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SEC Statement On Emerging Markets Is A Stunning Failure

By **Jerry Silk** (April 27, 2020, 5:41 PM EDT)

The recent announcement by the U.S. Securities and Exchange Commission warning investors to be careful when making investments in Chinese and other emerging markets companies listed on U.S. exchanges is the epitome of abdication.[1]

The SEC was founded in 1934 to protect American businesses and investors from fraudulent conduct. The fundamental founding principal of the SEC was that companies seeking access to the vast store of American capital must be truthful in their communications to investors and potential investors. Our country's financial history is littered with times when the SEC, despite its best intentions, made mistakes, falling asleep at the wheel while bad actors deceived the public right under its nose.



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The Madoff Ponzi scheme, WorldCom, Enron, Tyco and the subprime meltdown are just a few examples of catastrophic failures of oversight that, in a perfect world, could have been prevented by increased SEC diligence. As notorious as those frauds were, and perhaps they could have been prevented by more sensible limitations on the "revolving door" reality where former SEC attorneys regularly go into private practice to represent the very companies they used to regulate, it would be harsh to suggest that the SEC knew beforehand that Enron, Worldcom and others were lying to investors.

That's why the SEC's most recent announcement is so chilling. It has completely abdicated its responsibility to investors. It is a stunning failure of this governmental agency. By admitting that it knows Chinese companies are lying to American investors — and doing nothing more to proactively protect the investing public — the SEC is abandoning its mission, which as described by the U.S. Supreme Court in *SEC v. Capital Gains Research Bureau Inc.* is to "substitute a philosophy of full disclosure for the philosophy of caveat emptor."

Although blaming the victim might be consistent with the darker elements of current American thinking, it is not consistent with the long-term success of American businesses. Nothing could be more dangerous to our country's capital markets than to abandon the teachings of Supreme Court Justice Louis Brandeis, who said, "sunlight ... is the best of disinfectants; electric light the most efficient policeman."

Chinese and certain other emerging markets refuse to play by the same rules applicable to U.S. companies seeking the benefits of listing on our exchanges. Many companies in those markets do not allow the Public Company Accounting Oversight Board access to their books, are not required to abide by the Sarbanes-Oxley Act, and do not submit to our laws and jurisdiction.

There are over 150 Chinese companies listed on U.S. exchanges, including many that went public in the U.S. via reverse mergers. Many of these have never had their books inspected by a U.S. or PCAOB registered auditing firm, but rather, are audited only by a Chinese accounting firm that is not subject to the authority of the SEC or U.S. courts.

The SEC's pronouncement on Chinese companies is a striking admission that now confirms what

many sophisticated investors already knew: The SEC is not willing to take the tough action necessary to protect our capital markets, and wants investors to do the work instead. This needs to end. If Chinese or other emerging market companies want access to our capital they have to play by our rules.

The SEC should, first and foremost, require that Chinese companies that seek to list their shares on U.S. exchanges follow the identical auditing and reporting rules and procedures as U.S. companies. A simple requirement forcing the CEO and chief financial officer of Chinese companies to certify the accuracy of their financial results under the 2002 Sarbanes-Oxley Act would be a good start at such active regulation.

Further, as proposed in a bill introduced by several U.S. senators, including Sens. Marco Rubio, R-Fla., and Bob Menendez, D-N.J. — the Ensuring Quality Information and Transparency for Abroad-Based Listings on our Exchanges Act, or EQUITABLE, Act — if these types of companies are unwilling to play by the rules that govern our regulatory regime, they should be delisted subject to certain provisions to protect existing shareholders.

Transparency and full disclosure in our capital markets have been and should continue to be sacrosanct and without more aggressive actions by the SEC, the recurring story of certain Chinese companies masquerading as legitimate enterprises will continue, causing investors harm.

Issuing a pronouncement urging investors to be careful is simply not enough. What will happen when Chinese companies that the SEC already suspects are lying to us collapse in value and American investors are left holding the bag? Will the SEC say, "I told you so" and blame the victimized investors?

And how is all of this fair to American businesses that follow the rules? How can the SEC responsibly say that foreign companies are probably lying to you but they get to market their securities here anyway, while we hold American companies to a long-established standard of honesty and fair dealing?

Our capital markets are the economic lifeblood of our nation and the envy of the world. If emerging market companies want access, they must agree to play by our rules, and American investors must insist that the SEC enforce those rules on a level playing field.

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[1] <https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting>

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