

Recent U.S. Developments, Including Passage of Holding Foreign Companies Accountable Act, Signal Harder Stance with China

December 7, 2020

Several recent developments underscore the continued efforts by the U.S. government to address perceived threats from China and Chinese companies. The most significant of these is the [Holding Foreign Companies Accountable Act](#) (the “Act”), which was approved by the U.S. House of Representatives on December 2 and which is expected to be signed into law by President Trump later this month. The Act is identical to the bill passed by the U.S. Senate in May and requires the U.S. Securities and Exchange Commission (“SEC”) to issue rules that could prohibit listing or trading securities of non-U.S. SEC reporting companies that retain a foreign accounting firm that cannot be inspected by the Public Company Accounting Oversight Board (“PCAOB”) for three consecutive years, starting in 2021. In addition to the Act, the U.S. government added to its list of Communist Chinese military companies and issued new rules restricting entry into the United States for members of the Chinese Communist Party and their immediate family members. The U.S. State Department has also designated another 14 Chinese officials in connection with the new National Security Law for Hong Kong. We cover each of these developments below.

Holding Foreign Companies Accountable Act

Background

The Act, which amends the Sarbanes-Oxley Act of 2002, is aimed at addressing issues arising from the inability of the PCAOB to inspect registered public accounting firms in China, Hong Kong, and a handful of other jurisdictions.¹ In 2013, the PCAOB entered into a memorandum of understanding (“MOU”) with the China Securities Regulatory Commission and the Ministry of Finance of China designed to address the issue. From the point of view of the PCAOB and the SEC, the manner in which the MOU was implemented in practice was inadequate and, in April 2020, the SEC issued a [statement](#)

¹ The PCAOB’s website also refers to France and Belgium, but adds that it expects to conclude bilateral agreements with those jurisdictions. <https://pcaobus.org/oversight/international/denied-access-to-inspections?pg=1&auditorlocations=China>.

regarding the PCAOB's continuing inability to inspect audit work papers in China. In June, SEC Chairman Jay Clayton gave an interview expressing support for the Act.²

The Act's Provisions

The Act requires the SEC to identify issuers trading on U.S. exchanges that file audit reports prepared by a registered public accounting firm with branches in foreign jurisdictions that impede the PCAOB's ability to "inspect or investigate completely" such registered public accounting firm. As of June 30, 2020, there were 202 such issuers in Mainland China and Hong Kong. Within 90 days of the Act becoming law, the SEC is required to issue rules setting forth the manner in which those issuers must submit documentation establishing that they are not owned or controlled by a government entity in the relevant jurisdiction.

If an identified issuer does not retain a registered public accounting firm that is subject to inspection satisfactory to the SEC for three consecutive years ("non-inspection years"), it would be delisted from U.S. securities exchanges and its securities would otherwise be prohibited from trading in the United States. The SEC will lift the delisting if an issuer certifies that it has retained a registered public accounting firm that has been and is subject to satisfactory inspection by the PCAOB. A recurrence of a non-inspection year would lead to a mandatory five-year delisting/prohibition on trading.

In addition, identified issuers would be required to disclose:

- their registered public audit firm;
- the percentage of government ownership of the issuer;
- whether governmental entities have a controlling financial interest in the issuer;
- the name of each of the issuer's (or issuer's operating entity's) board members who is a member of the Chinese Communist Party; and
- whether the issuer's articles of incorporation contain any charter of the Chinese Communist Party.

² Benjamin Bain and David Westin, "SEC Chief Backs Bill to Delist China Firms Barring Audit Reviews" Bloomberg (June 2, 2020), <https://www.bloomberquint.com/politics/sec-chief-backs-bill-to-delist-china-firms-barring-audit-reviews>.

Additional SEC Actions

Concurrent with Congress's deliberation on the Act, the Executive Branch has also been considering ways to address the PCAOB's inability to conduct inspections abroad. In July, the President's Working Group on Financial Markets issued a "[Report on Protecting United States Investors from Significant Risks from Chinese Companies](#)" recommending that the SEC consider:

- enhancing listing standards for companies from jurisdictions that do not cooperate with PCAOB inspections;
- enhancing investor disclosure for such companies;
- enhancing disclosure requirements for funds investing in such companies;
- increasing diligence requirements for funds tracking indexes that include such companies; and
- issuing guidance for investment advisors with respect to fiduciary obligations when investing in such companies.

In August, the SEC issued a [statement](#) that it was preparing proposals to implement these recommendations and requested public input on the same.

The Impact of the Act and the U.S. Election

In January 2021, a new administration under President-elect Joe Biden will take office. As the Act passed both houses of Congress with bipartisan support, it is unlikely to be the target of legislative revision in the foreseeable future.

We expect President Trump to sign the bill before he leaves office. Once he does, PRC companies will have to make the enhanced disclosures and will have three years to find an auditor that complies or face delisting. The Act grants the PCAOB the power to determine which jurisdictions are uncooperative. As such, at any time during the three-year period, the PCAOB and the Chinese authorities could revise the 2013 MOU or enter into a new protocol similar to [those](#) entered into with the other jurisdictions. In the meantime, the SEC will continue to have discretion to enact rules supplementing the provisions of the Act. In addition, it appears that many companies already disclose to varying degrees much of the disclosure that would be mandated by the Act.³

³ The disclosure rules will become effective when the Act becomes law. With the exception of disclosure of Communist Party Membership, the types of disclosure required by the Act were already discussed in guidance

Communist Chinese Military Company Designations, Passport/Visa Restrictions and Additional Sanctions Related to Hong Kong

On December 3, one day after the passage of the Act, the U.S. Defense Department [added](#) four companies to its list of “Communist Chinese Military Companies.” The four companies are: China Construction Technology Co. Ltd. (CCTC), China International Engineering Consulting Corp. (CIECC), China National Offshore Oil Corp. (CNOOC), and Semiconductor Manufacturing International Corp. (SMIC). This designation brings these companies under the ambit of Executive Order 13959, the key elements of which we previously [described](#). Under the Executive Order, after 60 days, U.S. persons generally will be prohibited from engaging in certain transactions in publicly traded securities issued by these companies. (February 1, 2021)

On the same day, *the New York Times* reported that the U.S. State Department had issued new rules restricting non-immigrant tourist and business visas for members of the Chinese Communist Party and their immediate family members.⁴ Going forward, according to media reports, such individuals and their immediate families would be eligible only for one-month single entry visas, as opposed to the 10-year multiple entry visas previously available to Chinese citizens.

Thereafter, on December 4, media reports indicated that the U.S. State Department would deny visas to Chinese citizens linked to overseas influence operations involving violence and other means of intimidation. The restrictions are apparently aimed at those who put pressure on people outside China who raise concerns about alleged human rights abuses in China.

Additionally, on December 7, the U.S. State Department [announced](#) the designations of 14 Vice-Chairpersons of China’s National People’s Congress Standing Committee (“NPCSC”) in connection with the role of the NPCSC in voting to adopt the new National Security Law for Hong Kong. As a result, a total of 29 individuals have now been designated by the United States for their involvement in China’s relationship with Hong Kong, and each of these persons has been added to the list of Specially Designated Nationals (“SDNs”).

for PRC entities recently issued by the SEC’s Division of Corporate Finance. See Securities and Exchange Commission, Division of Corporate Finance, CF Disclosure Guidance Topic No. 10, Disclosure Considerations for China-Based Issuers (Nov. 23, 2020), <https://www.sec.gov/corpfin/disclosure-considerations-china-based-issuers>.

⁴ Paul Mozur and Raymond Zhong, “U.S. Tightens Visa Rules for Chinese Communist Party Members,” *New York Times* (Dec. 3, 2020), <https://www.nytimes.com/2020/12/03/world/asia/us-visa-china-communist-party.html>.

* * *

Please do not hesitate to contact us with any questions.

NEW YORK



Andrew J. Ceresney
aceresney@debevoise.com



Matthew E. Kaplan
mekaplan@debevoise.com

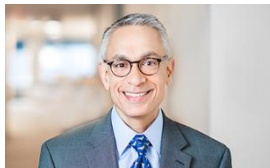


Peter J. Loughran
pjloughran@debevoise.com

WASHINGTON, D.C.



Kara Brockmeyer
kbrockmeyer@debevoise.com



Satish M. Kini
smkini@debevoise.com



Jonathan R. Tuttle
jrtuttle@debevoise.com

HONG KONG



Ada Fernandez Johnson
afjohnson@debevoise.com



William Y. Chua
wychua@debevoise.com



Gareth Hughes
ghughes@debevoise.com

SHANGHAI



Tingting Wu
twu@debevoise.com



Philip Rohlik
prohlik@debevoise.com