

MEMO# 33943

December 8, 2021

SEC Finalizes Rules Implementing the Holding Foreign Companies Accountable Act

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TO: ICI Members

ICI Global Members SUBJECTS: Audit and Attest

Compliance

Disclosure

International/Global RE: SEC Finalizes Rules Implementing the Holding Foreign Companies Accountable Act

In March 2021, the Securities and Exchange Commission (SEC) adopted interim final rules to implement the Holding Foreign Companies Accountable Act (HFCA Act), which requires the SEC to identify issuers that have filed annual reports with audit reports issued by a registered audit firm located in a foreign jurisdiction that the Public Company Accounting Oversight Board (PCAOB) is unable to inspect because of a position taken by an authority in the jurisdiction.^[1] On December 2, the SEC adopted amendments to finalize the interim final rules (Final Amendments) that revised Forms 20-F, 40-F, 10-K, and N-CSR.^[2] Further, the SEC established procedures to identify issuers and prohibit the trading of the securities of identified registrants as required by the HFCA Act.

The amendments are effective 30 days after publication in the *Federal Register*. The earliest that the SEC could identify an issuer is after the company files its annual report for 2021 (i.e., Spring 2022 for calendar-year issuers). The earliest any trading prohibitions would apply is in 2024, after an issuer has been identified for three consecutive years (2022, 2023, and 2024).

We would be pleased to hear from members about the expected impact of these Final Amendments on regulated funds, and in particular your views on the trading prohibition provisions. Please reach out to me as soon as possible by email at emykolenko@ici.org or 202-657-7926.

HFCA Act Background

The HFCA Act requires the SEC to identify covered issuers^[3] that have retained a

registered audit firm to issue an audit report where that audit firm (i) has a branch or office that is located in a foreign jurisdiction; and (ii) the PCAOB is unable to inspect because of a position taken by an authority in the foreign jurisdiction^[4] (Commission-Identified Issuers). Issuers so identified are required to submit documentation to the SEC that establishes that they are not owned or controlled by a governmental entity in the foreign jurisdiction of the PCAOB-Identified Audit Firm. If a Commission-Identified Issuer is identified for three consecutive years, the HFCA Act directs the SEC to prohibit trading in the issuer's securities. Identified issuers that are foreign issuers^[5] (Commission-Identified Foreign Issuers) are subject to additional disclosure requirements intended to inform investors about the inability of the PCAOB to inspect the auditor and foreign governmental entity ownership of the issuer.

Documentation Submission Requirements

The interim final rules amended Form 10-K, Form 20-F, Form 40-F and Form N-CSR (Reporting Forms) to require any Commission-Identified Issuer to submit to the SEC documentation establishing that the issuer is not owned or controlled by a governmental entity in the relevant foreign jurisdiction. The interim final rules required this documentation to be submitted electronically to the SEC on a supplemental basis through EDGAR on or before the due date of the relevant annual report form. The Final Amendments finalize the interim final rules with respect the document submission requirements without modification.

Additional Disclosure Requirements for Commission-Identified Foreign Issuers

The interim final rules amended the Reporting Forms to require Commission-Identified Foreign Issuers to provide specified disclosures in their annual reports for the year the SEC so identifies the issuer.^[6] Commenters on the interim final rules noted that many companies with Chinese operations are listed in the United States using variable interest entity (VIE) structures incorporated in jurisdictions outside of China and that the disclosure requirements could be read as not requiring disclosure of Chinese government ownership of shares of the registrant. In response to these comments, the Final Amendments modify the interim final rules to make clear that the registrant must, in addition to providing the required disclosures for the Commission-Identified Foreign Issuer, look through a VIE or any structure that results in additional foreign entities being consolidated in the financial statements of the registrant and provide the required disclosures about any consolidated operating company in the relevant jurisdiction. The Final Amendments also include a new XBRL tagging requirement to facilitate the Commission's timely identification of Commission-Identified Issuers.^[7]

Determination of Commission-Identified Issuers

The SEC will identify registrants pursuant to the HFCA Act based on the PCAOB's determination and on registrants' annual reports for fiscal years beginning after December 18, 2020. The earliest that the SEC could identify a Commission-Identified Issuer would be after registrants file their annual reports for 2021 and identify the audit firm that audited their financial statements. This means that if a registrant is identified as being a Commission-Identified Issuer based on its annual report filing made in 2022 for the fiscal year ended December 31, 2021, the registrant will be required to comply with the submission, and if applicable disclosure requirements, in its annual report filing covering the fiscal year ended December 31, 2022, that is required to be filed in 2023.

Process for Preparing and Publishing Commission-Identified Issuer List

Taking into consideration the commenter's suggestion, the Release indicates that registrants will be identified as early as possible after the filing of an annual report and on a rolling basis. Promptly after the filing of an annual report, the SEC will evaluate, using XBRL tagging, whether the annual report contains an audit report signed by a PCAOB-Identified Audit Firm. The SEC will "provisionally identify" a registrant as a Commission-Identified Issuer on the SEC's website at www.sec.gov/HFCAA. For a period of 15 business days after the provisional identification, a registrant may contact the SEC if it believes it has been incorrectly identified and provide evidence supporting such claims. If the registrant does not contact the SEC to dispute the provisional identification, the determination that the registrant is a Commission-Identified Issuer will be conclusive 15 business days after the provisional identification, i.e. "conclusive identification."^[8] We were pleased to see that, as we requested in our comment letter on the interim rules, the Commission-Identified Issuer list published on the SEC's website will indicate the number of consecutive years a Commission-Identified Issuer has been identified and whether it has been subject to any prior trading prohibitions under the HFCA Act.

Process for Imposing Trading Prohibition

As background, if a registrant is determined to be a Commission-Identified Issuer for three consecutive years, Section 2 of the HFCA Act requires the SEC to prohibit the trading of such registrant's securities on a national securities exchange or through over-the-counter trading (initial trading prohibition). If the SEC ends the initial trading prohibition and, thereafter, the registrant is again determined to be a Commission-Identified Issuer, the SEC is required to impose a trading prohibition for a minimum of five years (subsequent trading prohibition). Despite indicating in the interim final rules that it anticipated separately consulting on the trading prohibition provisions, the SEC included in the Final Amendments the process for imposing trading prohibitions. The Release provides that interested parties may contact the SEC to provide feedback or discuss issues regarding the implementation of the trading prohibition.^[9]

The SEC believes that, given the procedural protections afforded to issuers (e.g., a 15-day period for issuers to contest the designations) and the fact that issuers and the investing public will have had sufficient notice of an issuer's status as a Commission-Identified Issuer over a period of three years, it is appropriate to impose an initial trading prohibition and issue an order prohibiting the trading of an issuer's securities as soon as practicable after the issuer has been determined to be a Commission-Identified Issuer for three consecutive years. Such initial trading prohibition will be effective on the fourth business day after the SEC publishes the order.

Similarly, the SEC will issue an order for a subsequent trading prohibition as soon as practicable after the issuer is again identified as a Commission-Identified Issuer. The subsequent trading prohibition will be effective on the fourth business day after the order is published.

Process for Terminating Trading Prohibitions

To end an initial trading prohibition, a Commission-Identified Issuer must certify that it has retained a registered audit firm that the PCAOB has determined it is able to inspect or investigate (non-PCAOB-Identified Audit Firm). Similarly, a Commission-Identified Issuer must certify that it will retain a non-PCAOB-Identified Audit Firm for the SEC to terminate

the subsequent trading prohibition.

The SEC acknowledges that the retention of a registered audit firm does not guarantee that the newly engaged audit firm will be the firm that issues an audit report on the financial statements of the issuer. Therefore, the certification must be preceded or accompanied by the filing of an annual report or an amended annual report with financial statements that include an audit report on the consolidated financial statements signed by a non-PCAOB-Identified Audit Firm. Upon receiving and verifying the certification, the SEC will issue as soon as practicable an order ending the initial or subsequent trading prohibition, as the case may be. The termination of the trading prohibition will be effective the next business day after the order is published.

Eva M. Mykolenko
Associate Chief Counsel - Securities Regulation

endnotes

[1] See Institute Memorandum No. 33399, dated March 29, 2021, for a summary of the interim final rules, *available at* <https://www.ici.org/memo33399>.

[2] Holding Foreign Companies Accountable Act Disclosure, Release No 34-93701, IC-34431 (December 2, 2021) *available at* <https://sec.gov/rules/final/2021/34-93701.pdf> (Final Amendments or Release).

[3] The Release explains that Sarbanes-Oxley Act Section 104(i)(1)(A) defines "covered issuer" as an issuer that is required to file reports under Section 13 or 15(d) of the Exchange Act, and that issuers filing reports under the Exchange Act are referred to in Commission forms as "registrants." In the Release, the SEC uses the term "issuers" when referring to the HFCA Act, but "registrants" when discussing the forms and form requirements.

[4] On November 4, 2021, the SEC approved the PCAOB Rule 6100, Board Determinations Under the Holding Foreign Companies Accountable Act. PCAOB Rule 6100 establishes a framework for the PCAOB to make its determinations required by the HFCA Act. The rule describes the form, public availability, effective date, and duration of such determinations. A firm so identified is referred to as a "PCAOB-Identified Audit Firm." See PCAOB Rule 6100 *available at* https://pcaobus.org/about/rules-rulemaking/rules/section_6#rule6100.

[5] See Exchange Act rule 3b-4.

[6] These disclosures include: (1) that, during the period covered by the form, the PCAOB-Identified audit firm that prepared an audit report for the issuer; (2) the percentage of the shares of the issuer owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated or otherwise organized; (3) whether governmental entities in the applicable foreign jurisdiction with respect to that audit firm have a controlling financial interest with respect to the issuer, (4) the name of each official of the Chinese Communist Party (CCP) who is a member of the board of directors of the issuer or the operating entity with respect to the issuer; and (5) whether the articles of incorporation of the issuer contains any charter of the CCP.

[7] Those data elements will identify the auditor who provided the opinion on the financial statements, the location where the auditor's report was issued, and the PCAOB ID number of the audit firm or branch providing the opinion.

[8] The Release notes that under PCAOB Rule 6100 the PCAOB will notify each PCAOB-Identified Audit Firm of its determination and will also publish the list on its website. Accordingly, the Release notes that the provisional identification of issuers on the SEC website is not anticipated to have any significant market impact.

[9] Feedback should be submitted to the SEC at hfcaa@sec.gov.

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