ROBERT P. CASEY, JR.
PENNSYLVANIA

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# United States Senate

WASHINGTON, DC 20510

July 8, 2014

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair White:

I am writing today to ask the Securities and Exchange Commission (SEC) to ensure adequate protection of U.S. investors in initial public offerings (IPOs) by Chinese firms.

As you know, Chinese companies are increasingly turning to U.S. capital markets to raise funds. This year, the trend appears to be accelerating, with Chinese firms accounting for 63 percent of money raised through tech IPOs in the second quarter, according to Bloomberg data. Several more Chinese stock offerings are expected this summer, most notably a proposed IPO from e-commerce giant Alibaba.

However, there are longstanding concerns about the transparency and legal structure of Chinese companies listed on U.S. stock exchanges. In the past three years alone, the SEC has charged a number of China-based companies with fraud, including China Sky One Medical Inc., AutoChina, SinoTech Energy Limited and China MediaExpress. The sheer number of fraud cases involving China-based companies listed in the U.S. reveals systemic problems with many Chinese companies' legal structures and accounting practices. Indeed, earlier this year, SEC Administrative Law Judge Cameron Elliot ruled that the Chinese units of several large accounting firms could not audit U.S.-listed companies due to their willful failure to disclose information to U.S. financial regulators.

As a result of these widespread problems, American investors in Chinese companies often do not enjoy the same protections and legal guarantees that they are afforded when they invest in American firms. Most Chinese firms that list in the U.S. use a structure known as a variable interest entity (VIE). VIEs are shell companies that give investors contractual claims to a firm's profits but do not legally grant them ownership of the company. For example, according to Alibaba's securities filing, Americans who invest in the company will not be buying stakes in Alibaba's profitable e-commerce business, but in a related Cayman Islands shell company. These structures allow companies to circumvent Chinese regulatory restrictions on foreign investment.

More concerning, given the Chinese government's interest in restricting foreign ownership in certain industries, it is far from clear that the contractual claims underlying VIEs are enforceable. In fact, in recent years Chinese courts and arbitration boards appear to have invalidated VIE contracts and similar arrangements. As a result, VIE structures pose significant risks to American investors accustomed to the idea that shares sold on stock exchanges amount to legally sound ownership stakes in revenue-generating companies.

I understand that the SEC has recently dedicated significant resources to reviewing the risks posed by VIEs and ensuring that Chinese firms adequately disclose these risks to investors. Most recently, in 2013, the SEC asked Beijing-based internet firm Baidu to make further disclosures to investors about the ownership structure of its VIE. These efforts have helped to significantly increase transparency and awareness of the risks that investors undertake when purchasing shares in Chinese firms.

However, as Chinese companies' offerings on U.S. financial markets continue to grow in number and size, we must ensure that investors are adequately protected from the unique risks posed by China-based VIE structures. According to a Bloomberg survey of investment analysts, the Alibaba IPO has the potential to be the largest new share offering in the history of U.S. stock markets. Stock listings by Chinese firms present attractive opportunities for U.S. investors and reflect the unparalleled dynamism of American capital markets, but it is essential that these listings fully abide by the basic norms of transparency and disclosure that underlie confidence in our financial system.

To this end, I respectfully request that you provide me with a detailed description of the SEC's efforts to review and address the risks posed by the growing number of Chinese IPOs that use VIE structures. I would also urge the SEC to strengthen its efforts to improve disclosure in listings that use these structures. Finally, I would appreciate your feedback on how Congress can better support and cooperate with the SEC in this endeavor.

I look forward to working with you to protect American investors and safeguard the integrity and dynamism of our financial markets.

Sincerely,

Bob Casey, Jr.

Robert P. Casey, Jr.
United States Senator