies to list on its domestic exchanges while leaving retail investors to sell off shares ahead of potential delisting, likely at significantly discounted rates. By signing the bicameral and bipartisan Act into law, however, the White House officially charged the Securities and Exchange Commission (SEC) with designing, implementing and enforcing the mechanisms through which the requirements and attendant consequences take effect.

Outgoing SEC Chairman Jay Clayton praised the enactment in a statement while also highlighting the fact that the SEC had concurrently been drafting its own proposals pursuant to the August 6, 2020, report from the President's Working Group on Financial Markets (PWG). In praising the enactment, Mr. Clayton expressed disappointment that he will not have the opportunity to consider the ultimate recommendations of his staff, noting the SEC now carries the duty to bridge the proposals of the PWG report with the requirements of the Act. Diverging from the Act, the PWG report offered companies subject to conflicting regulations of "Non-Cooperating Jurisdictions" a workaround to get out of this maze in the form of a co-audit. Under the co-audit approach, a company could engage a public accounting firm that is duly registered with the PCAOB, and therefore subject to inspection by the same, to conduct an audit of the company's principal audit.

Regardless of form, the new regulations will materially alter the capital markets landscape. Two hundred and seventeen Chinese companies maintained shares listed on primary US exchanges as of October 2, 2020, commanding more than US$2.2 trillion in market capitalization among them, according to the US-China Economic Security Review Commission. For its part, China's Securities Regulatory Commission (CSRC) echoed its call for bilateral talks between the two countries when asked at a recent press conference about the likelihood of the Act's enactment into law. In response to reporters, the CSRC appeared resolved to its steadfast wait-and-see approach by reiterating the need for bilateral discussions to resolve what it deems cross-border cooperative initiatives, while also describing portions of the Act as "discriminatory."

The SEC will now embark on its rulemaking process to issue rule proposals establishing the manner and form in which the Act will take effect. If interim statements and report recommendations provide any forward-looking insight, the SEC may require indexes to build transparency into listing prerequisites and require expanded disclosure statements on behalf of fund managers. A core component of compliance will likely require listed companies to certify retention of a public accounting firm that is both registered with the PCAOB and has been inspected by the PCAOB to the satisfaction of the SEC. If the PWG's co-audit workaround is swept away in the rulemaking process, however, Chinese companies may face a steep path ahead to either come into compliance or seek alternative exchanges on which to list their shares.

We continue to carefully monitor the situation.

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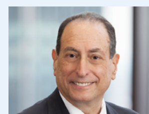

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