

Via Email

February 18, 2021

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

*Re: File Number SR-NASDAQ-2021-007.*

Dear Madam Secretary:

I am writing in response to the *Notice of Filing of 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 Rules).<sup>1</sup>

The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of 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 the leading voice for effective corporate governance and strong shareholder rights, CII believes that accurate and reliable audited financial statements are critical to investors in making informed decisions, and vital to the overall well-being of our capital markets.<sup>3</sup> Consistent with our membership approved policies, we have long been troubled by the lack of cooperation of China’s regulators with the U.S. Securities and Exchange Commission (SEC or Commission) and the Public Company Accounting Oversight Board (PCAOB) and their efforts to promote

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<sup>1</sup> Notice of Filing of 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, Exchange Act Release No. 91,089, 86 Fed. Reg. 9,549 (Feb. 9, 2021), <https://www.federalregister.gov/documents/2021/02/16/2021-02993/self-regulatory-organizations-the-nasdaq-stock-market-llc-notice-of-filing-of-proposed-rule-change>.

<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> CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), [http://www.cii.org/policies\\_other\\_issues#indep\\_acct\\_audit\\_standards](http://www.cii.org/policies_other_issues#indep_acct_audit_standards).

high quality audits of financial reports of Chinese companies that are listed on U.S. exchanges.<sup>4</sup> In recent years those concerns have grown as the number of Chinese companies listed has increased significantly.<sup>5</sup> What is also concerning is that many of those companies have adopted variable interest entity and dual-class stock structures,<sup>6</sup> both of which involve risks that are not fully understood by many market participants.<sup>7</sup>

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<sup>4</sup> See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, PCAOB 6 (Sept. 6, 2018), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2018/September%206,%202018%20PCAOB%20Strategic%20Plan.pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2018/September%206,%202018%20PCAOB%20Strategic%20Plan.pdf) (“We are particularly concerned about PCAOB-registered firms located in China for at least four reasons: (1) since 2010 the PCAOB has actively sought without success inspections of China-based audit firms and the mainland affiliates of the Big Four accountancies - Deloitte, KPMG, PricewaterhouseCoopers and EY; (2) many of the China-based audit firms do significant work on audits of major U.S. companies doing business in China; (3) the recent surge in the number of Chinese companies listed on U.S. stock exchanges; and (4) most of the Chinese companies listed on U.S. stock exchanges in recent years have a variable interest entity structure that is highly complex and might include risks that some investors and auditors may not fully understand or appreciate.”).

<sup>5</sup> See Dave Michaels & Alexander Osipovich, SEC Pursues Plan Requiring Chinese Firms to Use Auditors Overseen by U.S., Wall St. J. (Nov. 17, 2020) (on file with CII) (“More than 170 companies based in China or Hong Kong have completed IPOs in the U.S. since January 2014, raising about \$58.7 billion, according to data from S&P Global Market Intelligence.”); Jing Yang, ‘The Gold Standard:’ Why Chinese Startups Still Flock to the U.S. for IPO’s, Wall St. J. (Aug. 13, 2020) (on file with CII) (“The U.S. remains a magnet for initial public offerings of Chinese technology companies, despite rising political, trade and regulatory tensions between the world’s two largest economies.”); Jon Swartz, A Chinese IPO Just Raised More than \$2 Billion Amid Tensions Between U.S., China, MarketWatch (Aug. 13, 2020), <https://www.marketwatch.com/story/ke-holdings-shares-are-off-to-a-flying-start-in-ipo-debut-that-raises-212-billion-2020-08-13> (“Investors have dumped billions into Chinese companies in recent years, even as shareholder advocates such as the Council of Institutional Investors warn of risks associated with low-visibility stocks far, far away.”); Michael Rapoport, They’d Find Fraud, Fraud, Fraud, Institutional Inves. (July 22, 2020), <https://www.institutionalinvestor.com/article/b1mlyjs554sgd/They-d-Find-Fraud-Fraud-Fraud> (“Fraud allegations involving Chinese companies that trade in the U.S. have plagued investors for years.”); Press Releases, Senate passes Kennedy and Van Hollen’s bill to kick deceitful Chinese companies off U.S. exchanges (May 20, 2020), <https://www.kennedy.senate.gov/public/2020/5/senate-passes-kennedy-and-van-hollen-s-bill-to-kick-deceitful-chinese-companies-off-u-s-exchanges> (“In the last 10 years, the number of Chinese companies listed on U.S. stock exchanges has increased significantly, as those firms take advantage of the capital available in America.”).

<sup>6</sup> See, e.g., CII, Dual-Class Snapshot: Statistics (as of Feb. 1, 2021) (on file with CII) (In 2020, 5.5% of initial public offerings (IPOs) were foreign private issuers (FPIs) from China (24 out of 433), of these 24 Chinese FPIs, 10 (41.67%) have a dual-class structure and 19 (79.1%) have a Variable Interest Entity (VIE) structure, and thus far 5.1% of IPOs in 2021 have been Chinese FPIs (5 out of 98), of these 5 Chinese FPIs, 1 (20%) has a dual-class structure and 4 (80%) have a VIE structure.).

<sup>7</sup> See Yujing Liu, Legally Ambiguous ‘VIE’ Structure Means Foreign Investors Don’t Technically Own Overseas - Listed Chinese Stocks – And That Could Spell Disaster, S. China Morning Post (Dec. 21, 2020), <https://www.scmp.com/business/markets/article/3114557/legally-ambiguous-vie-structure-means-foreign-investors-dont> (“As China reasserts control over its powerful private enterprises, US and Hong Kong investors in Chinese stocks need to be aware of a rarely discussed risk that has the potential to jeopardise their holdings: the fact that they do not technically own the companies.”); SEC CF Disclosure Guidance: Topic No. 10 (Nov. 23, 2020), <https://www.sec.gov/corpfin/disclosure-considerations-china-based-issuers> (“These China-based Issuer VIE structures pose risks to U.S. investors that are not present in other organizational structures.”); Chinese VIE Structure: Wall Street Continues to Ignore the Risks, CGI (Nov. 10, 2020), <https://globescapital.com/chinese-vie-structure-wall-street-continues-to-ignore-the-risks/> (“Most of the Western investment community does not even talk about the VIE structure – they either don’t know about it, don’t understand how it works, or don’t care to learn.”); Jonathan Barnett, Lessons from Luckin Coffee: The Underappreciated Risks of Variable Interest Entities, CLS Blue Sky Blog (July 28, 2020), <https://clsbluesky.law.columbia.edu/2020/07/28/lessons-from-luckin-coffee-the-underappreciated-risks-of-variable-interest-entities/> (“it is unclear that individual investors in an ‘irrationally exuberant’ stock such as Luckin typically appreciate the issuer’s multi-layered VIE structure, often bundled . . . with

CII has previously submitted written comments to the Commission on September 30,<sup>8</sup> July 8,<sup>9</sup> June 25<sup>10</sup> and June 18,<sup>11</sup> providing our views on prior SEC releases relating, at least in part, to issues addressed by the Proposed Rules.<sup>12</sup> This letter is intended to incorporate those comments

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a dual-class voting structure that doubly disadvantages public shareholders”); Letter from Marco Rubio, U.S. Senator to The Honorable Steven Mnuchin, Secretary, U.S. Department of the Treasury (July 21, 2020), [https://www.rubio.senate.gov/public/\\_cache/files/30ba40e5-7359-4706-9ccc-4126c2e78478/C09DEAFE10626E89603CCC9B7CEB5A9C.20.07.21-rubio-to-president-s-working-group-on-financial-markets-re-china-investment.pdf](https://www.rubio.senate.gov/public/_cache/files/30ba40e5-7359-4706-9ccc-4126c2e78478/C09DEAFE10626E89603CCC9B7CEB5A9C.20.07.21-rubio-to-president-s-working-group-on-financial-markets-re-china-investment.pdf) (“To skirt China’s foreign ownership restrictions, these [VIE] firms operate in a state of contradiction, telling the Chinese government that they are not owned by foreign investors, while effectively telling foreign investors the opposite.”); CII Research Analyst Brandon Whitehill, Buyer Beware: Chinese Companies and the VIE Structure 2 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf) (“VIEs are fraught with complexity and risk for investors, including vulnerability to Chinese government pressures and management conflicts of interest”); *see also* U.S. Securities and Exchange Commission, Office of Investor Advocate, Report on Activities 10 (Dec. 29, 2020) (“In our view, . . . minimum listing standards should . . . include the following requirements: . . . If a company chooses to issue multiple classes of stock with differing voting rights, then the dual-class stock must contain a “sunset” provision.”); Letter from Ash Williams, Chair, CII, et al. to John Zecca, Senior Vice President, General Counsel, North America and Chief Regulatory Officer, NASDAQ Stock Market 3-4 (Oct. 24, 2018), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2018/20181024%20NASDAQ%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NASDAQ%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf) (“over time and on average, the valuation of these [dual class stock structure] firms tends to decline, as the “wedge” between ownership and control widens, the agency costs of insider control and lack of shareholder accountability increase, founder’s entrepreneurial skills and insights that initially propelled a company become dated, and opportunities and risks change in ways not foreseeable by investors at IPO.”).

<sup>8</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission (Sept. 30, 2020), [https://www.cii.org/Files/issues\\_and\\_advocacy/correspondence/2020/September%2030%202020%20Nasdaq%20letter%20final-AB.pdf](https://www.cii.org/Files/issues_and_advocacy/correspondence/2020/September%2030%202020%20Nasdaq%20letter%20final-AB.pdf).

<sup>9</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Jay Clayton, Securities and Exchange Commission (July 8, 2020), [https://www.cii.org/files/July%208%202020%20SEC%20letter%20\(final\)%20KB-AB.pdf](https://www.cii.org/files/July%208%202020%20SEC%20letter%20(final)%20KB-AB.pdf).

<sup>10</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission (June 25, 2020), <https://www.sec.gov/comments/sr-nasdaq-2020-027/srnasdaq2020027-7347631-218689.pdf>.

<sup>11</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission (June 18, 2020), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2020/June%2018%202020%20Nasdaq%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2020/June%2018%202020%20Nasdaq%20letter%20(final).pdf).

<sup>12</sup> Order Instituting Proceedings to Determine Whether To Approve or Disapprove a Proposed Rule Change to Apply Additional Initial Listing Criteria for Companies Primarily Operating in Restrictive Markets, Exchange Act Release No. 89,799, 85 Fed. Reg. 57,282 (Sept. 15, 2020), <https://www.federalregister.gov/documents/2020/09/15/2020-20259/self-regulatory-organizations-the-nasdaq-stock-market-llc-order-instituting-proceedings-to-determine>; Notice of Filing of Proposed Rule Change To Apply Additional Initial Listing Criteria for Companies Primarily Operating in Restrictive Markets, Exchange Act Release No. 89,027, 85 Fed. Reg. 35,962 (June 8, 2020), <https://www.federalregister.gov/documents/2020/06/12/2020-12685/self-regulatory-organizations-the-nasdaq-stockmarket-llc-notice-of-filing-of-proposed-rule-change>; Notice of Filing of Proposed Rule Change To Adopt a New Requirement Related to the Qualification of Management for Companies From Restrictive Markets, Exchange Act Release No. 89,028, 85 Fed. Reg. 35,967 (June 8, 2020), <https://www.federalregister.gov/documents/2020/06/12/2020-12686/self-regulatoryorganizations-the-nasdaq-stock-market-llc-notice-of-filing-of-proposed-rule-change>; Notice of Filing of Proposed Rule Change To Amend IM–5101–1 (Use of Discretionary Authority) To Deny Listing or Continued Listing or To Apply Additional and More Stringent Criteria to an Applicant or Listed Company Based on Considerations Related to the Company’s Auditor or When a Company’s Business Is Principally Administered in a Jurisdiction That Is a Restrictive Market, Exchange

and respond to the SEC’s February 2021 solicitation of comments in connection with the Proposed Rules.<sup>13</sup>

### Proposed Rules

The Proposed Rules would (1) require “a minimum offering size or public float percentage for Restrictive Market Companies [14] seeking to list on Nasdaq through an [initial public offering] IPO or business combination,”<sup>15</sup> and (2) permit “Restrictive Market Companies to list on Nasdaq Global Select Market or Nasdaq Global Market, rather than the Nasdaq Capital Market, in connection with a Direct Listing.”<sup>16</sup>

CII shares the concerns expressed by The Nasdaq Stock Market LLC (Nasdaq) in the Proposed Rules that:

[T]he PCAOB’s inability to inspect the audit work and practices of auditors in certain countries weakens the assurance that the auditor obtained sufficient appropriate audit evidence to express its opinion on a company’s financial statements, and decreases confidence that the auditor complied with PCAOB and SEC rules and professional standards in connection with the auditor’s performance of audits. Nasdaq believes that without reasonable assurances from an auditor that a company’s financial statements and related disclosures are free from material misstatements, there is a risk that a company that would otherwise not have qualified to list on Nasdaq may satisfy Nasdaq’s listing standards by presenting financial statements that contain undetected material misstatements. In *In the Matter of the Tassaway, Inc.*, the Commission observed that  
Though exclusion from the system may hurt existing investors, primary emphasis must be placed on the interests of prospective future investors. The latter group is entitled to assume that the securities in the system meet the system’s standards. Hence the presence in NASDAQ of non-complying securities could have a serious deceptive effect.<sup>17</sup>

CII, however, does not share Nasdaq’s view that the changes in the Proposed Rules are sufficient to address the concerns identified.

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Act Release No. 88,987, 85 Fed. Reg. 34,774 (June 2, 2020),  
<https://www.federalregister.gov/documents/2020/06/08/2020-12271/self-regulatoryorganizations-the-nasdaq-stock-market-llc-notice-of-filing-of-proposed-rule-change>.

<sup>13</sup> 86 Fed. Reg. at 9,555 (“**Solicitation of Comments**”).

<sup>14</sup> *Id.* at 9,551 (defined by The Nasdaq Stock Market LLC as “as a jurisdiction that does not provide the PCAOB with access to conduct inspections of public accounting firms that audit Nasdaq listed companies”).

<sup>15</sup> *Id.* at 9,554.

<sup>16</sup> *Id.*; see generally Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission (Oct. 8, 2020),  
[https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2020/October%202020%20Nasdaq%20direct%20listing%20\(final\)%20AB1.pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2020/October%202020%20Nasdaq%20direct%20listing%20(final)%20AB1.pdf) (for a discussion and citations to CII views on direct listings).

<sup>17</sup> *Id.*

### CII's Proposal

As indicated in our letters of September 30,<sup>18</sup> July 8,<sup>19</sup> June 25<sup>20</sup> and June 18,<sup>21</sup> we believe the Proposed Rules should include the following provisions:

- . . . new rules that would require that listing applicants and listed companies from a Restrictive Market, including companies listed prior to the effectiveness of the new rules, 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).
- . . . a Nasdaq staff determination to deny the initial or continued listing of a company for lack of compliance with the New Auditor Inspection Rules would result in the issuance "of a denial or delisting 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."<sup>22</sup>

We note that our proposal is generally consistent with the July recommendations of the President's Working Group on Financial Markets to "*enhance[]listing standards to require as a condition to initial and continued exchange listing . . . PCAOB access to audit work papers of the principal audit firm for the audit of the listed company.*"<sup>23</sup> Our proposal also is responsive to the multiple, varied, and significant risks associated with China-based issuers that the SEC's Division of Corporation Finance detailed in November.<sup>24</sup>

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<sup>18</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 4.

<sup>19</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Jay Clayton, Securities and Exchange Commission at 5.

<sup>20</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 4.

<sup>21</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 6-7.

<sup>22</sup> *Id.*

<sup>23</sup> President's Working Group on Financial Markets: Report on Protecting United States Investors from Significant Risk from Chinese Companies 9 (July 24, 2020) (emphasis added), <https://home.treasury.gov/system/files/136/PWG-Report-on-Protecting-United-States-Investors-from-Significant-Risks-from-Chinese-Companies.pdf>. We note that CII and many financial reporting experts are strongly opposed to one aspect of the President's Working Group on Financial Markets: Report on Protecting United States Investors from Significant Risk from Chinese Companies (PWG Report); the PWG Report recommendation (1)(b) the so-called "co-audit" exception. *See id.* at 3. CII and many financial reporting experts view the co-audit exception as nonsensical and impractical. *See* Paul Gillis, President's Working Group, China Acc. Blog (Aug. 11, 2020), <https://www.chinaaccountingblog.com/weblog/presidents-working-group.html> ("If China is to agree [to the co-audit exception] . . . why not inspections instead?"); Soyoung Ho, Trump Administration Seeks to Delist U.S.-Listed Chinese Companies for Blocking Audit Inspections, Thomson Reuters Tax & Acct. (Aug. 10, 2020), <https://tax.thomsonreuters.com/news/trump-administration-seeks-to-delist-u-s-listed-chinese-companies-for-blocking-audit-inspections/> (quoting two financial reporting experts opposing the co-audit exception).

<sup>24</sup> SEC CF Disclosure Guidance: Topic No. 10 (detailing the risks associated with China-based issuers relating to "High-Quality and Reliable Financial Reporting," "Access to Information and Regulatory Oversight," "a Company's Organization Structure," and "Regulatory Environment").

Most importantly, our proposal is generally consistent with the requirements of the Holding Foreign Companies Accountable Act (Act) that was signed into law in December.<sup>25</sup> Under the provisions of Act, the SEC will be required to begin prohibiting companies from listing on the Nasdaq and other exchanges by 2024 if it determines that those companies have three consecutive PCAOB “non-inspection years.”<sup>26</sup> In light of this statutory deadline, Nasdaq should explain why it would be in the public interest to continue to list companies that use an auditor that is not subject to PCAOB inspection and how investors in any such company would be adequately protected in the company's impending delisting.

For all these reasons, we believe the Proposed Rules are not consistent with Section 6(b) of the Securities and Exchange Act of 1934.<sup>27</sup>

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<sup>25</sup> Holding Foreign Companies Accountable Act, Public Law No: 116-222, § 2(i)(3)(a)(1) (2020), *available at* <https://www.congress.gov/116/plaws/publ222/PLAW-116publ222.pdf> (“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— . . . on a national securities exchange”).

<sup>26</sup> 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 ‘non-inspection 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.”); *cf.* Andrew Olmem, Christina Thomas, & Jason Elder, Mayer Brown LLP, *Congress Passes the “Holding Foreign Companies Accountable Act,”* Harv. L. Sch. F. on Corp. Governance (Jan. 10, 2021), <https://corpgov.law.harvard.edu/2021/01/10/congress-passes-the-holding-foreign-companies-accountable-act/> (suggesting, despite the language and intent of the Holding Foreign Companies Accountable Act (Act), that the Securities and Exchange Commission might implement the Act so that “it is possible that the three consecutive non-inspection years required for delisting . . . would not begin to be counted until 2022, meaning that no company would be delisted until 2025 at the earliest.”); *see also* U.S. Securities and Exchange Commission, Office of Investor Advocate, *Report on Activities at 10* (“We were pleased with the adoption of this legislation, which addressed a significant risk to U.S. investors, and we encourage Congress to consider other threats to investor protection that have arisen because of weak qualitative listing standards.”).

<sup>27</sup> National Securities Exchange, 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.”).

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We appreciate your consideration of our comments. Please let me know if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Jeff Mahoney". The signature is written in a cursive style with a large, stylized "J" and "M".

Jeffrey P. Mahoney  
General Counsel