

[Securities Regulation Daily Wrap Up, TOP STORY—SEC takes first step to implement audit inspection disclosure legislation, \(Mar. 24, 2021\)](#)

Securities Regulation Daily Wrap Up

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Last December Congress passed legislation giving the SEC authority to suspend trading of certain foreign company stocks if the companies operate in countries that disallow PCAOB audit inspections.

The SEC has begun implementation of the Holding Foreign Companies Accountable (HFCA) Act, a new law that grants the agency authority to delist foreign companies' stocks from U.S. exchanges if those companies are based in foreign jurisdictions that bar PCAOB audit inspections. The SEC was charged with implementing portions of the law within 90 days after enactment, which the agency has begun to do via the issuance of an Interim Final Rule that updates several SEC forms and provides a method to document required company disclosures. However, a registrant is not required to comply with the amendments made by the Interim Final Rule until the Commission has identified the registrant as having had a non-inspection year, as defined by the new law, under a yet-to-be-adopted Commission process. As a result, the SEC will likely issue additional rules to complete implementation of the law.

The Interim Final Rule is effective 30 days after publication in the *Federal Register*, the same date on which public comments are due regarding outstanding issues concerning how the SEC should identify companies subject to the law and how to enforce law (*Holding Foreign Companies Accountable Act Disclosure*, [Release No. 34-91364](#), March 18, 2021) (the rule was announced by the SEC on March 24, 2021 and the earlier date of the Interim Final Rule—March 18, 2021—likely reflects that the rule was adopted seriatim by the commissioners without an open Commission meeting).

Legislative history. The HFCA Act (Pub. L. [No. 116-222](#)), sponsored by Sen. John Kennedy (R-La) and Sen. Chris Van Hollen (D-Md), was signed into law on December 18, 2020, after having [passed](#) the Senate, in amended form, by unanimous consent, and then having passed the House by voice vote, a rare showing of deep bipartisan support. However, it remains unclear precisely how the law is to be implemented by the SEC, with some members of Congress arguing for stricter enforcement and some urging more flexibility.

For example, a statement submitted to the House by Rep. Brad Sherman (D-Calif), expressed the view of Sen. Kennedy that the SEC should have discretion in implementing the bill's trading ban provisions (See, [Congressional Record](#), December 2, 2020, at H6033-H6034). Specifically, the Kennedy statement addressed how much of the audit must be done within the PCAOB's jurisdiction. "[I]t is our expectation that the Commission will not prohibit trading in the securities of companies under this act, as long as not more than one third of a company's total audit is performed by a firm beyond the reach of PCAOB inspections," said the statement.

A [press release](#) issued by the SEC announcing the Interim Final Rule said the agency seeks public comment on issues such as how to identify foreign companies and how to enforce the law.

Interim final rule. The Interim Final Rule addresses two key areas: (1) the disclosure requirement; and (2) the submission requirement. The latter item is addressed through updates to the text of Forms 20-F, 40-F, 10-K, and N-CSR.

The disclosure component of the Interim Final Rule addresses the requirements contained in Section 3 of the HFCA Act. Specifically, subject companies must disclose in their relevant filing the following:

- that a registered public accounting firm not inspected by the PCAOB prepared the issuer's audit report;
- the percent of the issuer's shares owned by governmental entities in the foreign jurisdiction where the issuer is incorporated or organized;

- whether governmental entities in the foreign jurisdiction with respect to the registered public accounting firm have a controlling financial interest regarding the issuer;
- the names of Chinese Communist Party (CCP) officials who are members of the board of directors of the issuer or its operating entity; and
- whether the issuer's articles of incorporation or other organizing document contain any charter (or charter text) of the CCP.

Generally, a registrant subject to the HFCA Act must electronically submit to the Commission on a supplemental basis documentation that establishes that the registrant is not owned or controlled by a governmental entity in the foreign jurisdiction. The amendments made to each of the forms noted above also provide two clarifying instructions: (1) a registrant must submit the required documentation on or before the due date to file the relevant form; and (2) a registrant that is owned or controlled by a foreign governmental entity is not required to submit the documentation.

The economic analysis contained in the Interim Final Rule was limited to the "discrete components" of the HFCA Act regarding the disclosure and submission requirements and did not address items to be addressed by the Commission in future rulemakings. The analysis noted that the HFCA Act could increase foreign companies' financial transparency which could affect the cost of capital for these companies (positively or negatively depending on a particular company's circumstances) if investors reassess the political risks of investing in these companies. For example, the costs could be greater for companies for which the information to be disclosed is not already publicly known. The analysis also noted that costs to companies required to comply may include accelerating the pace with which they comply with the remainder of the HFCA Act, changing audit firms, or exiting U.S. markets. Overall, the analysis judged costs to many companies would not be significant. An analysis of the costs of a trading prohibition must await further Commission action to implement the enforcement mechanisms of the HFCA Act.

Request for comment. The Interim Final Rule asks the public to comment on any aspect of the HFCA Act. Specifically, the request for comment lumps a number of questions into several categories which, among other things, ask the following:

- **Determination of Commission-Identified Issuers**—(1) What does it mean to "retain" a registered public accounting firm in the context of the HFCA Act?; (2) Should the SEC establish a single determination date each year (e.g., May 15)?; and (3) Should the SEC publish a list of Commission-identified issuers on its website?
- **HFCA Act Disclosure Requirement**—(1) Should the SEC define what it means to be an official of the CCP or would further guidance on this requirement be helpful?; and (2) Should the SEC forms amendments cover any additional forms?
- **HFCA Act Submission Requirement**—(1) Should the documentation submitted to the Commission be made publicly available, should it be retained non-publicly (subject to applicable law), and/or should the registrant be allowed to request confidential treatment for some or all of the submission?

As previously mentioned, public comments on the Interim Final Rule to implement portions of the HFCA Act are due within 30 days of the rule being published in the Federal Register.

The release is [No. 34-91364](#).

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