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Original Paper

Regulatory Challenges for Chinese Concept Stocks Listed in the U.S.

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Abstract

This paper provides a comprehensive analysis of the regulatory challenges facing Chinese concept stocks listed in the U.S., with a specific focus on the impact of geopolitical tensions, regulatory disparities, and high-profile financial fraud cases such as Luckin Coffee. It delves into the intricate dynamics between the U.S. Securities and Exchange Commission (SEC) and Chinese regulatory authorities, underscored by the enactment of the Holding Foreign Companies Accountable Act (HFCAA). Through examining these issues, the paper highlights the complexities of navigating cross-border listings within the fraught U.S.-China geopolitical landscape.

The analysis reveals the multifaceted nature of the regulatory challenges, including auditing disputes, information security concerns, and the broader implications of international political shifts on financial markets. The Luckin Coffee scandal serves as a pivotal case study, illustrating the risks of financial misconduct and the difficulties faced by U.S. regulators in ensuring transparency and accountability among foreign companies operating within its borders.

Keywords

SEC, HFCAA, Chinese Concept Stocks, Securities Regulatory

1. Introduction

In the past few years, the surge in Chinese companies, often referred to as “Chinese concept stocks”, listing on U.S. stock exchanges has captured significant attention from investors, regulators, and policymakers worldwide. Going public in the United States was once the top choice for many Chinese companies, especially those in the new economy sector. Even for Chinese companies that were already listed in other countries or regions, there was a tendency to pursue cross-listing in the United States. However, the enthusiasm for listing in the US has significantly diminished due to escalating tensions between China and the US, incidents of fraud among Chinese concept stocks (with the Luckin Coffee case being emblematic), and the subsequent introduction of laws holding foreign companies accountable, such as the Holding Foreign Companies Accountability Act (HFCAA).

As a result, there has been a noticeable shift in the US securities market's attitude toward Chinese concept stocks. Chinese idea stocks continue to encounter significant obstacles, despite modest improvement since the year's beginning. These firms have their primary business operations in Mainland China and are subject to regulatory scrutiny, and most notably, US securities legislation. This phenomenon is evidence of the globalization of capital markets as well as a complicated web of regulatory obstacles and compliance needs involving two of the biggest economies in the world.

The U.S. capital markets are known for their rigorous regulatory standards, designed to ensure transparency, accountability, and the protection of investors. These standards are upheld by a comprehensive legal and regulatory framework, with the Securities and Exchange Commission (SEC) playing a central role in enforcement. In contrast, companies with their main business operations in China will inevitably be subject to regulation by the Chinese government when conducting business activities within China. The deteriorating relationship between China and the United States in recent years has led to greater regulatory challenges for Chinese concept stocks, especially in terms of auditing issues and data security. When these companies seek to list on U.S. exchanges, they must face significant dual compliance challenges, balancing their obligations to U.S. regulators with those of Chinese authorities.

The necessity of addressing the regulatory challenges faced by Chinese concept stocks becomes evident when considering the implications for international investors, the integrity of U.S. capital markets, and the potential for cross-border financial fraud. One notable case that underscores these challenges is that of Luckin Coffee. Launched in 2017, Luckin Coffee quickly expanded its operations across China, aiming to overtake Starbucks in its number of outlets. The company went public on the NASDAQ in May 2019, raising substantial funds from international investors. However, in April 2020, Luckin Coffee disclosed that some of its employees had fabricated sales transactions, significantly inflating its reported revenues. This revelation led to a precipitous decline in its stock price, substantial financial losses for investors, and ultimately, the delisting of Luckin Coffee from the NASDAQ. The Luckin Coffee scandal serves as a stark reminder of the regulatory and compliance risks associated with Chinese concept stocks. It highlights the challenges U.S. regulators face in conducting oversight and enforcement activities across jurisdictions, especially when dealing with companies whose operations and records are primarily located in China.

In conclusion, the discussion of regulatory challenges for Chinese concept stocks listed in the U.S. is not only timely but essential. It involves navigating a complex interplay of legal, financial, and geopolitical considerations, with significant implications for global investors, regulatory bodies, and the companies themselves. By examining cases like Luckin Coffee, stakeholders can better understand the risks involved and work towards more robust frameworks for oversight, transparency, and cross-border regulatory cooperation. This paper seeks to examine the intricacies of U.S. and Chinese regulations, highlighting their profound impact on global investors and the dynamics of international capital markets. By analyzing the regulatory frameworks governing Chinese concept stocks listed in the U.S., such as the case of Luckin Coffee, this study aims to unravel the complex interplay between differing regulatory standards and their implications for transparency, corporate governance, and investor protection. Through this lens, the paper will explore the challenges and opportunities presented by cross-border listings, proposing pathways for enhancing regulatory cooperation and ensuring the integrity of global financial markets.

2. Chinese Concept Stocks Crisis: The Luckin Coffee Fraud Incident

In a broader context, the crisis of confidence in Chinese concept stocks has been gradually building up, becoming seemingly inevitable following the intensification of the China-US trade war in recent years. This ongoing conflict not only strained economic relations between the two superpowers but also cast a shadow over the operations and perceptions of Chinese companies on international platforms, particularly in the United States. The enactment of the HFCAA is often interpreted not merely as a reaction to a singular incident but as an amplification of an ongoing regulatory and ideological confrontation that has been simmering for years (Note 1). The legislation underscores the United States' determination to scrutinize and regulate foreign corporations accessing its financial markets more rigorously, aiming to protect investors and ensure fair competition.

The narrative surrounding the regulation of Chinese concept stocks is deeply intertwined with the Luckin Coffee fraud scandal. This event did not just spotlight the potential risks associated with these companies but also triggered a broader reevaluation of their governance and transparency practices. The scandal, which revealed significant financial misconduct by one of China's rising stars in the coffee industry, served as a stark reminder of the vulnerabilities in financial reporting and corporate governance among Chinese firms listed abroad. Consequently, in the aftermath of the Luckin Coffee incident, the Chinese academic community and market observers have labeled the ensuing period of heightened scrutiny and skepticism as the "second crisis of Chinese concept stocks" (Note 2).

This crisis has led to a tangible shift in the strategy of numerous Chinese companies listed in the US. Faced with increased regulatory pressure, reputational challenges, and the looming threat of delisting due to non-compliance with the new regulatory requirements, a significant number of these firms have started to explore or undertake privatization and delisting from US exchanges. Their objective is to return to the perceived safety of listing on the main boards in mainland China, where they anticipate a more favorable regulatory environment and a potentially more sympathetic investor base. This trend not only reflects the direct impact of heightened US regulatory scrutiny but also signifies a broader reassessment of the costs and benefits of international listings for Chinese companies amid shifting geopolitical and economic landscapes.

Luckin Coffee was established in March 2018, rapidly positioning itself as a tech-forward (Driving company growth with technology development) coffee chain aiming to rival Starbucks in China. The company differentiated itself through aggressive marketing and an emphasis on its mobile app, positioning itself not just as a traditional coffee chain, but as an internet company similar to Amazon (Note 3). By May 2018, Luckin boasted over 500 stores and one million users. It sought to disrupt Starbucks' monopoly, though it faced criticism for its quality and customer experience. Luckin successfully raised significant capital in a series of funding rounds, valuing the company at billions of dollars. This financial backing supported its swift expansion, including improvements in delivery times and customer satisfaction. By the end of 2018, Luckin had opened thousands of stores across China, despite concerns about market saturation and the sustainability of its rapid growth.

The narrative takes a turn as Luckin faces accusations of financial fraud, highlighted by a short-selling report in January 2020. This report detailed alleged fraudulent practices, including inflated sales figures, fabricated transactions, and misleading advertising expenditures. The investigation suggested that Luckin's reported growth and performance were significantly embellished to attract investment and enhance its stock market valuation. In April 2020, Luckin announced an internal investigation that revealed fabricated sales of approximately 2.2 billion yuan, constituting a significant portion of its reported revenue. This revelation led to a crisis of confidence among investors, a sharp decline in its stock price, and raised questions about the future of the company. This case ended with the company delisting from NASDAQ in June 2020.

However, the aftermath of the Luckin Coffee incident did not stop there. Amid already tense Sino-US relations, this atmosphere inevitably spread to the financial sector. In a sense, the Luckin Coffee incident served as a direct catalyst for the enactment of the HFCAA (Note 4). The HFCAA is a United States federal law enacted on December 18, 2020. Its primary aim is to address concerns over the auditing standards of foreign companies listed on U.S. stock exchanges. The law has significant implications for foreign companies, especially those based in China, due to longstanding issues regarding access to audit work papers of companies based in such jurisdictions. It requires foreign companies listed on U.S. stock exchanges to declare that they are not owned or controlled by a foreign government.

More crucially, these companies must allow the U.S. Public Company Accounting Oversight Board (PCAOB), the regulator of the auditing profession, to review their audit work papers. If a company fails to comply with the PCAOB audits for three consecutive years, the HFCAA mandates the delisting of such companies from U.S. stock exchanges. This provision is aimed at ensuring transparency and trust in the financial reporting of foreign companies. The HFCAA has been particularly relevant for Chinese companies listed in the U.S., as China has historically restricted the PCAOB's ability to inspect audit records within its jurisdiction, citing national security concerns.

The enactment of the HFCAA has led to increased scrutiny and pressure on Chinese companies to comply with U.S. auditing standards. The law has spurred diplomatic and regulatory discussions between the U.S. and China. Some Chinese companies have started seeking listings in Hong Kong and other markets as a hedge against the possibility of being delisted in the U.S. According to the Act, a considerable number of foreign companies, primarily Chinese firms, may face delisting if they fail to meet the audit requirements stipulated by the law. As of August 5, 2022, the SEC had published a list of 165 “potential delistings” of Chinese concept stocks. Some state-owned enterprises such as Sinopec, PetroChina, and China Life voluntarily delisted from the New York Stock Exchange (Note 5).

Fortunately, regulatory agencies in both China and the United States have not closed the door to communication. On August 26, 2022, the China Securities Regulatory Commission announced that a Sino-US regulatory cooperation agreement on auditing had been reached. On December 15, the PCAOB confirmed that inspections and investigations for mainland China and Hong Kong accounting firms could be completed for the year 2022, temporarily alleviating the risk of collective delisting of Chinese concept stocks before 2024.

However, it can be seen from the statements issued by both China and the United States that there are still differences in their positions on the two core issues of audit inspection methods and sensitive information. The Chinese side emphasizes that the US side must rely on Chinese regulatory authorities to review audit workpapers and strictly protect information security, limiting access to sensitive information. The US side insists on obtaining complete audit work papers and emphasizes the autonomy and independence of audit inspections. On December 15, 2022, PCAOB announced that inspections of mainland China and Hong Kong accounting firms for the year 2022 could be completed, and revoked the determination made in 2021 that inspections or investigations could not be completed.

PCAOB also stated that this announcement only provides a positive response to the question of whether PCAOB has sufficient authority to conduct comprehensive inspections, and any audit deficiencies discovered during inspections will be announced separately. According to the China Securities Regulatory Commission, the US will obtain audit work papers and other documents from Chinese regulatory authorities and, with Chinese assistance, will question pertinent accounting firm personnel. The Chinese side will specifically handle any personal information found in the workpapers related to inspections. It can be seen that the reaching of this cooperation is a phased result of bargaining and compromise between China and the United States. Although the pressure for collective delisting of Chinese concept stocks before 2024 has been somewhat relieved, the crisis of Chinese concept stocks has not been eliminated. PCAOB Chairman Williams stated that if the opinions of China and the United States are divided on cooperative regulatory issues in the future, the PCAOB Board of Directors will take immediate action and consider the necessity of issuing new restrictions.

3. Three Main Challenges

The regulatory conflicts that followed the financial fraud incident of Luckin Coffee, which involved several Chinese concept stocks, brought to light the difficulties that these stocks confront in enduring the strategic competition that exists between China and the United States. These challenges primarily stem from three issues: auditing, information security, and the international political environment. Firstly, the issue of auditing revolves around whether Chinese concept companies can provide accurate and transparent financial reports, a matter of great concern to Western investors. Secondly, information security has emerged as an increasingly prominent issue, especially in terms of cross-border data transmission and personal privacy protection. Chinese concept stocks are required to comply with Chinese laws while also meeting the demands of Western countries, a balance that is exceedingly difficult to achieve. Lastly, fluctuations in the international political environment, such as the US-China trade war and the tech cold war, introduce further uncertainties for these companies. They must navigate these turbulent waters in search of opportunities for survival and growth.

3.1 Audit Issues

Audit issues are considered the earliest, most central, and persistently unresolved dilemma in the regulation of Chinese concept stocks. The disparities in audit regulations between the US and China, along with institutional short-selling, are exactly what led to the 2010 “first Chinese concept stock crisis” as defined by the Chinese academic community. In 2012, only four Chinese concept stock companies were successfully listed in the US, while 31 were delisted (Note 6). The crisis of trust in Chinese concept stocks to some extent highlighted regulatory issues. The SEC lacked effective channels to obtain data when investigating Chinese companies listed in the US. Moreover, the target of cross-border audit regulation is the accounting firms rather than the audited listed companies. Additionally, there is controversy over whether audit working papers should be exported. Therefore, cross-border audit regulation is key to improving regulatory conflicts in the capital markets of China and the US. However, the divergence in audit issues stems not only from different audit regulatory laws between China and the US but also from different audit disclosure systems.

One important reason for the regulatory dilemma in auditing Chinese concept stocks lies in the differences in legal regulations between China and the United States. The effectiveness of a country’s legal framework, its coverage, and the recognition and enforcement of foreign judgments can all affect the effectiveness of its legal regulations. Firstly, there are differences in the regulatory legal systems of both sides. The United States has a comprehensive legal system centered around federal securities regulation, primarily based on the Securities Act of 1933 and the Securities Exchange Act of 1934, supplemented by numerous securities laws enacted by individual states. This comprehensive legal system has resulted in relatively effective regulatory outcomes in the US.

However, China’s legal system for cross-border securities regulation still needs more construction. The supervision of cross-border securities issuance and trading activities mainly relies on regulations or provisions issued by the State Council or the China Securities Regulatory Commission (CSRC). These regulations cannot resolve all conflicts related to the application of foreign securities laws. In particular, the effectiveness of regulating behaviors such as data falsification and credit fraud by overseas-listed companies in China is limited. Legislation to truly address cross-border audit conflicts is almost nonexistent. Additionally, the newly revised Securities Law lacks specific provisions and operational guidelines for implementing and safeguarding cross-border audit supervision, while complementary regulations are also lacking (Note 7).

Secondly, there are differences in the jurisdictional scope of both legal systems. For cross-border audit supervision of Chinese concept stocks, the United States established the principle of territorial jurisdiction in enforcing the Securities Act of 1933 and the Securities Exchange Act of 1934. Subsequently, the United States has expanded its jurisdictional scope by relying on the principle of extraterritorial jurisdiction, effectively breaking through the territorial jurisdiction principle. In contrast, China’s approach to jurisdiction is generally more cautious or passive. Regarding the supervision of Chinese concept stocks, since most companies are listed outside the jurisdiction of China and the victims of securities fraud are typically not within China's borders, Chinese regulatory agencies do not typically take special action in practice.

The focus of the controversy over cross-border audit supervision of Chinese concept stocks lies in the audit working papers reports issued by registered accounting firms for listed companies. However, there are multiple differences in the review of auditors’ working papers containing company data information between China and the United States. Firstly, both China and the United States differ in the importance they attach to audit working papers. The U.S. highly values the significance of auditors’ working papers for securities regulation, considering them as crucial evidence for intermediary service institutions to review and assess the accuracy of the disclosure of financial information in corporate financial reports. This is deemed essential for the SEC and the PCAOB in identifying and auditing companies. The U.S. particularly emphasizes the integrity and audited disclosures mandated by its securities laws. It believes that detailed and reliable audit working papers can both prevent violations at the source and protect investor rights. Auditors’ working papers of Chinese concept stock companies are considered by U.S. regulatory agencies as crucial for evaluating the reliability of the auditors’ assurance opinions.

Additionally, there are differences in the powers of audit regulatory agencies between both sides. The difficulties in information disclosure between China and the US are closely related to the differing regulatory powers of their respective regulatory agencies. In the United States, the SEC and PCAOB are federal government securities law enforcement agencies, endowed with significant legal powers. These agencies aggressively enforce laws against violations by listed companies and their auditors and impose penalties directly without requiring higher-level approval. The PCAOB, which is subject to SEC oversight and rule approval, directly exercises powers such as reviewing audit reports issued by auditors of Chinese concept stock companies and serves as a strong source of supplemental federal oversight of mandated disclosure by public companies.

In contrast, China’s audit regulatory agency has long been dominated by the CSRC. The CSRC used to be a directly affiliated institution of the State Council without independent administrative status, which significantly limited its regulatory effectiveness (Note 8). Furthermore, there were questions regarding the extent of its fining and law enforcement authority in addition to the need to collaborate with other State Council departments to undertake enforcement proceedings. These factors impeded its capacity to effectively execute its regulatory responsibilities as a securities regulator. Additionally, China lacks relevant auxiliary departments and agencies such as a specialized audit regulator similar to the PCAOB.

Certainly, the root of all of these auditing issues ultimately lies in the contention over auditing sovereignty. Despite reaching a certain consensus in 2022, there are still differences in the statements between the two sides regarding the auditing regulatory cooperation agreement. The CSRC claims that the US side must obtain audit working papers through Chinese regulatory authorities and conduct inquiries of accounting firm personnel with Chinese assistance. Meanwhile, the PCAOB states that it has the right to independently select any issuer’s auditing firm for inspection or investigation, and can directly interview or obtain testimony from all personnel of the auditing firm that is inspecting or investigating the issuer’s business. This disagreement on the power to review auditors’ work at the bottom reflects a disagreement between the two sides on the autonomy of regulatory inspections of auditors’ work.

3.2 Security Issues

Security issues, particularly data and information security concerns, are also among the significant challenges in the regulation of Chinese concept stocks. A typical case is DiDi Chuxing, which was penalized by the China Securities Regulatory Commission. DiDi’s listing in the US was considered a threat to China’s national data security. Due to its massive data collection and involvement in vital transportation sectors, this mobile travel technology platform has created risks related to aggregated derivative risks (Note 9), sensitive data exposure, and national data security as well as personal information protection and economic development. DiDi approaches the status of a key infrastructure operator in the transportation industry. Moreover, extensive data analysis and mining of DiDi’s data, with continuous layering (the process of systematically adding and organizing layers of data to build a more comprehensive and detailed dataset), could dynamically reveal the development of the cities and key industries it serves, leading to the risk of data volume aggregation (Note 10) and derivation (Note 11) (Note 12).

The data security issues related to DiDi’s listing in the US have received attention from China. In July 2022, the Cyberspace Administration of China conducted a cybersecurity review on of DiDi, stating that the company’s business operations and data processing activities posed severe risks and hidden dangers to the nation’s critical information infrastructure and data security. This review brought the data security issues related to cross-border listings into regulatory focus. Regulatory authorities are also strengthening the supervision of Chinese concept stocks and emphasizing the improvement of data security, cross-border data flows, and the management of sensitive information in capital market activities.

This demonstrates the determination of Chinese regulatory authorities to uphold data security in complex domestic and international environments and indicates that companies must prudently consider the extraterritorial impact of data outflows on national data security in cross-border securities activities. As scholars have pointed out, cross-border data flows attached to economic issues also involve non-economic concerns such as national security and sovereign jurisdiction. From this perspective, the collective move of Chinese concept stocks to list in the US involves China's national data security. Didi ultimately announced its delisting from the U.S. stock market in 2022, which was undoubtedly closely related to data security issues. Didi's failed rush to go public also indirectly highlights China's emphasis on information security.

U.S. regulatory agencies implement information disclosure regulatory mechanisms subject to high standards, which they are unwilling to lower. It follows that the SEC and PCAOB also require the level of regulatory cooperation from China to meet American standards, which implicitly carries risks affecting data security. From a regulatory framework perspective, the U.S. information disclosure regulatory system not only has dedicated securities regulatory agencies but also expands the scope and execution of regulation through closely integrated legislative provisions and enforcement tactics. Section 102 of the Sarbanes-Oxley Act (SOX Act) provides authority for the PCAOB to inspect audit working papers, other financial data, and business data, setting a baseline for the authenticity of corporate information disclosures and driving the optimization of disclosure quality.

Furthermore, the PCAOB includes Chinese concept stocks listed in the US within its regulatory scope and has the authority to directly obtain audit-related documents from the entities under supervision. Sections 105 and 106 of the SOX Act state that the PCAOB may presume that an accounting firm "consents" to supervision when the firm prepares or releases an audit report for a foreign-listed business by expressing an opinion or in other ways. This broadens the PCAOB's regulatory scope. Additionally, the PCAOB investigates the standardization of the audit working paper preparation process and the objectivity of conclusions. The PCAOB can obtain audit working papers and related documents and conduct inquiries under Section 105 of the SOX Act. This permits the regulator to obtain pertinent data from Chinese concept stocks that are objectively linked to Chinese data security.

The objective of the PCAOB is to protect investors by ensuring the accuracy of audited information. The PCAOB claims that the basis for cross-border regulatory cooperation with other countries is to not change or diminish its regulatory objective (Note 13). As a result, the regulatory compromises or differences between the US and other nations are essentially reduced to the following two factors: first, the question of whether the other nations are willing to cooperate internationally under US regulatory standards, and second, the question of whether they can meet these standards becomes crucial to achieving regulatory cooperation with the US. Since the US has more open capital markets and more robust financing options than other countries, foreign companies are drawn to list there and comply with US regulations. This allows the US to leverage its strong capital markets to support the PCAOB's implementation of inspection powers without needing to loosen its regulatory requirements (Note 14). Fundamentally, cross-border securities regulation concerns the gamesmanship involving economic strength and financial market influence between nations, externally manifested as the power of one country's cross-border securities regulation and the execution of extraterritorial jurisdiction.

In practice, the SEC and PCAOB prioritize implementing their regulatory standards in cross-border regulatory cooperation with other countries. For example, Japan and the European Union, to avoid unilateral expansion of regulatory powers by American regulatory agencies, have attempted to adopt audit regulatory equivalence recognition for cooperation, comprehensively avoiding PCAOB inspections in their countries (Note 15). However, the PCAOB considers that the SOX Act does not grant this mode of regulation and insists on implementing its regulatory mechanisms. Japan, Germany, and France subsequently abandoned such attempts and accepted PCAOB enforcement through joint inspection (Note 16) and other means. This shows that the United States, in its regulatory cooperation with other countries, focuses on whether its regulatory needs can be met, demonstrating a relatively firm regulatory stance and non-negotiable regulatory expectations. However, if a country blindly meets American regulatory standards in regulatory cooperation, there is a risk of compromising financial regulatory sovereignty and exacerbating data security risks.

The China-US Audit Agreement has eased some regulatory differences between China and the US and reduced data security risks, but it cannot completely dissolve the regulatory discord between the two countries, thus not eliminating data security risks inherent in the agreement. The underlying mechanism lies in the coexistence of consensus and divergence in cross-border securities regulation between China and the US. First, although the China-US Audit Agreement protects certain data, it cannot fully avoid the data security risks associated with Chinese concept stock listing in the US. The agreement designates sensitive and personal information as “specific data” subject to special handling procedures.

However, due to the insufficient comprehensiveness of its data protection scope, there are concerns about missing categories of data protection. Indeed, specifying “specific data” for special handling procedures is crucial, yet the data security risks involved in the listing of Chinese concept stocks in the US may extend beyond this. One concern is whether special processes can be applied to “sensitive information” and “personal information” under Chinese law and whether there are perception gaps between the two parties. These kinds of questions will reduce the agreement's protective effect on pertinent data.

Secondly, data that is closely tied to security but falls outside the current protected data categories outlined in the agreement still encounters challenges in terms of protection. If the data’s content is significant, or it originates from a key industry without corresponding protection, it may easily pose a risk of sensitive data; similarly, data may evolve into a threat to national data security through accumulation (the collection of data over time) and subsequent processing (the actions taken to manipulate, analyze, or utilize this collected data), even if it seems not directly linked to national security.

Furthermore, the data security risks existing in the China-US Audit Agreement have the hidden danger of extending the risk chain. One aspect is the “forward extension” of data security risks, as both sides may have different assertions on how to define the scope of data required for examination by US regulatory agencies. The US side, however, emphasizes that the PCAOB must have complete access and can exercise sole discretion in selecting inspection subjects and defining the scope of data. The Chinese side indicates that the data to be examined by US regulatory agencies should be determined through prior full communication and consultation, and obtained through coordination by Chinese regulatory agencies.

If US regulatory agencies lack prior consultation with the Chinese side, the unilaterally selected data may exceed a reasonable scope. This forward extension risk is likely related to the source of sensitive data risks due to the lack of Chinese regulatory agencies' assessment of whether data content can be transferred abroad. Another aspect is the behavior of US regulatory agencies in retaining and transferring data, which may lead to the "backward evolution" of data security risks. The PCAOB can retain the complete materials inspected and reviewed to corroborate its regulatory investigation results; the PCAOB can also transmit such data to the SEC to fulfill legal obligations and daily uses. It is unclear to what extent the data provided to US regulatory agencies will be utilized and processed, not excluding the possibility of aggregated derivative risks.

Lastly, differences in the expected level of regulatory cooperation between China and the US not only affect the long-term implementation of the agreement but also place Chinese concept stocks back into a legally unstable state, making it difficult to fundamentally resolve the issue of data transfer security. The Chinese side emphasizes that the CSRC or relevant authorities should provide necessary assistance based on bilateral and multilateral cooperation mechanisms. The US side argues that regulatory agencies have the sole discretion to select regulatory subjects and the scope of data, with direct access to an interview or testimony. Moreover, US regulatory agencies require that the data should not be edited or filtered by the Chinese side with any redactions, not allowing any concealment or omission for any reason and that their staff may review all unredacted audit documents (Note 17). It should be noted that, against the backdrop of international digital competition, China tends to adopt "data protectionism" for security measures, while the US essentially favors "data liberalism" (Note 18).

The aforementioned differences continue the historical divergences in cross-border securities regulation between the two sides. Whether it's the "Securities Law of the People's Republic of China" (2019 Revision) Article 177, based on securities regulation logic, or the "Data Security Law of the People's Republic of China" Article 36, based on the perspective of data security protection, both indicate that individuals or units should not provide materials, documents, or domestic data abroad without authorization; they should respond to cross-border law enforcement's regulatory needs under the guidance of regulatory agencies. However, the SEC and PCAOB once gave a "cold treatment" to China's proposal for bilateral regulatory cooperation, leading to a deadlock in the cross-border regulatory cooperation issue of Chinese concept stocks. Therefore, the different expectations of the two sides on the level of agreement cooperation are both a reason for the previous cooperation obstruction and likely to cause new divergences in current regulatory cooperation.

3.3 Political Factors

The HFCAA reflects a complex interaction between the leading role of U.S. capital markets and the challenges posed by the integration of Chinese firms, which are emblematic of state capitalism. This dynamic encapsulates the broader geopolitical conflicts between the U.S. and China, serving both as a reflection of current tensions and a catalyst for future shifts in global financial markets. Representative Andy Barr articulates this nuanced view, stating:

"The United States has the most robust and advanced capital markets in the world. They provide access to capital for some of the most innovative businesses and create an avenue for investors of all levels to save for retirement and plan for their futures. It follows that companies from around the globe flock to the U.S. capital markets to fund their businesses, and the U.S. is happy to be the destination for these firms. However, to play in our markets, companies need to play by our rules, and Chinese firms listed on American exchanges are the worst and most frequent offenders. Gone are the days when we could sit idly by and let Chinese firms, many with strong ties to the Chinese Communist Party, participate in our markets at the expense of protection for everyday investors. The strategic responses from both nations will not only reshape their bilateral relations but also set precedents for how economic tools are utilized in global political strategies" (Note 19).

In response, Chinese SOEs such as PetroChina, Sinopec, and China Life Insurance have begun to delist from the NYSE. These actions go beyond simple regulatory compliance; they represent a strategic retreat from exposure to U.S. jurisdiction, minimizing potential vulnerabilities. Each delisting removes significant assets from the reach of U.S. regulators, reducing the immediate leverage that U.S. authorities have over these enterprises, which are integral to China's national economic strategy.

Fundamentally, the problem of Chinese SOEs is an unsolvable issue. In industries related to public safety and essential livelihoods, China largely practices state monopoly. These companies, closely linked to national security, clearly cannot surrender all relevant information to the United States due to sovereign considerations. Admittedly, the US never assumes SOEs under the control of China's Communist Party leadership to integrate fully into U.S. financial markets. This resistance stems from a justified wariness under different ideologies and intense competitive relationships.

On the other hand, for Chinese private enterprises, this regulatory requirement might seem overly strict, particularly as the U.S. is rapidly expanding the scope of what it considers to be control related to the Chinese Communist Party. Representatives in China's People's Congress do not hold substantial political power comparable to that of U.S. Congress members. This means that just because the managers of private enterprises are deputies in the People's Congress, it does not imply that they possess actual political power or that the enterprises are controlled by the Chinese Communist Party. The role of a deputy in the People's Congress is largely symbolic, recognizing the contributions of entrepreneurs rather than offering them any real power to participate in making national decisions. Likewise, this position does not allow them to control their enterprises (Note 20).

However, the classification of a substantial number of private Chinese start-ups as entities influenced by the Communist Party, while initially appearing to be an overreach, actually represents a strategic measure by the U.S. to mitigate China's burgeoning economic influence. This tactic is part of a broader containment strategy that mirrors actions such as the high-profile and controversial banning of TikTok in the United States. The U.S. government justifies such moves by citing national security concerns, which it argues extend beyond the realm of state-owned enterprises to include private firms that, despite their independence, are perceived to maintain close ties with the Chinese government. This approach not only curtails the economic expansion of these firms but also serves as a preventive measure to block potential channels for foreign influence that could undermine U.S. economic sovereignty and security.

In other words, the HFCAA's stringent requirements—demanding transparency in audit processes and detailed disclosures about control and governance structures—reflect a calculated move by the U.S. to leverage its financial markets in service of its foreign policy objectives. This move aligns with other tactics such as trade tariffs, technology export restrictions, and direct sanctions, forming a multi-pronged approach to reduce China's technological and economic ascent.

The HFCAA also aims to shine a light on the governance structures of Chinese firms, requiring disclosures that reveal the extent of state influence in their operations. Such disclosures are politically charged, as they may influence global perceptions of Chinese businesses and impact their ability to operate and expand internationally. The stigmatization that can arise from these disclosures may deter investors and complicate partnerships with Western firms, thereby isolating Chinese companies from international markets.

The enforcement of the HFCAA illustrates a significant shift in global financial governance norms, where U.S. domestic laws have international repercussions. This shift could encourage other nations to adopt similar stances, leading to a more fragmented global financial system characterized by regional blocs and differing standards. Such fragmentation poses risks to the global economy, potentially leading to inefficiencies, increased transaction costs, and reduced global capital flows, which could stifle global economic growth.

China's countermeasures, including bolstering the attractiveness of Hong Kong and Shanghai as alternative financial hubs, indicate a strategic pivot towards self-reliance in financial markets. This strategy not only aims to safeguard Chinese firms from U.S. regulatory reach but also challenges the hegemony of U.S. capital markets by promoting alternative global financial centers. This development could lead to a more multipolar financial world, diminishing the unilateral influence the U.S. currently holds over global financial practices and norms. In conclusion, the HFCAA is a microcosm of the broader U.S.-China geopolitical conflict, serving as both a reflection of current tensions and a catalyst for future shifts in global financial markets. The strategic responses from both nations will not only reshape their bilateral relations but also set precedents for how economic tools are utilized in global political strategies.

The conclusion that emerges is that despite the United States and China each having their legitimate concerns—be it the U.S.'s insistence on rigorous auditing standards or China's staunch defense of its data security—the underlying reality of the HFCAA cannot be overlooked. At its core, the HFCAA transcends mere regulatory measures and reveals itself as a deeply politicized tool. This act is strategically employed in the broader context of U.S.-China relations, where it functions as a significant component of a geopolitical chess game aimed at curbing China's economic ascent and ensuring American interests are safeguarded. Both nations frame their arguments around national security and economic integrity, yet it is clear that these regulations serve broader political objectives, making the HFCAA a pivotal piece in the ongoing power struggle between these two global giants.

4. Conclusion

In conclusion, the narrative of Chinese concept stocks in the U.S. is far from concluded. It continues to evolve, shaped by regulatory responses, market dynamics, and the broader geopolitical context. This paper posits that the challenges faced are not insurmountable but require a renewed commitment to international cooperation, regulatory innovation, and the pursuit of a balanced approach that safeguards the integrity of global financial markets while accommodating the diverse interests of a multipolar world. As we look to the future, the lessons drawn from this saga will undoubtedly inform the approaches adopted by regulators, policymakers, and market participants in navigating the complex interplay of finance, regulation, and geopolitics on the global stage.

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Notes

Note 1. Rose, P. (2023). Chinese State Capitalism and the Holding Foreign Companies Accountable Act (August 6, 2023). *Southern California Law Review Online*. Available at SSRN: https://ssrn.com/abstract=4532978

Note 2. Han, H., Chen, S., & Chen, H. (2020). Luckin Incident and the Crisis of Chinese Stocks--Basic Triggers, Regulatory Reactions and Expectation Gap. *Finance & Accounting Monthly, 18*, 3-8.

In 2011, Southeast Rongtong was suspended by the New York Stock Exchange for financial fraud, which led to frequent credit crises and a sharp drop in the share prices of U.S.-listed Chinese companies. Selling, shorting, delisting and, suspension became synonymous with Chinese concept stocks, and the "first crisis of Chinese concept stocks" broke out in full force. In 2012, there were only two Chinese companies listed in the U.S., while the number of delistings exceeded 20, and some companies suspended their plans to go public in the U.S.

Note 3. Qu, Y. (2020). The Story of Luckin (June 9, 2020). Available at SSRN: https://ssrn.com/abstract=3622214 or http://dx.doi.org/10.2139/ssrn.3622214

Note 4. Li, Y., & Pan. Z. (2020). On the Cross-border Audit and Regulatory Cooperation between China and the U.S. under the Crisis of Chinese Stocks. *Securities Market Herald*, *10*, 72-78.

Note 5. Five state-run Chinese giants to delist from U.S. stock exchanges, *The New York Times*, Aug 12, 2022, https://www.nytimes.com/2022/08/12/business/china-us-delisting-stock-exchange.html

Note 6. Mu, Y. (2013). Trust Crisis and Privatization of Overseas Chinese Stocks. *Business Economics*, *14*, 117-118.

Note 7. Refer to the Securities Law of the People's Republic of China, which came into effect on March 1, 2020.

Note 8. In March 2023, the CSRC was announced to be restructured as an institution directly under the State Council, which may alleviate this issue to some extent. However, during the crisis of Chinese concept stocks from 2020 to 2022, it still held an awkward administrative status.

Note 9. The complex risks that emerge when data from multiple sources is combined and then used to derive further information or conclusions.

Note 10. This involves the collection and combination of data from various sources into a single, extensive dataset.

Note 11. This refers to the process of extracting or deriving new data from the aggregated dataset.

Note 12. Refer to the statement by the person in charge of the Cyberspace Administration of China regarding the decision to legally conduct a cybersecurity review and impose administrative penalties on Didi Global Inc., in response to journalists' questions. https://www.cac.gov.cn/2022-07/21/c_1660021534364976.htm?eqid=c4523608001d0a4b0000000464476d0f&eqid=fb99a19e00204a2a00000006648c7a10

Note 13. See PCAOB, "China-Related Aces Challenges", https://pcaobus.org/oversight/international/china-related-aces-chalenges.

Note 14. By the end of 2021, the PCAOB had established audit cooperation with accounting firms from more than 50 countries or regions.

Note 15. Leng, J. (2021). Beyond Audit Disputes: How to Solve the Crisis of Chinese Stocks? *China Law Review, 1*, 179-193.

Note 16. A collaborative approach where regulatory agencies from different jurisdictions work together to conduct audits and oversight activities.

Note 17. See PCAOB, "PCAOB Signs Agreement with Chinese Authorities, Taking First Step Toward Complete Aces for PCAOB to Select, Inspect and Investigate in China" (2022), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-signs-agrement-with-chinese-authorities-taking-first-step-toward-complete-aces-for-pcaob-to-select-inspect-and-investigate-in-china.

Note 18. See Liu, J. & Cui B. (2020). The Reasonableness and Trend of Data Localization and Data Defense. *International Outlook, 6,* 89-107+149-150.

Note 19. 166 CONG. REC. H6034 (daily ed. Dec. 2, 2020 statement of Rep. Andy Barr).

Note 20. Milhaupt C. J., & Zheng, W. (2015), Beyond Ownership: State Capitalism and the Chinese Firm, *Georgetown Law Journal, 103*, at 684 it said "ninety-five out of the top one hundred private firms and eight out of the top ten Internet firms whose founder or de facto controller is currently or formerly a member of central or local party-state organizations such as People's Congresses and People's Political Consultative Conferences". This can't be proof of "most of the largest private firms in China are led by controllers who are or were members of central or local party-state political organizations".