

Suggestions on advancing cross-border regulatory cooperation between the United States and China

Li Youxing, Xing Huiqiang, Pan Zheng, Qian Haoyu¹

July 6, 2020

Via Electronic Mail

Hon. W. Jay Clayton, Chairman

Securities and Exchange Commission

100 F Street, NE Washington, DC 20549-1090

RE: Roundtable on Emerging Markets Risks

Dear Chairman Clayton,

In order to solve the cross-border regulatory cooperation issues involved in the Chinese concept share (CCS) and protect the legitimate rights and interests of investors in China and the United States, Chinese scholars held Forum on Stability of the CCS market, Investor Protection and Cross-Border Supervision Cooperation on June 29, 2020. Many top Chinese and foreign securities law scholars participated in the meeting and made suggestions on cross-border regulatory cooperation between China and the United States. The recommendations of Chinese scholars are now listed below for reference by U.S. Securities and Exchange Commission (SEC).

I.Executive Summary

China and the United States have common goals and broad cooperation foundation in jointly fighting against securities violations and safeguarding investors' legitimate rights and interests. China has been trying to promote cooperation on audit supervision in recent years and has made great strides in cracking down on securities violations. According to Chinese laws, there are no legal obstacles in Sino-US cross-border audit supervision cooperation. China and the US should jointly advance cross-border regulatory cooperation on the basis of equality and mutual benefit. Firstly, China and the United States should respect each other's sovereignty and seek and expand the basis for cooperation. Secondly, China and the United States should fulfill their obligations of multilateral or bilateral cross-border regulatory cooperation and work together to promote cross-border regulatory cooperation. Thirdly, China and the United States can conduct cooperation through joint inspection and exchange of audit working papers. Fourthly, emphasizing the specialization of securities regulatory issues. Securities regulatory agencies need to respect the market and the independent

1. Professor Li Youxing, Guanghua Law School of Zhejiang University

Professor Xing Huiqiang, Law School of Central University of Finance and Economics

Dr Pan Zheng, Guanghua Law School of Zhejiang University

Dr Qian Haoyu, Guanghua Law School of Zhejiang University

This article is the research result of the National Social Science Fund Key Project (19AFX020).

choices of investors from both countries.

II.China-US cross-border regulatory cooperation has common goals and broad cooperation foundation

Firstly, China and the United States share common goals in cross-border regulatory cooperation. Protecting the legitimate rights and interests of investors, promoting the healthy development of the capital market, enhancing information disclosure, and improving the quality of listed companies are the common goals of the securities regulatory agencies of China and the United States. In 2019 alone, China Securities Regulatory Commission (CSRC) made 296 administrative punishment decisions, the number of fines and confiscations reached 4.183 billion yuan, and 66 people were banned from the market. In terms of day-to-day supervision, CSRC has taken 247 and 115 administrative supervision measures for listed companies and non-exchange-listed public companies respectively; took 289 administrative supervision measures against securities funds and futures business institutions and 120 responsible persons; administrative supervision measures were taken against 2 law firms and 12 lawyers, and were also taken against 1 accounting firm and 6 certified public accountants. Financial fraud is detrimental to both Chinese and US capital markets. Therefore, there is no doubt that CSRC and SEC share the same goal in cracking down on illegal activities in the securities market.

Secondly, the cross-border regulatory cooperation between China and the United States has a broad basis for cooperation. Cross-border listing of Chinese companies could broaden the investment scope of US investors and enable US investors to make profits from the development of Chinese companies. The wise choice is to enhance the supervision over these Chinese issuers and relevant auditors, rather than removing them from the US capital market. The interdependence between Chinese and US regulators deserves attention. On one hand, the operating entities of those Chinese issuers are located in China, and the supervision of Chinese issuers by US regulators requires the assistance and support of the Chinese government; on the other hand, due to the further opening-up of China, many Chinese listed companies also conduct businesses in the United States, CSRC also needs the support of US regulators and American accountants. The interaction between Chinese and US capital markets provides a solid foundation for cooperation between the two sides. Both parties should adopt a rational and positive attitude to carry out effective cooperation including joint inspections and exchange of audit working papers.

In addition, the academic communication between the two sides have deepened the mutual understanding and cooperation between China and the United States. On August 14, 2010, Professor Guo Feng, Chairman of China Institute of Securities Law, led a delegation to visit the United States. The delegation exchanged views with the management of the New York Stock Exchange, NASDAQ, CBOT and other exchanges on China-US securities regulatory cooperation and other issues. and other exchanges on china-us securities regulatory cooperation. Furthermore, the delegation also conducted academic seminars with George Washington University Law School,

University of Maryland Law School and other academic institutions.

Finally, the space for Sino-US cooperation is huge, and the door to cooperation between the two sides is always open. In recent years, the Chinese government and CSRC have been trying to promote cross-border securities regulatory cooperation. CSRC signed the “Multilateral Memorandum of Understanding concerning Consultation and Cooperation, and Exchange of Information” issued by the IOSCO in May 2007, and began to carry out cross-border regulatory enforcement with overseas regulatory agencies under the framework of bilateral and multilateral regulatory cooperation. As of December 2019, CSRC has established cross-border supervision and enforcement cooperation mechanisms with securities and futures regulatory agencies in 64 countries and regions. Under the cooperation framework of the IOSCO MMoU and other cooperation frameworks, CSRC has provided audit working papers of 23 overseas listed companies to a number of overseas regulators, including SEC and PCAOB. CSRC provided audit working papers for 14 Chinese companies listed in the United States, including 3 in 2019. Over the years, CSRC has maintained active communication with SEC and PCAOB, and there have been many cases of successful cooperation. CSRC and SEC can continue to deepen their regulatory cooperation under such cooperative frameworks as the IOSCO MMoU.

III. There are no legal obstacles in Sino-US cross-border audit supervision cooperation

Firstly, the Chinese government has always been committed to promoting international audit and supervision cooperation, and China's accounting standards have also converged to international standards. Since the reform and opening-up, China has been committed to promoting the internationalization of audit supervision and the convergence of accounting standards towards international standards. In 2011, the European Commission for the first time recognized the equivalence of audit supervision systems in ten third countries, including China. This is the first time that the international capital market has officially accepted Chinese corporate accounting standards. On November 16, 2019, the European Commission once again passed a resolution on the assessment of the appropriateness of Chinese regulatory agencies in the field of statutory audit supervision. This is another bilateral continuation resolution following the 2011 China-EU Audit Equivalence Agreement. In the area of audit supervision, CSRC has also proposed several possible solutions to assist PCOAB to fulfill its mandate, including proposals with respect to joint inspection.

Secondly, the divergence of views on audit and supervision cooperation between China and the United States does not affect the future supervision cooperation between the two sides. In 2013, CSRC and Ministry of Finance of China signed an MOU on enforcement cooperation with PCAOB. China agreed to provide the US with audited working papers that do not involve state secrets in accordance with relevant procedures, but the specific form of cooperation still needs to be determined. “China

has never prohibited or prevented relevant accounting firms from providing audit working papers to overseas regulatory agencies. The essence of relevant Chinese laws is that information such as audit working papers should be exchanged through regulatory cooperation channels and comply with relevant regulations on security and confidentiality. This is also a common practice in line with international conventions.”

² For example, EU regulators adopt an approach of recognition and deference in their cross-border regulatory cooperation. In Chinese laws, there is no substantive obstacle to the cooperation between China and the United States, and the two sides can find a satisfactory and appropriate path for cooperation.

Thirdly, the differences in the jurisdictions of the securities regulatory agencies in China and the United States do not affect the development of cross-border regulatory cooperation between the two countries. The legal authority of the securities regulatory agencies in China and the United States is different, especially when it comes to the investigative authority or the authority to obtain certain types of regulatory information. In general, SEC has greater authority in inspections and investigations. In addition, the Chinese stocks are registered overseas and listed in the United States. There is a lack of prior notification and cooperation between Chinese and US regulators on US-listed Chinese companies. These facts might impede the joint action and regulatory cooperation between Chinese and US regulators. However, these difficulties could be overcome in various ways. For example, CSRC can conduct investigations and collect evidence under the premise of international enforcement cooperation, and cooperate with foreign securities regulators in conducting joint investigations.

IV. China and the United States should uphold the principle of equality and mutual benefit and jointly promote cross-border regulatory cooperation

In view of the regulatory issues arising from cross-border listed companies such as Luckin Coffee, we believe that strengthening cross-border cooperation is the right way to solve the problem. The current disputes between China and the United States are affected by many non-economic and non-legal factors. Both sides should uphold the principle of equality and mutual benefit and jointly promote cross-border regulatory cooperation, seeking a common value of both parties and respecting each other's reasonable demands.

Firstly, China and the United States should adhere to the principle of territorial supervision and seek and expand the basis of cooperation. Financial fraud and other securities violations and criminal acts are the enemies for the regulatory agencies in both China and the United States. The common objectives of Chinese and US regulators are maintaining the stability of the capital market and protecting the rights and interests of investors. China and the United States should strengthen regulatory cooperation and jointly fight against misconduct in capital markets.

2. See CSRC Chairman Yi Huiman taking an interview with Caixin (transcript), available in China Securities Newspaper Website (last modified Jul. 6, 2020) <http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/202006/t20200624_378786.html>.

However, Sino-US securities regulatory cooperation must also respect national sovereignty and the principles of non-interference in internal affairs and international comity, and adhere to the principle of territorial supervision. In the field of cross-border securities regulatory cooperation, China and the United States should explore feasible cooperation plans on the basis of respecting basic principles such as national sovereignty, resolve conflicts and differences between the two sides in the form of an MOU, seek maximum consensus for cooperation, respect each other's bottom line and demands, and seek mutual benefit.

Secondly, fulfill multilateral and bilateral cross-border supervision cooperation obligations and jointly promote Sino-US cross-border audit supervision cooperation. Sino-US cross-border audit and supervision cooperation are the key to solving the current problem. In the field of international securities regulatory cooperation, CSRC follows the IOSCO's Objectives and Principles of Securities Regulation and has signed the MMoU. CSRC and SEC may, in accordance with the MMoU and their bilateral MOU, earnestly fulfill their obligations of cross-border supervision cooperation and provide enforcement assistance. The incident of Luckin coffee actually exposed the difficulty of the US side in the supervision over companies listed in the United States. It also reflects that China needs to pay attention to overseas listed VIE-structure companies and supervise such companies within the scope authorized by law. Though it is the responsibility of SEC to supervise US-listed Chinese companies, Chinese and US regulators should jointly carry out cross-border regulatory cooperation on the basis of reciprocity, strengthen cooperation with each other, jointly investigate and deal with financial fraud and other violations of listed companies, and maintain market integrity.

Thirdly, adopt various measures to improve cooperation, including joint inspection and exchange of audit working papers. Chinese and US regulators could establish a cross-border joint inspection mechanism to further enhance bilateral cooperation. CSRC has already conducted a pilot joint inspection program together with PCAOB. Based on the experience derived from this program, Chinese and US regulators could refine their plans for joint inspections and start to carry out more inspection programs on US-listed Chinese companies. Regarding the provision of audit working papers, both China and the United States may adopt a pragmatic and flexible attitude, and, under the premise of respecting each other's laws, strive to find a practical way to exchange audit working papers through regulatory cooperation channels and comply with relevant provisions on security and confidentiality.

Fourthly, emphasizing the specialization of securities regulatory issues, securities regulatory agencies need to respect the market and the independent choices of investors from both countries. The leading position of US stock markets not only stems from the well-functioning legal system of securities regulation, but also relies on the independent and diversified investment decisions made by US investors. The incident of Luckin Coffee's financial fraud cannot represent all Chinese companies

listed in the United States. In fact, after the United States launched a series of policies and regulations against Chinese stocks, US investors' confidence for Chinese stocks were not weakened. For example, the Holding Foreign Companies Accountable Act passed Senate on May 20, 2020. However, the data at the end of May show that the prices of Chinese stocks rose by 13% on average, and the stock price of Pinduoduo Inc. rose by more than 80%. This market performance demonstrates the value of Chinese companies and reflects that a great number of US investors are willing to invest in some of the emerging Chinese companies. The choices of US investors deserve SEC's consideration.

I wish the cooperation between China and the US securities regulators a success, and both sides could start a new chapter on cross-border supervision cooperation.

Sincerely,

Contacts:

Li Youxing

Professor of Guanghua Law School of Zhejiang University
[REDACTED]

Xing Huiqiang

Professor of Law School of Central University of Finance and Economics
[REDACTED]

Pan Zheng

Ph.D., Guanghua Law School, Zhejiang University
[REDACTED]

Qian Haoyu

Ph.D., Guanghua Law School, Zhejiang University
[REDACTED]