July 9, 2020

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: July 9, 2020 Roundtable on Emerging Markets Risks

Dear Ms. Countryman:

The American Securities Association ("ASA")[1] welcomes the opportunity to comment on the upcoming Securities and Exchange Commission ("SEC") roundtable on risks to investors from emerging markets, in particular China ("Roundtable"). The ASA has long warned policymakers and investors about the dangers of U.S.-listed Chinese firms that fail to follow basic regulatory and financial reporting standards that are required of companies based in the United States. This has directly exposed retail investors in the U.S. to Chinese companies that are outright frauds, arms of the Chinese Communist Party, or engaging in activities that are hostile to American interests.

Recently, the U.S. Senate passed the "Holding Foreign Companies Accountable Act" by unanimous consent. This legislation would mandate the delisting of any company that fails to comply with Public Company Accounting Oversight Board (PCAOB) inspection requirements for three consecutive years. It would also require public companies to disclose whether they are owned or controlled by any foreign government. The ASA has strongly supported this legislation as it will provide much-needed transparency into companies based in China and other companies that want access to U.S. markets.

The swift passage of the Senate bill – and expected consideration in the House of Representatives – was necessary due to the failure of the SEC and other government agencies to properly address this issue. The granting of a "free pass" from PCAOB requirements to Chinese

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

companies in 2013 needlessly exposed American investors to enormous risks and eroded confidence in our capital markets and the ability of regulators to properly oversee them.[2]

Just in the last 12 months, at least two high-profile companies – Luckin Coffee and TAL Education – have both been accused of financial fraud. Luckin Coffee – the stock of which has dropped by over 90% - is finally in the process of being delisted in the United States. The PCAOB notes that there are still over 200 companies currently trading in the U.S. where the PCAOB is unable to inspect the books of auditors.[3] While the Roundtable and joint statements from the SEC and PCAOB may incrementally raise public awareness of this issue, there is no legitimate reason for why companies should be allowed to list in the U.S. if they continuously fail to live up to our regulatory standards.

Compounding this problem is the existence of a loophole that allows passive investment funds to steer investor dollars into these opaque businesses. As former Commissioner Jackson has noted, "index providers have influence over stock prices that even the largest investors can only envy."[4] Inclusion of a company in an index can lead billions of investor dollars to unwittingly flow into companies that don't meet basic auditing standards. While there are many benefits to index investing - in particular low costs and the ability to access a broad change of stocks – this is one of the risks inherent in the approach. And at the end of the day, the argument about diversification is a red herring especially when the "growth" is based on false, misleading, and fraudulent numbers.

To end China's fraud on our markets, the SEC should: 1) terminate the 2013 agreement; 2) delist every Chinese or other foreign company that doesn't meet the same company-specific disclosure, audit, and reporting standards as U.S. companies; and 3) close the passive index loophole which allows index funds to steer investor money into foreign companies that fail to live up to U.S. standards.

Thank you for your attention and please use us a resource as you make policy in this area.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association

[2] https://pcaobus.org/News/Releases/Pages/05202013_ChinaMOU.aspx
[3] https://pcaobus.org/International/Inspections/Pages/IssuerClientsWithoutAccess.aspx
[4] https://www.sec.gov/news/speech/jackson-your-index-fund

Exhibit A

RealClear Politics

Washington Must End China's Fraud on Our Markets

By Christopher A. Iacovella | May 30, 2020

As China's great power competition with America intensifies, financial markets have become a frontline battleground. Anyone who denies the Chinese Communist Party is using deception as statecraft in this competition is ignoring reality or a willing participant in its grand strategy. A glaring example of this deception is China's exploitation of our capital markets.

China needs access to Western capital to become a dominant world superpower and it found a willing partner in Wall Street. The partnership works like this: First, Wall Street spins a narrative about emerging market returns and the "can't miss China growth story." Then, it markets and sells Chinese companies to American investors. After the sale, proceeds are sent to China, it continues to support these companies by putting them in stock index funds, promoting them in the financial media, and lobbying Washington on their behalf.

But this arrangement only succeeds if U.S. regulators cannot audit the financials of Chinese companies. So, in 2013, the CCP persuaded high-level American officials to agree to give Chinese companies a "free pass" from the Sarbanes-Oxley rules enacted to protect investors in the wake of the Enron and WorldCom frauds.
Since then, China has used billions of American investor dollars to finance its cyber army, its technology-driven elimination of civil liberties, its human rights abuses, and its destruction of the environment. Wall Street ignores this inconvenient truth in its pursuit of profit.

Now, the partnership is under fire because the reason the CCP didn't want U.S. regulators to audit Chinese companies has finally been exposed.

America's mom-and-pop investors, labor unions, pension funds, and retirement plans have lost millions investing in fraudulent Chinese companies. From reverse mergers and stock indexes to single-stock listings, this fraud has been deliberate and pervasive. Just this year, Luckin Coffee – the Chinese equivalent of Starbucks – which did an IPO last May, saw its stock drop over 80% as investors learned of fabricated sales and shoddy accounting. Recently, two other Chinese companies – TAL Education and iQiyi – have also been accused of fraud. Over an eight-year period, a pattern of cheating has emerged.

It begs the question: Is this fraud a normal part of investment risk or an intentional part of China's larger geopolitical strategy? Facts suggest the latter, leading observers to conclude the CCP executed a purposeful and strategic defrauding of American investors in broad daylight.

American investors and Washington politicians started asking why Chinese companies continue to access our markets. They also pressured the U.S. Securities and Exchange Commission to do more. But the 2013 agreement lets China assert a "national security privilege" to avoid the rules and regulatory oversight that apply to American companies. So, without support from Congress and the administration to end the agreement, the SEC's only option was to release a statement essentially telling investors: On China, "*Buyer Beware*."

How quickly things change.

Earlier this month, the administration recognized China's statecraft and acted swiftly to stop it. Supported by a bipartisan group in the House and Senate, it ordered a government retirement plan not to invest in a Wall Street index fund holding Chinese companies. The administration pointed to "*serious concerns about the reliability of financial information from Chinese companies and the significant risks to investors*."

Last week, the Senate took action of its own, unanimously passing a bill that requires Chinese companies to comply with U.S. laws. The House is expected to pass this bill soon. The SEC now has overwhelming political support to protect investors and the integrity of our markets.

To end China's fraud on our markets, the SEC should: (1) terminate the 2013 agreement; (2) deregister every Chinese company that doesn't meet the same company-specific disclosure, audit, and reporting standards as U.S. companies; and (3) close the "passive index loophole," which allows index funds to sell shares of an index holding Chinese companies listed on Chinese stock exchanges that are not subject to *any* U.S. laws and regulations (i.e. China A-Shares).

These common-sense bipartisan reforms will protect American investors and level the playing field for American companies to create jobs for American workers.
America's capital markets are the deepest and most resilient in the world because investors have confidence the rule of law exists here. Allowing China to continue to deceive them undermines America's national security, economic security, and our values.

Christopher A. Iacovella is CEO of the American Securities Association.

Exhibit B

RealClear Politics

Why Are American Investors Funding Chinese Fraud?

By Christopher A. Iacovella | October 19, 2019

Wall Street's ETF issuers and index providers have funneled billions of dollars of American investor money out of the U.S. and into Chinese companies pushing the "you can't miss out on China growth" narrative. The problem for investors is they have no insight into whether these companies are growing, profitable, or losing money because the Chinese Communist Party (CCP) regularly asserts a national security privilege to prevent routine audits from taking place. This intentionally keeps investors in the dark and subjects them to a risk of fraud that is very real.

Why has this happened? Wall Street is using a loophole that allows Chinese companies to avoid the SEC's rigorous company-specific disclosure and audit regulations and still be included in an index sold to investors through an ETF. Normally, ETF issuers rely on index providers to conduct diligence on each company they put into the index, but diligence in China is impossible because the Communist Party won't allow it. This roadblock should have immediately stopped the sale of these securities to America's retail investors. But, in true Wall Street fashion, it didn't because the ETF issuers desperately want access to the Chinese market and the index providers bowed to a regime that pressured them to increase China's access to global capital. As a result, neither the index providers nor the ETF issuers know whether the Chinese companies in the indexes they sold are Enron-like frauds, arms of the Chinese military, or supporting human rights abuses.

If you think this concern is misplaced, think again. Earlier this year, Kangmei Pharmaceutical, a Chinese company included in MSCI indexes, had over $4.4 billion go "missing." While the company called it an "accounting error," China's late-to-the-party regulator called it a "premeditated and malicious cheating of investors." How many more of these companies will have their cash go missing when the CCP determines their useful life has come to an end? As more frauds emerge, it will be America's mom-and-pop investors who get stuck holding the bag, with limited legal recourse. It defies logic to think that retail investors are exposed to this type of risk 11 years after a financial crisis triggered by asset-backed securities filled with fraudulent mortgages.

Incredibly, the diligence failure doesn't stop there. As if ignoring the risk of fraud isn't bad enough, the indexes also include companies placed on the U.S. government Entity List and OFAC Sanctions List. This generally happens when a company is "acting contrary to the national security or foreign policy interests of the United States" or is a "threat to the national security, foreign policy or economy of the U.S." Yet, American investor money continues to flow into these companies. Does that make sense to anyone, except those profiting from it? Do Americans even know that when they buy a global index ETF they could be investing in adversarial state-controlled companies like Rosneft, Gazprom, ZTE, Hikvision, or Aviation Industry Corporation of China?

This is fiduciary malfeasance of the highest order. U.S. investors, savers, and retirees will suffer if these companies turn out to be frauds, and it's almost certain that their money is being used to fund the buildup of China's military and a cyber army that relentlessly attacks this country.

The money Wall Street directed to China could have been used to fund small businesses here. America's public companies incur an average of $1.5 million per year in compliance costs, but Chinese companies benefiting from the loophole bear none of this cost. While we believe capital should always seek out its best use, Chinese companies should no longer get a free pass from minimum audit and disclosure requirements if they want to access the American market. This change will protect investors and level the playing field for American companies competing for the same capital.

Fortunately, this is not a partisan issue. Sen. Chuck Schumer expressed concerns in a 2013 letter to then-Treasury Secretary Jack Lew, and Sens. Marco Rubio, Jeanne Shaheen, John Kennedy, and Chris Van Hollen, along with SEC Commissioner Robert Jackson have all raised these issues more recently. We agree with their message: Investor protection and transparency in America's capital markets must not be compromised.

Any company that refuses to submit itself to basic regulatory scrutiny or has been sanctioned by the U.S. government must be removed from these indexes. While the rise of passive index investing has its benefits, it's time for Washington to prioritize America's retail investors by closing the loophole before it causes massive losses in their portfolios.

Christopher A. Iacovella is CEO of the American Securities Association.