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US law targeting Chinese firms on American exchanges could trigger delistings and hurt investors, finance professor says

- The Holding Foreign Companies Accountable Act tightens auditing requirements for Chinese firms listed on US stock exchanges
- Bill could force compliant Chinese companies to leave the US capital markets, hurt American investors, says Cornell finance professor

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Legislation that could see Chinese companies booted from US stock exchanges if they do not comply with auditing standards could lead to a wave of delistings and ultimately hurt American shareholders and the financial industry, a Cornell University finance professor has said.

President Donald Trump on Friday signed the Holding Foreign Companies Accountable Act, applying more pressure on Beijing as he prepares to leave office next month. The Trump administration has already targeted a range of Chinese companies with sanctions, trade blacklists and import bans over his term amid worsening bilateral relations.

A key provision of the bill is that foreign companies listed in the US will be required to submit audited financials for review by the US Public Company Accounting Oversight Board (PCAOB) within three years' time. Companies will also have to establish that they are not owned or controlled by a foreign government.

Firms whose auditors are not subject to PCAOB inspection must disclose if anyone on the board of directors is a member of the Chinese Communist Party and if the firm's articles of incorporation include the party's charter.

Andrew Karolyi, deputy dean and college dean for academic affairs at the Cornell SC Johnson College of Business, said in an interview with the *South China Morning Post* the bill could force compliant Chinese companies to leave the US capital markets because of a perception they were no longer welcome.

"My worry is that this group of Chinese firms may decide that the new legislation reflects that the goalposts are being moved, and the environment is less friendly than they had hoped for and initiate a delisting," Karolyi said, adding US investors could also be denied access to good companies.

"Blocking Chinese firms from US markets is too blunt a tool."

The Sarbanes-Oxley Act of 2002, which expanded US disclosure requirements in response to corporate and accounting scandals, including those involving Enron and WorldCom, caused negative share-price reactions to deregistration announcements by foreign firms, according to Karolyi's earlier research. He said the new legislation could have the same effect.

There are 202 listed companies operating in China and Hong Kong that have a combined market cap of US$1.8 trillion on US and foreign exchanges, according to the PCAOB.

The oversight board has tried for more than a decade to access the accounting documents of the US-listed Chinese companies, but Chinese laws prohibit them from leaving China or being shared with a foreign institution.

The issue has gained fresh momentum as US-China trade and diplomatic ties have sharply deteriorated over the past few years.

Drew Bernstein, co-managing partner at Marcum Bernstein & Pinchuk, a PCAOB-registered accounting firm, said some Chinese issuers may view the requirement that they disclose ties to the Communist Party as intrusive, given the importance of the party in setting economic and industrial policy.

"State-owned enterprise and technology companies that operate in highly sensitive areas now have the option to list on domestic exchanges in China and may not be suitable candidates to list overseas," Bernstein said.

Multiple scandals have raised questions about Chinese accounting standards. In the latest high-profile case, Luckin Coffee said in May its sales were inflated by hundreds of millions of dollars. The company has since fired its CEO and chief operating officer, causing its share price on the Nasdaq to plummet by 97 per cent from its mid-January peak.

Joel Gallo, CEO of management consultancy Columbia China League Business Advisory, said that improving auditing would instill confidence in investors about cross border listings, knowing that Chinese equities were subject to thorough review.

But US financial markets also need to stay competitive by attracting international investment, especially since highly-valued Chinese companies have started pursuing secondary listings in Hong Kong as an insurance policy against any further deterioration in US-China relations, Gallo said.

The volume of US-listed Chinese companies with secondary listings in Hong Kong and China's stock exchange jumped to US$21.2 billion this year, from US$12.9 billion in 2019 and US$902 million in 2018, data from Refinitiv showed.

Alibaba, the owner of the *South China Morning Post*, became the world's largest offering to date through its secondary listing in Hong Kong in 2019.