

# United States Senate

WASHINGTON, DC 20510

March 5, 2020

Mr. Rick Fleming  
Investor Advocate  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

Dear Mr. Fleming:

The Office of the Investor Advocate (“Investor Advocate”) at the Securities and Exchange Commission (“SEC” or “Commission”) was established by the 2010 Dodd-Frank Act to serve as a voice for retail investors on issues under the SEC’s jurisdiction. Amongst other duties, Congress tasked the Investor Advocate with “[identifying] areas in which investors would benefit from changes in the regulations of the Commission” and with regularly providing Congress and the SEC a summary of the most serious threats facing Main Street investors.

The Investor Advocate has several tools available to raise investor protection issues with SEC leadership and the general public: a direct report to the SEC Chairman, public statements and speeches, an annual report that includes recommendations for legislative or regulatory action, and a permanent seat on the SEC’s Investor Advisory Committee.

However, it appears your office has not addressed one serious threat facing American investors today: a regulatory loophole that allows Chinese companies to list in the United States without complying with the regulatory and auditing standards required of companies listed in the U.S. This loophole has exposed billions of retail investor dollars to Chinese companies that could be outright frauds, arms of the Chinese Communist Party, or involved in cyber espionage against the United States.

The SEC has noted that there are currently over 200 U.S.-listed companies where the Public Company Accounting Oversight Board (PCAOB) has difficulty in obtaining work related to the principal auditor.<sup>1</sup> Additionally, index providers, such as MSCI, and passive investment funds run by the world’s largest asset managers encourage the flow of money into such companies, regardless of whether a company’s auditors have undergone a PCAOB inspection. The fact that a Chinese company can be included in an index to avoid the SEC’s rigorous company-specific disclosure and audit regulations seems to fly in the face of the investor protection mandate of the Commission, your office, and the Investor Advisory Committee.

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<sup>1</sup> Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally – Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China (December 7<sup>th</sup>, 2018).

Recent examples showcase just how significant the risk is for investors. Kangmei Pharmaceuticals, which is included in a number of MSCI global indices, last year stated it had an “accounting error” that led it to overstate its cash holdings by \$4.4 billion.<sup>2</sup> And last year, the shares of China Ding Yi Feng were frozen by the Hong Kong Securities regulator when the company was charged with market manipulation – but not until after its shares had risen by 5,000%, securing inclusion into MSCI’s emerging markets index.<sup>3</sup>

Unfortunately, these instances are not new developments. In 2009, the U.S. markets saw a boom of Chinese companies listing on the U.S. exchanges. These fraudulent companies would merge with an American shell company in order to get access to U.S. investors without an initial inspection by the SEC. When many of these companies inevitably crashed in 2011, it became known as the “reverse merger fraud crisis” and contributed to the loss of billions of dollars in market capitalization.

Americans are increasingly concerned that the federal government is not doing enough to address the threat that China poses to our capital markets and national security. A recent survey found that 72% of Americans believe if Chinese companies want to list in the United States, they should have to satisfy the same regulatory requirements as U.S. businesses.<sup>4</sup> These developments have increased our concerns about the protection of American investors who are unknowingly investing in the self-dealing, human rights abuses, cyberattacks, and frauds perpetrated by the CCP through these companies.

If ever there was an issue that the Investor Advocate should be deeply involved in, this is it. The Investor Advocate was created to speak on behalf of America’s retail investors, not index providers or asset management firms whose top concern is their own bottom line.

We encourage you to use the tools at your disposal to hold a hearing and educate the investing public about: (1) what risks are posed to American investors by Chinese companies that are listed on U.S. exchanges and registered with the SEC to sell securities (2) Chinese-related risks underlying certain index funds (i.e. fraud, funding of human rights abuses, funding CCP cyberarmy, etc.), (3) how Chinese companies on the U.S. Government Entity List and OFAC Sanctions List can be included in index funds sold to American investors, and (4) to explore self-dealing conflicts of interest at index providers, such as MSCI, and large asset management firms that facilitate the flow of American investor capital into opaque, high-risk Chinese companies.

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<sup>2</sup> Chinese firms' missing \$6 billion tests regulators' resolve. Reuters (May 17<sup>th</sup>, 2019).

<sup>3</sup> Kangmei's \$4bn accounting error highlights China risk. Financial Times (April 30, 2019).

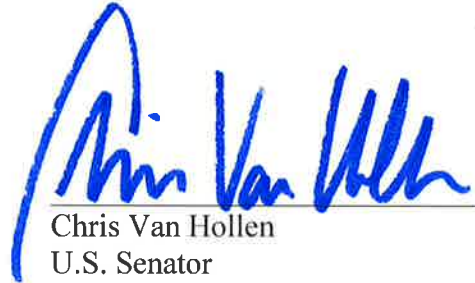
<sup>4</sup> Committee on the Present Danger: China. National Survey Results – “The China Poll”  
<https://presentdangerchina.org/2020/02/national-survey-the-china-poll/>

This is a problem that your committee and the Commission are statutorily obligated to address.<sup>5</sup> We look forward to hearing more from you and the Office of the Investor Advocate regarding this critical issue.

Sincerely,



John Kennedy  
U.S. Senator



Chris Van Hollen  
U.S. Senator

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<sup>5</sup> <https://www.investor.gov/introduction-investing/basics/role-sec>