July 30, 2010 Hearing
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Testimony before the U.S.-China Economic and Security Review Commission (USCC)
China's Information Control Practices and the Implications for the United States

In October 1992, Brilliance China Automotive Holdings Ltd., a minivan manufacturer and one of the first state-owned enterprises (SOE) to become a share-owned company, became the first Chinese company to list on the New York Stock Exchange (NYSE) through a Bermuda-based holding company.[1] [2] Today, more than 75 companies maintain active listings on the NYSE, NASDAQ Stock Market (NASDAQ), and NYSE American Stock Exchange. Over time, the composition of companies seeking listings in the U.S. has shifted from mainly large SOEs to privately-owned Chinese companies. However, adequate disclosure and access to information required under U.S. securities laws are not concepts immediately associated with Chinese companies. Yet with the opening up of China's economy in the late 1970s, Chinese companies eventually began seeking capital from stock markets around the world, including markets in the United States. This shift should serve as an impetus to the Security and Exchange Commission (SEC) to revise its entire risk factor disclosure regime for Chinese and other foreign issuers to ensure that U.S. investors receive all material information about country risks when reading foreign issuers' prospectuses. Initially, Chinese issuers relied upon boilerplate language to convey country risks to U.S. investors. However, coinciding with the increased number of private Chinese issuers in recent years, U.S. investors are being offered more material disclosure about China country risks. Yet more accurate and tailored disclosure is required. This testimony will first examine the relevant aspects of U.S. securities law that guide what disclosure is material, and then it will examine the unique challenges posed by Chinese issuers in the context of materiality. Finally, I will explore the opportunity afforded to the SEC by Chinese issuers who have begun to improve their disclosure of material risks. The SEC should craft a new risk factor disclosure regime based upon company-specific company risk factors. The SEC in cooperation with Chinese issuers' professionals and its Chinese counterpart, the Chinese Securities Regulatory Commission (CSRC), must work to ensure that country risk disclosure remains true to its original intent of protecting U.S. investors and Chinese issuers without becoming politicized by special interest groups and lawmakers.[3]

Relevant Background About U.S. Securities Laws and Foreign Issuers

The two main bodies of federal securities law are the Securities Act of 1933 (Securities Act) and the Exchange Act of 1934 (Exchange Act). The general purpose of the federal securities laws was to "substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry."[4] The Securities Act pertains to registration statements and prospectuses from IPOs of foreign and domestic

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[1] The views expressed in this written testimony are those of myself, acting in my individual capacity, and do not represent the views of the USCC or of institutions or organizations to which I am attached.
[2] Brilliance China Automotive delisted its American Depositary Shares from the NYSE, effectively July 27, 2007 due to the decline in trading volume of the Company's ADSs and the increase in administrative costs to comply with US reporting and registration obligations. At that time, the company maintained its American Depositary Receipts (ADR) that traded on over the counter (OTC) markets. The company ultimately terminated its ADR program, effective August 31, 2009.
[3] Professionals primarily refer to the lawyers, accountants, and investment bankers that Chinese issuers engage to represent them on their U.S. IPOs.
[4] *In re Rediff.Com India Ltd.*, 358 F. Supp. 2d 189, 205 (S.D.N.Y. 2004).

companies listing in the U.S. When an issuer wishes to list a registered offering in the U.S., they must file with the SEC a registration statement pursuant to the Securities Act, which is comprised of the prospectus (usually the only part given to investors) and supplemental information that can be viewed by the public at the SEC.[5]

Risk factors are one way that the SEC uses disclosure to make an offering unattractive to investors without explicitly telling investors to avoid a risky offering. Examples of risk factors required by the SEC include the lack of business history, adverse business experience, competitive factors, and certain types of transactions with insiders. The country risk associated with foreign companies is notably absent from this list. The prospectus serves both as a selling document to advertise the issuer's securities to the public, and as a disclosure document to protect issuers from liability under federal securities laws. Risk factors are one way to balance these twin interests of marketing securities while simultaneously ensuring full and fair disclosure.

To unify disclosure requirements under the Securities Act and Exchange Act, the SEC adopted Regulation S-K. Within Regulation S-K, Item 503 is the only provision specifically regarding risk factors. Risk factors should contain the "most significant factors that make the offering speculative or risky" and the section should not "present risks that could apply to any issuer or offering." In other words, boilerplate language is not acceptable disclosure. SEC-created regulations and rules are designed to ensure that issuers disclose all material information to investors and avoid possible civil liability arising from material omissions or misrepresentations. However, Item 503 is the only provision dealing specifically with risk factors.

Materiality

The Securities Act defines what is "material" when it is applied to providing information to investors as "limit[ing] the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."[6] However, the Securities Act's definition includes subjective terms that elude precise meaning. These subjective gaps in the definition of "material" have been filled in by case law. In 1976, the Supreme Court case, *TSC Industries, Inc. v. Northway, Inc.*, became the seminal case on materiality. The Court wrote, "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote" and further clarified the definition by writing that, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[7]

Courts have further refined the *TSC Industries'* definition of "material" information by ruling that if an issuer only tells part of the truth, the information may be deemed to be incomplete and misleading if additional facts are not revealed. [8] Liability stems from the defendant's decision to speak about material details without providing additional known facts that would make his statements not misleading. There is a probability that a reasonable investor would rely on the

[5] The terms registration statement and prospectus are used interchangeably throughout this written testimony.
[6] 17 C.F.R. § 230.405 (2005).
[7] Ten years later the Court reaffirmed its definition of "material" articulated in *TSC Industries* in *Basic, Inc. v Levinson*.
[8] *City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 387 F.3d 468, 487 (6th Cir. 2004).

statements contained in the country risk factor section in a Chinese issuer's prospectus. A reasonable investor might read the risk factors associated with China's legal system and be unsure about the meaning behind the statements. However, there is no case law discussing materiality in the context of country risk factors, so the SEC can still further refine this concept when applied to country risk factor disclosure in Chinese prospectuses.

Problems with Materiality In Context of Chinese Companies

Materiality is a highly subjective concept. When discussing materiality and the adequacy of disclosure for Chinese companies, it is first useful to distinguish between SOEs and privately-owned companies seeking capital by listing on U.S. stock exchanges. A noticeable trend since the first Chinese companies began listing in the U.S. has been the gradual shift in listings from mainly large SOEs such as China Southern Airlines (listed on NYSE in 1997), PetroChina (listed on NYSE in 2000), China National Offshore Oil Company (CNOOC) (listed on NYSE in 2002), and China Telecom (listed on NYSE in 2002) to privately-owned companies such as eLong, Inc. (listed on NASDAQ in 2004), Baidu.com, Inc. (listed on NASDAQ in 2005), JA Solar Holdings Co., Ltd. (listed on NASDAQ in 2007), and China Lodging Group, Limited (listed on NASDAQ in 2010). This shift from large SOEs to seemingly private Chinese companies has an impact on what becomes material to a U.S. investor.

After looking at the prospectuses of many of these private companies that have listed in the U.S., mainly on the NASDAQ, it appears that while these companies are private, an analysis of the ownership structures of these companies raises some issues. The entities listed in the U.S. are usually offshore holding companies incorporated in the U.S. Cayman Islands or other domiciles outside of China and the operating entities and assets are located in China. There is no easily searchable database or other resource to verify the onshore ownership structure of these companies. Nothing is usually disclosed in the prospectuses to indicate any government involvement, but it is difficult to know whether local or provincial governments play a role in the operation of these companies and the extent of that role. It is not necessarily a problem that local and provincial governments may be involved with these companies in some capacity, but such disclosure is lacking and the U.S. investor is left wondering what exactly is going on with the onshore operating entities. The opacity of the ownership structures is one problem that U.S. investors face when trying to assess Chinese companies listing in the U.S.

Materiality also depends on who is meant by the "reasonable investor". Perhaps the notion of the "reasonable investor" needs to shift to accommodate the fact that those investing in Chinese companies are doing so because s/he believes in the China growth story perpetuated by the media. A reasonable investor in Chinese companies may be different than a reasonable investor in American retail companies. Investing in a Chinese company is not for the faint of heart, and like investing in any emerging market, implies a certain understanding or knowledge about China that would lead an investor to invest in Chinese companies. Therefore, the level of country risk disclosure may be different for a U.S. investor in a Chinese initial public offering (IPO).

Further contributing to a different notion of a reasonable investor in Chinese companies relative investors in other sectors or countries is the copious amount of publicly-available information about China. The availability of this information means that U.S. investors know more about China today than they did when the first companies began listing in the early 1990s. Appellate

courts have found that the public availability of information is relevant when considering whether a company has fulfilled its disclosure obligations under U.S. securities laws, including what might be considered material to the reasonable investor. Combined with the fact that a reasonable investor in Chinese companies may be different than a reasonable investor interested in another sector or region, the widespread availability of information about China for U.S. investors also affects what is material when considering the adequacy of country risk disclosure in SEC filings for Chinese companies. It also raises the question whether the SEC is responsible for educating U.S. investors about China or merely to ensure that Chinese companies disclose all material information in the risk factors section if their SEC filings to ensure that no information that could "alter" the total mix of information available has been omitted or misrepresented.[9] Can and should the SEC be making the presumption that U.S. investors in Chinese companies are different? Perhaps going forward the notion of what is material in terms of country risk factors for Chinese companies should be analyzed on a case-by-case basis, similar to what courts have been doing in other cases of alleged violations of sections 11 and 12 of the Securities Act.

China poses a challenge for the SEC when analyzing the adequacy of country risk disclosure because of the question of whether a reasonable investor in Chinese companies listing in the U.S. is different than a reasonable investor in other sectors or regions, as well as the availability of public information in the media and elsewhere about the risks of investing in China that could alter what is required to be disclosed about China in a registration statement.

Disclosure Has Improved In Recent Years

Since the time that I researched and wrote my article, *Risky Business: Can Faulty Country Risk Factors in the Prospectuses of U.S. Listed Chinese Companies Raise Violations of U.S. Securities Law,* that was published in the Columbia Journal of Transnational Law in 2005, country risk factor disclosure has been steadily improving. Disclosure has improved due to a combination of the following: (i) the SEC, Chinese issuers, and these issuers' professionals have been engaging in more beneficial dialogue over drafts of prospectuses before they go effective than they previously did, (ii) the line between company and country risk factors have been blurring, and (iii) the number of private Chinese companies listing on U.S. exchanges has increased.

As the SEC and professionals have reviewed more prospectuses of Chinese issuers and engaged in more back and forth discussions about what material country risk disclosure is required to provide U.S. investors with enough information, the quality of the disclosure has improved. It only makes sense that the more IPOs a particular professional takes part in, the more knowledgeable those professionals will become about China and the particular country risks that could affect an issuer. The growing experience of professionals combined with the SEC's more active and informed role in reviewing and commenting upon Chinese prospectuses before they go effective has resulted in better disclosure for U.S. investors.

Another factor is the apparent blending of company and country risk disclosure over the last five years that should cause the SEC to re-think its approach to country risk disclosure. When

[9] Certain courts have found that an omission or misrepresentation is only actionable if it was material at the time the registration statement became effective. Thus, risk factors about the effect of certain laws on the operations of the company may not be material if the company is not aware that such laws are in the process of being promulgated.

Chinese companies began listing in the U.S. in the early 1990s, Chinese companies included an appendix with their registration statements titled “The People’s Republic of China”, serving as a primer for investors who may have known nothing about China and included subsections such as “Geography and Population”, “History”, “Government”, “Economic Reforms”, “Industrial Production”, “Inflation”, and “Foreign Investment”. This appendix quietly faded from prospectuses by 2000 and Chinese companies began including industry risk sections to replace the appendix, but were lacking in details. I am not advocating a return to the appendices of the past because U.S. investors know more about China than they did 15 years ago due to the explosive growth of publicly-available China information. However, the most important development that is still working itself out is that Chinese companies have been issuing prospectuses that appear to conflate company and country risk disclosure, with the overall result being greater disclosure overall.

For example, China Lodging Group, Limited priced its IPO on NASDAQ on March 25, 2010. Its prospectus is a good example of the improved disclosure that I have been describing, as well as the conflation of company and country risk factors. Under the section titled, “Risks Related to Our Business”, the company included the following risk factor: “Our legal right to lease certain properties could be challenged by property owners or other third parties or subject to government regulation.”, which discloses that the company does not own the land its hotels are built upon, but instead relies upon leases with third parties who either own or lease the properties from the ultimate property owner. The company also discloses that under Chinese law, all leases must be registered with the local housing bureau and that a number of these leases have not been registered as required, which could expose the company or the lessors to potential monetary fines.[10] This risk factor could be categorized as a country risk factor, as well. However, the company has decided to categorize it as a business-specific risk factor. In this same section, the company proffers the following: “Failure to protect our trademarks and other intellectual property rights could have a negative impact on our brand and adversely affect our business”. A statement is included declaring that the laws are uncertain and enforcement procedures in China fail to protect intellectual property rights as well as they may be protected in the U.S. Moreover, the company also includes other risk factors in this section, such as “Our current employment practices may be adversely impacted under the labor contract law of the PRC” and “We are subject to various franchise, hotel industry, construction, hygiene, safety and environmental laws and regulations that may subject us to liability.” The company also includes five pages of “Risks Related to Doing Business in China”, which are a combination of seemingly boilerplate country risk disclosures such as “Adverse changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business” and “Fluctuation in the value of the Renminbi may have a material adverse effect on your investment” and company-specific country risk factors such as “Rapid urbanization and changes in zoning and urban planning in China may cause our leased properties to be demolished, removed or otherwise affected.” Risk factor disclosure in the

[10] China Lodging discloses that many of the leases are not registered with the local housing bureau and that the company **may** face monetary fines, but in actuality this arrangement could perhaps be perpetuated by special relationships with local authorities that render this risk factor moot as long as those special relationships are maintained. However, such relationships are mere speculation and there is no way to verify the exact nature of the arrangement whereby China Lodging can disclose this fact in a public American document and still operate its businesses without suffering material consequences from running afoul of Chinese law. By offering partial disclosure, Chinese issuers could raise the scepter of requiring additional disclosure to explain lingering questions.

China Lodging's prospectus cannot be neatly divided between company risk and country risk, but this is not necessarily a bad thing. This prospectus could be a model for a more tailored risk factor disclosure regime for Chinese and other foreign issuers going forward – a regime of company-specific country risk disclosure.

Another example of relatively useless general country risk disclosure and more relevant company-specific country risk disclosure can be found in the prospectus for JA Solar Holdings Co., Ltd, a Chinese manufacturer of solar cells that listed on the NASDAQ in February 2007. The company's prospectus contains company and country risk factors, but the country risk factors read as boilerplate disclosures that are very similar to the disclosures in the first Chinese companies' prospectuses that listed on U.S. exchanges in the early 1990s. These country risk disclosures pertain to the uncertainty of the Chinese legal system, the possibility of fluctuations in the value of the Renminbi relative to other major currencies, certain Chinese income tax laws for Chinese enterprises with foreign investment and foreign enterprises, and the new Chinese mergers and acquisitions law that could possibly affect offshore special purpose vehicles (SPVs) formed for listing purposes overseas through the acquisition of Chinese onshore entity and controlled by Chinese residents.

However, reading through the company risk factors, several statements are buried in the text that could easily be labeled country risk factors, but are more specific and relevant to the operations of the company and would certainly be of more interest to U.S. investors than boilerplate language about possible fluctuations in the value of the Renminbi, which seems to be front page news of late in most major newspapers around the country. U.S. investors considering whether to invest in JA Solar's IPO would find it more material to know whether the company has complied with national and local environmental laws and regulations. The company notes that it had approved all necessary approvals only after its manufacturing lines were fully operational, but that the government did not impose any fines on the company.[11] Company-specific country risks such as compliance with environmental laws should be highlighted for U.S. investors considering whether to buy shares in JA Solar, and are much more valuable to a U.S. investor when considering the total mix of information available about Chinese companies to such investors.

The SEC should work to revise the risk factor disclosure regime for Chinese companies, as well as other foreign issuers listing on U.S. markets by tailoring the country risk disclosure to each specific company. Ultimately, the risk factors should fall under the rubric of company-specific country risk factors.

Unique Problems with Disclosure and Specifically China Country Risk Disclosure

Revising the country risk factor disclosure regime is more difficult than it seems because the SEC's risk factor disclosure regime has become precedent-based in practice. Before drafting a Chinese company's prospectus, the issuer's legal counsel usually will review the prospectuses of companies in the same industry, as well as other Chinese companies to get a sense of what

[11] A U.S. investor may wonder how a company can break the law in China, but not have any fines levied against it by any local or national government. The prospectus does not explain this phenomenon and such disclosure may be something that the SEC should consider inquiring about when commenting on prospectuses for Chinese issuers since the Chinese issuer has opened the door to more questions in order to satisfy the materiality standard.

companies have disclosed in the past. This disclosure is then compiled and risk factors are stripped away if deemed irrelevant based on precedents. This past disclosure sets the bar for what a Chinese company will currently disclose. For example, if past Chinese issuers have not disclosed anything about China's new anti-monopoly law that became effective on August 1, 2008, it is highly likely that the current issuer will not do so either. Disclosure becomes less about what is material to U.S. investors and more about precedent or what was done by previous issuers. There is no incentive to improve upon prior disclosures because if the SEC comes back with further questions, an issuer merely needs to point to what was done before to satisfy the risk factor disclosure requirements. Current Chinese issuers not only look at what industry competitors are disclosing across all countries, but also looking at what all other Chinese companies are disclosing in their prospectuses. The resulting risk factor disclosure is a combination of replicating their U.S. competitors' disclosure, which fails to account for the unique reality on the ground in China. These same issuers are also disclosing what other Chinese companies are disclosing in their prospectuses and will only seek to disclose as many country risks as their Chinese counterparts, no more and no less. Chinese issuers' careful scrutinizing of what their industry and country competitors are disclosing has taken the SEC disclosure regime's purpose of protecting U.S. investors and turned it into a race to the bottom or a least common denominator approach to disclosure.

Chinese companies pose another unique problem to those professionals who are trying to get better country risk disclosure because they view disclosure not as protecting U.S. investors, but highlighting the particular issuer's flaws. This issue is more cultural and requires employing professionals who understand how to coax such information out of Chinese issuers, and creating a shift in Chinese issuers' understanding and comfort with disclosure, which is a slower process and requires education by professionals, as well as the SEC and the CSRC.

Many Chinese companies are also reluctant to disclose that the Chinese government may provide certain incentives or subsidies to companies that engage in emerging technology industries. The government can take these incentives and subsidies away at any time, but Chinese companies will either choose to not disclose that they receive these subsidies so as not to tip off competitors, or if they disclose these subsidies, they fail to disclose that they can be taken away at without any notice, so as not to alarm investors. Such information would be deemed material by an investor and is an excellent example of the challenges posed by creating a company-specific country risk disclosure regime.

Crafting a More Tailored Disclosure Regime Not Just for Chinese Issuers, but All Foreign Issuers

Requiring Chinese companies to provide country risk disclosure in its prospectuses for listings on U.S. exchanges is a good idea in theory, but the practice over the nearly last 20 years has resulted in boilerplate, precedent-based disclosure. Most country risk disclosure in Chinese companies' prospectuses is of little use to the reasonable investor seeking to invest in the IPO of a Chinese company because the information contained within that section is readily available from other sources. The country risk factor sections in Chinese prospectuses should either be scrapped or revamped in conjunction with the other risk factor sections to provide company-specific country risk disclosure. Prospectuses of Chinese companies that have listed on U.S. exchanges in the past five years contain more country risk factors in the company risk factors section of the prospectus, but often these country risks are either buried within the explanation of

the particular company risk factor or raise more questions than they answer, such as when a company discloses that it has flouted the laws and regulations in a particular area, but has not suffered any consequences. Country risk disclosure going forward needs to be more narrowly tailored to address the laws, policies, and activities that affect a particular issuer. Most investors know that China's currency may change in value relative to other currencies and that the legal system can be arbitrary and capricious. These risks are usually already built into the price of the IPO because these are widely-known facts about doing business in China. The SEC should review prospectuses of Chinese companies with an eye towards compelling company-specific country risk disclosure.

The "one-size-fits-all" approach for Chinese companies seeking to list on U.S. exchanges should be abandoned in favor of a disclosure regime that critically assesses each company seeking to list in the U.S. and inquires about which specific country risks should be disclosed to ensure U.S. investors are receiving all material information about that issuer and can make an informed decision whether to invest in the IPO. By scrapping the existing risk factor disclosure regime, the SEC can start anew with Chinese and other foreign issuers to escape the problems associated with precedent-based disclosure. Rather than merely having Chinese issuers respond to additional comments and questions from SEC staffers with precedents showing their current disclosure is adequate, the SEC can implement a regime to extract better company-specific country risk disclosure by creating new guidelines for foreign issuers to provide U.S. investors with all material information.

To revamp the disclosure regime to embody company-specific country risk disclosure, the SEC should either have people on staff in its Division of Corporate Finance that are more familiar with China or establish other arrangements with private consultants or government agencies to ensure people with relevant China backgrounds review these prospectuses. The result of having people familiar with China review these prospectuses will ensure that Chinese companies listing on U.S. exchanges are providing U.S. investors with all material information needed to make an investment decision.

Avoid Politicizing Disclosure

It is imperative that any changes to the country risk disclosure regime for Chinese companies listing on U.S. exchanges must be accomplished without politicizing such disclosure. The purpose of disclosure under the Securities Act is to ensure that investors are protected, not to advance the political agendas of special interest groups or politicians. In its 2004 report, this Commission recommended that Congress ask the Director of Central Intelligence to conduct a more thorough review of security-related concerns of Chinese issuers seeking to list on U.S. exchanges by communicating with the SEC and other governmental agencies. If that recommendation came to fruition, the politicization of the disclosure regime would be almost certain. If the SEC modifies its disclosure regime for Chinese issuers, it should be because China presents a unique situation for investors who may be unfamiliar with Chinese offerings, not to satisfy political ends or because of fears that a rising China needs to be reined in with more onerous disclosure requirements.

In 2004, the SEC created the Officer of Global Security Risk (OGSR) to work with the review staff of the Division of Corporate Finance to review material information disclosed about business with and in countries designated as state sponsors of terrorism by the Department of

State, as well as other global security risk issues. The OSGR has worked to educate the review staff about major developments related to these issues.[12] With the creation of the OSGR, the SEC was able to ensure greater disclosure related to global security while upholding the materiality standard that has been the centerpiece of investor protection since the promulgation of the Securities and Exchange Acts. When the OSGR overstepped its bounds and tossed the materiality standard by the wayside by listing on its website a link to the annual report of any company that merely mentioned in its SEC filings any country on the Department of State's state-sponsored terrorism list, it betrayed the SEC's original intent and dangerously politicized the SEC's disclosure requirements.[13] Changes to the country risk factor disclosure regime must not scapegoat Chinese or any other foreign issuers by linking disclosure requirements with the political cause of the moment. The purpose of SEC country risk disclosure requirements is to protect and empower investors by providing them with material information, thus these country risk disclosure requirements should remain true to the purpose of the laws as written and interpreted, not the agendas of those moving for politically motivated changes.

<u>The Role for Professionals to Encourage China Country Risk Disclosure Has Grown</u>

While disclosure has improved over time since Chinese companies began listing on U.S. stock exchanges in the early 1990s, especially within the past five years, the degree to which Chinese companies disclose country risk also depends on the professionals who represent the issuers. Not only does country risk disclosure depend on a particular professionals' degree of experience working with Chinese issuers, but also the particular risk appetite of the professionals representing the issuer and the professionals internal compliance standards.

As Chinese IPOs in the U.S. grew in number during the 1990s, bulge bracket investment banks like Morgan Stanley and Goldman Sachs began devoting more resources to courting Chinese companies seeking U.S. IPOs. Large white-shoe U.S. law firms like Sullivan & Cromwell LLP, Davis Polk & Wardwell LLP, and Shearman & Sterling LLP have also played increasingly active roles representing Chinese companies in their U.S. IPOs during the past two decades. These investment banks and law firms only represent a small sampling of the larger group of American professionals who have been actively building up their China expertise and courting U.S. listing opportunities from Chinese companies. Those professionals with longer-standing and a better-established China presence are going to not only have a greater knowledge of the various laws and policies that may affect their Chinese clients, but will also have a deeper understanding of the mindset of Chinese companies. These qualities will lead to better country risk disclosure in these companies' U.S. prospectuses.

One can also draw a link between the quality of country risk disclosure and the risk appetite of the particular investment bank engaged by Chinese issuers. Those investment banks with a lower tolerance for risk may walk away from those Chinese IPOs that could raise significant SEC disclosure issues, especially in the area of company-specific country risk. Unfortunately, one cannot deduce an investment banks' risk profile from its size or global reach alone. Even among the bulge bracket investment banks, internal compliance standards vary.

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[12] *See* Description of Office of Global Security Risk, at http://www.sec.gov/divisions/corpfin/globalsecrisk.htm (last modified March 2, 2005).

[13] *See* Floyd Norris, *S.E.C. Rethinks Lists Linking Companies and Terrorist States,* THE NEW YORK TIMES, July 21, 2007, *available at* http://www.nytimes.com/2007/07/21/business/21sec.html.

The quality of the country risk disclosure not only depends on the particular Chinese company seeking to list on U.S. exchanges, but also on the professionals engaged by that company. Professionals with significant exposure to China are better positioned to be both more knowledgeable about the company-specific country risks that may affect their client, as well as being more adept about working with Chinese issuers to convince such companies to make the kind of material disclosure that is going to protect U.S. investors.

Cooperation with Chinese Securities Regulators

The SEC, through its Office of International Affairs has also been reaching out to Chinese securities regulators at the CSRC to discuss, among other things, issues related to disclosure made by Chinese companies listing on U.S. Exchanges. Former SEC chairman, Christopher Cox, in remarks made before the Securities Industries Association/Tsinghua University Conference at Tsinghua University in Beijing, China in October 2005 highlight the greater importance that the SEC has been placing on country risk disclosure by Chinese companies. Chairman Cox said, "Eliminating restrictions on access to material information is essential for the success of Chinese issuers and markets, and for the protection of investors." A few days earlier, Chairman Cox made a similar statement in remarks before the US – China Joint Economic Committee in Hebei, China, "The full, accurate, and timely disclosure of material information that is promised to investors when Chinese companies list on U.S. exchanges will improve company disclosure practices right here in China. And that will help achieve China's objective of upgrading the governance of its firms." This public commitment to disclosure in front of Chinese audiences is indicative of the SEC's commitment to ensuring that Chinese companies accurately disclose country risk factors to U.S. investors purchasing their securities on U.S. exchanges. Further commitment is evidenced by the May 2006 announcement that the CSRC and the SEC had signed the Terms of Reference for Cooperation and Collaboration, which, among other things, laid out the framework for identifying and discussing regulatory developments of common interest, including corporate governance and disclosure. This dialogue is supposed to take place between senior staff members, as well as the chairmen of the SEC and the CSRC. These efforts should just be the beginning of greater cooperation between the SEC and the CSRC on not just disclosure issues, but a host of other matters.

Conclusion

U.S. securities laws were created to ensure full and fair disclosure protecting both U.S. investors and issuers seeking access to American capital markets. Chinese issuers and U.S. investors in Chinese companies should not be treated any differently under those laws. Chinese issuers should also benefit from the American disclosure regime as long as they comply by providing U.S. investors with all material company-specific country risk factors that these investors can weigh when making an investment decision. The SEC has generally avoided politicizing disclosure, but when it has done so, cooler heads have prevailed and reverse such forays into strategic review of disclosure documents. As the SEC contemplates any changes to the risk factor disclosure regime, it must avoid becoming a regulator enforcing disclosure requirements to merely serve political ends. Instead, the SEC should take this opportunity to work with Chinese issuers, their professionals, and the CSRC to address the unique disclosure problems that Chinese companies present and ensure that any push for more material company-specific country risk disclosure is consistent with the purpose and intent of U.S. securities laws.