

Legal Update

SEC Adopts Interim Final Rules to Implement the Holding Foreign Companies Accountable Act

On March 24, 2021, the US Securities and Exchange Commission (SEC) adopted interim final rules to implement portions of the Holding Foreign Companies Accountable Act (the HFCA Act), which was signed into law by President Trump on December 18, 2020. As explained in an earlier Mayer Brown [Legal Update](#), the HFCA Act aims to address restrictions China has placed on the ability of the Public Company Accounting Oversight Board (PCAOB) to inspect or investigate PCAOB-registered public accounting firms in connection with their audits of Chinese companies by mandating certain disclosures and requiring the delisting in the United States of companies whose auditors do not (or cannot) comply with the PCAOB's inspection rules.

As our earlier Legal Update explained, the HFCA Act contains a statutory mandate for the SEC to issue rules implementing the statute's disclosure requirement within 90 days of its enactment. Importantly, the statute is silent as to the timing of implementation of the HFCA Act's other provisions, including the requirement that the SEC prohibit the trading of securities of any Commission-Identified Issuer (defined below) meeting that definition for three consecutive years.

With respect to the trading prohibition, the interim adopting release notes that the SEC will address that statutory mandate separately and that "[t]he Commission staff, in deciding what to recommend to the Commission, is actively considering ways to implement the trading prohibition, and the Commission anticipates seeking comment from the public." This move provides the SEC with more time (and potentially recommendations from market participants) before proposing a trading prohibition.

Amendments Related to Identification and Disclosure

The HFCA Act amends the Sarbanes-Oxley Act and directs the SEC to identify reporting companies that use an audit firm that has a branch or office that:

- (1) is located in a foreign jurisdiction; and
- (2) authorities in that foreign jurisdiction restrict the PCAOB's ability to inspect or investigate the audit firm (as determined by the PCAOB).

Each such company, defined in the SEC's new rule as a "Commission-Identified Issuer," will be required to submit to the SEC via its Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system documentation that establishes that the Commission-Identified Issuer is not owned or controlled by a governmental entity in the foreign jurisdiction.

In addition, each foreign issuer that is a Commission-Identified Issuer (referred to in the release as a “Commission-Identified Foreign Issuer”) must disclose the following in its annual report covering the year it was identified as a Commission-Identified Issuer:

- “That, during the period covered by the form, the registered public accounting firm has prepared an audit report for the issuer;
- The percentage of the shares of the issuer owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated or otherwise organized;
- Whether governmental entities in the applicable foreign jurisdiction with respect to that registered public accounting firm have a controlling financial interest with respect to the issuer;
- The name of each official of the Chinese Communist Party (“CCP”) who is a member of the board of directors of the issuer or the operating entity with respect to the issuer; and
- Whether the articles of incorporation of the issuer (or equivalent organizing document) contains any charter of the CCP, including the text of any such charter.”

The SEC is amending each of its forms used by registrants for annual reporting purposes—specifically, Form 10-K, Form 20-F, Form 40-F, and Form N-CSR—to add these disclosure requirements for annual reports (but not for registration statements filed on the same forms).

Timing of Implementation

As an initial matter, the identification process will require coordination with the PCAOB. Specifically, pursuant to Section 104(i)(2) of the Sarbanes-Oxley Act, as added by the HFCA Act, the PCAOB must determine that it is unable to inspect or investigate an auditor in a foreign jurisdiction completely as a result of restrictions implemented by authorities in that jurisdiction. The release indicates that the PCAOB is currently considering how it will implement the requirements of the HFCA Act, including how it will make such determinations. Any PCAOB rulemaking in this respect will be subject to SEC review and approval prior to implementation. The release explains that “[o]nce the PCAOB process has been established, the Commission will use the PCAOB’s determination about which firms it is unable to inspect or investigate completely, along with information in a registrant’s annual reports, to compile a list of registrants that are Commission-Identified Issuers.” In other words, the SEC cannot move forward with implementation of these new rules until the PCAOB has completed its implementation of the HFCA Act.

Request for Comment

The release requests feedback from market participants and other members of the public on a variety of questions related to the interim final rules. Questions relate to the Commission-Identified Issuer determination process, the HFCA Act disclosure requirements, and the HFCA Act documentation submission requirements.

For instance, the SEC requests input regarding:

- Commission-Identified Issuer determination dates;
- whether the SEC should publicly identify Commission-Identified Issuers on the SEC website;
- whether a definition or further guidance on what it means to be “an official of the Chinese Communist Party” would be helpful;
- whether disclosure should be required in registration statements or on Form 8-K;

- whether specific types of documentation should be required; and
- how best to implement the trading prohibition required by the HFCA Act.

Practical Considerations

The new rules were not proposed pursuant to the Administrative Procedure Act because the SEC determined that doing so would be impractical and unnecessary in light of the statute's 90-day implementation mandate and prescriptive disclosure requirements. While, as a result, no notice and comment period is required, the SEC is providing a 30-day comment period for the public to provide feedback on the implementation of the new rules.

SEC reporting companies that are likely to be characterized as Commission-Identified Issuers, PCAOB-registered public accounting firms, US securities exchanges and over-the-counter markets, and other interested members of the public should consider providing feedback to both the SEC and PCAOB now while there is still opportunity to inform the implementation of the HFCA Act.

For more information about topics raised in this Legal Update, please contact any of the lawyers listed below.

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