

Via E-Mail

May 27, 2021

Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

*Re: File No. SR-NASDAQ-2021-007*

Dear Madam Secretary:

I am writing of behalf of the Council of Institutional Investors (CII) in response to the Securities and Exchange Commission's (SEC or Commission) May 17, 2021, request for comment to address the sufficiency of The Nasdaq Stock Market LLC's (Nasdaq) statements in support of the *Proposed Rule Change to Adopt Additional Initial Listing Criteria for Companies Primarily Operating in Jurisdictions That Do Not Provide the PCAOB With the Ability To Inspect Public Accounting Firms* (Proposed Rule).<sup>1</sup>

CII is a nonprofit, nonpartisan association of United States (U.S.) public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$40 trillion in assets under management.<sup>2</sup>

As indicated in our letter of February 18, 2021 (February Letter),<sup>3</sup> we do not agree with Nasdaq that the provisions of the Proposed Rule are sufficient “to address . . . the unique potential risks

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<sup>1</sup> Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Adopt Additional Listing Criteria for Companies Primarily Operating in Jurisdictions That Do Not Provide the PCAOB With the Ability To Inspect Public Accounting Firms, Exchange Act Release No. 91,909, 86 Fed. Reg. 27,659 (May 17, 2021), <https://www.federalregister.gov/documents/2021/05/21/2021-10710/self-regulatory-organizations-the-nasdaq-stock-market-llc-order-instituting-proceedings-to-determine>.

<sup>2</sup> For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

<sup>3</sup> See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission 4 (Feb. 18, 2021), <https://www.sec.gov/comments/sr-nasdaq-2021-007/srnasdaq2021007-8389976-229379.pdf> (“CII, however, does not share Nasdaq’s view that the changes in the Proposed Rules are sufficient to address the concerns identified.”).

to U.S. investors due to restrictions on the [Public Company Accounting Oversight Board’s] PCAOB’s ability to inspect the audit work and practices of auditors in Restrictive Markets . . . .”<sup>4</sup> Moreover, we question Nasdaq’s statement “that there are multiple governmental initiatives underway to resolve . . . [CII] concerns, including recommendations of the President’s Working Group on Financial Markets and the Holding Foreign Companies Accountable Act” (HFCAA).<sup>5</sup>

In CII’s view, the HFCAA is not a “governmental initiative[] underway,” but rather it is a part of existing U.S. federal securities laws.<sup>6</sup> It was signed into law by President Trump on December 18, 2020,<sup>7</sup> after receiving an extraordinary level of bi-partisan support in both the U.S. Senate<sup>8</sup> and the U.S. House of Representatives.<sup>9</sup>

The language and intent of the HFCAA require the Commission to begin prohibiting companies from listing by 2024 if it determines that those companies have had three consecutive PCAOB non-inspection years.<sup>10</sup> Given that some fifteen years of efforts have not resulted in the PCAOB being able to inspect Chinese companies’ audits, we agree with many commentators that the China Securities Regulatory Commission is unlikely to permit the required inspections in the next few years.<sup>11</sup> Other than its reference to the “multiple governmental initiatives underway to resolve these concerns,” Nasdaq does not offer any reason for the Commission to assume that the current impasse will be overcome in time to prevent delisting of such companies in 2024.

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<sup>4</sup> Letter from Jeffrey S. Davis, Senior Vice President, Senior Deputy General Counsel, Nasdaq, Inc. to Ms. Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission 3 (Apr. 30, 2021), <https://www.sec.gov/comments/sr-nasdaq-2021-007/srnasdaq2021007-8747296-237282.pdf>.

<sup>5</sup> *Id.* at 2-3 (footnotes omitted).

<sup>6</sup> *See* Holding Foreign Companies Accountable Act, Pub. L. No. 116-222 (Dec. 18, 2020), <https://www.congress.gov/bill/116th-congress/senate-bill/945/text> (“To amend the Sarbanes-Oxley Act of 2002 to require certain issuers to disclose to the Securities and Exchange Commission information regarding foreign jurisdictions that prevent the Public Company Accounting Oversight Board from performing inspections under that Act, and for other purposes.”).

<sup>7</sup> Holding Foreign Companies Accountable Act, Pub. L. No. 116-222 (Dec. 18, 2020), <https://www.congress.gov/bill/116th-congress/senate-bill/945/actions>

<sup>8</sup> *Id.* (“Passed Senate with an amendment by Unanimous Consent”).

<sup>9</sup> *Id.* (“Passed/agreed to in House: On motion to suspend the rules and pass the bill Agreed to by voice vote”).

<sup>10</sup> *See, e.g.,* Richard Vernon Smith & Jinsong Zhang, Orrick, Herrington & Sutcliffe LLP, The Holding Foreign Companies Accountable Act Is Signed Into Law, JDSUPRA (Jan. 22, 2021), <https://www.jdsupra.com/legalnews/the-holding-foreign-companies-5211670/> (“If the SEC determines that a public company has three consecutive ‘noninspection years,’ beginning in 2021, the SEC would prohibit the company’s securities from being traded on a U.S. national securities exchange or an ‘over-the-counter’ market subject to SEC regulations.”); Holding Foreign Companies Accountable Act, Pub. L. No. 116-222, § 104(i)(3)(A) (“if the Commission determines that a covered issuer has 3 consecutive non-inspection years, the Commission shall prohibit the securities of the covered issuer from being traded.”).

<sup>11</sup> *See, e.g.,* Thomas Gorman, Dorsey & Whitney LLP, Is a Proper Audit of China Operations Possible?, JDSUPRA (May 19, 2021), <https://www.jdsupra.com/legalnews/is-a-proper-audit-possible-of-china-3845595/#:~:text=While%20the%20Board%20has%20conducted,required%20inspections%20with%20few%20exceptions> (“There is nothing, however, to suggest that CSRC and the PRC are about to join the international community and help ensure that the Board can properly conduct the required inspections to safeguard public investment and trading markets which benefit everyone.”).

We are concerned that as 2024 approaches and China-based companies are required to be delisted, many U.S. investors will be exposed to unfair take-private transactions. As Professor Jesse Fried and Matthew J. Schoenfeld explained in an article posted last June:

Over the last decade, controlling shareholders of more than 90 China-based U.S.-traded firms have arranged low-ball “take private” transactions. The goal is to delist U.S. shares at a depressed buyout price and then relist in China at a much loftier valuation. The poster child for this maneuver is Qihoo 360, an internet security firm. Founders squeezed out U.S. shareholders in mid-2016 at a valuation of \$9.3 billion. In February 2018, they relisted Qihoo on the Shanghai Stock Exchange at a valuation exceeding \$60 billion, a 550% return. Qihoo’s chairman personally made \$12 billion, more than the entire company was claimed to be worth 18 months earlier.

Investors in U.S.-listed Chinese companies are much more vulnerable to an unfair take-private than investors in publicly-traded American firms. Not only are financial statements unreliable, but most China-based firms—including Luckin Coffee—incorporate in the Cayman Islands. This jurisdiction affords investors much less protection than Delaware, home to most U.S. companies. Neither U.S. nor Cayman court judgments can be enforced in China, where insiders and assets are based. And, when American investors are hurt, the same state-secrecy laws make it difficult for shareholders and regulators to collect litigation-critical information.

. . . Consider a Chinese controller who plans a cheap take-private, but is willing to bide her time if that enables an even lower price. If China continues to bar PCAOB inspections, the SEC will eventually announce a trading ban for the controller’s firm, causing a rout in the stock as investors dump shares before the ban takes effect. The controller can then use a take-private to cash out investors at a rock-bottom price, all while blaming the delisting on the SEC. The legislation will have handed the controller a gift on a silver platter: a means to conduct a take-private on even more confiscatory terms.<sup>12</sup>

In light of this risk, Nasdaq should explain how the continued listing of Restrictive Market companies with the attendant risks to minority shareholders is consistent with the public interest and the protection of investors. At a minimum, the Nasdaq should promptly limit the U.S. investor exposure to potentially unfair take-private transactions by adopting the provisions proposed in the February Letter that would prevent the *initial listing* of Restrictive Market

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<sup>12</sup> Jesse Fried & Matthew J. Schoenfeld, Delisting Chinese Firms: A Cure Likely Worse than the Disease, Harv. L. Sch. F. On Corp. Governance (June 9, 2020), <https://corpgov.law.harvard.edu/2020/06/09/delisting-chinese-firms-a-cure-likely-worse-than-the-disease/>.

companies.<sup>13</sup> Without such a change, we continue to believe the Proposed Rule is not consistent with Section 6 of the Securities Exchange Act of 1934.<sup>14</sup>

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Thank you for consideration of our views. If we can answer any questions or provide additional information, please do not hesitate to contact me.

Sincerely,



Jeffrey P. Mahoney  
General Counsel

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<sup>13</sup> See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 5 (As indicated in our letters of September 30, July 8, June 25 and June 18, we believe the Proposed Rules should include the following provisions: . . . [1] new rules that would require that listing applicants . . . from a Restrictive Market . . . be prohibited from having an auditor or an accounting firm engaged to assist with their company audit that is located in a jurisdiction that limits the PCAOB's ability to inspect the auditor (New Auditor Inspection Rules) [and 2] . . . a Nasdaq staff determination to deny the initial . . . listing of a company for lack of compliance with the New Auditor Inspection Rules would result in the issuance 'of a denial . . . letter to the company that will inform the company of the factual basis for Nasdaq's determination and its right for review of the decision pursuant to the Rule 5800 Series.'"); cf. Jesse Fried & Matthew J. Schoenfeld, *Delisting Chinese Firms: A Cure Likely Worse than the Disease*, Harvard L. Sch. F. On Corp. Governance ("Congress should consider barring *future* listings from countries that impede PCAOB inspections or otherwise frustrate the pursuit of cross-border wrongdoers.").

<sup>14</sup> National Securities Exchanges, 15 U.S.C. § 78f(b)(5)(1934), *available at* <https://www.law.cornell.edu/uscode/text/15/78f> ("The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.").