

MEMO# 33708

July 30, 2021

SEC Chair Gensler Issues Statement on Investor Protection Related to Recent Developments in China

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TO: ICI Members

ICI Global Members SUBJECTS: International/Global RE: SEC Chair Gensler Issues Statement on Investor Protection Related to Recent Developments in China

On July 30, the Chair of the Securities and Exchange Commission (SEC), Gary Gensler, issued a statement^[1] expressing concern with recent developments in China and the overall risks for investors presented by the China-based variable interest entity (VIE) structure, including the fact that average investors may not realize that they hold stock in a shell company rather than a China-based operating company.

In the statement, Chair Gensler stated that he has asked staff to seek certain disclosures from offshore issuers associated with China-based operating companies before their registration statements will be declared effective. In particular, China-based operating companies will need to disclose prominently and clearly:

- that investors are not buying shares of a China-based operating company but instead are buying shares of a shell company issuer that maintains service agreements with the associated operating company. Thus, the business description of the issuer should clearly distinguish the description of the shell company's management services from the description of the China-based operating company;
- that the China-based operating company, the shell company issuer, and investors face uncertainty about future actions by the government of China that could significantly affect the operating company's financial performance and the enforceability of the contractual arrangements; and
- detailed financial information, including quantitative metrics, so that investors can understand the financial relationship between the VIE and the issuer.

In addition, all China-based operating companies seeking to register securities with the SEC, either directly or through a shell company, will need to disclose prominently and clearly:

- whether the operating company and the issuer, when applicable, received or were denied permission from Chinese authorities to list on US exchanges; the risks that such approval could be denied or rescinded; and a duty to disclose if approval was rescinded; and
- that the Holding Foreign Companies Accountable Act, which requires that the Public Company Accounting Oversight Board (PCAOB) be permitted to inspect the issuer's public accounting firm within three years, may result in the delisting of the operating company in the future if the PCAOB is unable to inspect the firm.

Chair Gensler further noted that, in addition to this specific guidance, the SEC will continue to hold all companies to the securities laws' high standards for complete and accurate disclosure.

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endnotes

[1] The statement is available at:

https://www.sec.gov/news/public-statement/gensler-2021-07-30?utm_medium=email&utm_source=govdelivery

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