The U.S. Chamber of Commerce is the world’s largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation’s largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber’s international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on issues are developed by Chamber members serving on committees, subcommittees, councils, and task forces. Nearly 1,900 businesspeople participate in this process.
Chairman Reinsch, Vice Chairman Shea, and members of the U.S. China Economic and Security Review Commission (“Commission”), my name is Tom Quadman, vice president for the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce (“Chamber”). The Chamber is the world’s largest business federation representing the interests of more than three million businesses and organizations of every size, sector, and region. On behalf of the Chamber’s membership, I appreciate the opportunity to testify on China’s Financial Sector: Governance, Transparency and Accountability.

The financial crisis has taught us that we truly live in a global marketplace. Up until recently, capital markets were hemmed in by national borders. Such a system allowed national regulators to have a clear window to oversee activities within their markets and act accordingly.

That is no longer the case today. The activities and regulatory policies of one country or region can have a domino effect worldwide.

As the interconnected global economy has grown, financial regulation has evolved. While national regulators still oversee domestic activities, new organizations, such as the International Organization of Securities Commissions (“IOSCO”), have started to emerge, allowing national regulators to share information and coordinate on cross border issues. However, as the 1997, 1998, and 2008 financial crises demonstrated, the advancement of cross border data sharing and coordination mechanisms did not keep pace with ever changing global financial markets. A failure by domestic regulators to understand cross border issues and to have the information to facilitate decision making was a factor in the gravity of these crises.

That is why the Chamber has supported the efforts of the G-20 nations to facilitate information sharing and coordination amongst financial regulators. Specifically, the Chamber backed Section 981 of the Dodd Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), which empowered the Public Company Accounting Oversight Board (“PCAOB”) to enter into agreements for reciprocal inspections and information sharing. It should be noted that the confidentiality of information shared is at the heart of Section 981.

The Chamber has also supported other efforts to facilitate efficient financial reporting. We have backed a global accounting system to provide investors with a common language to evaluate financial information and make rational decisions. Similarly, the Chamber has repeatedly called for the convergence of international auditing standards to provide a global yard stick to promote confidence in financial reports. Together, these developments would create a holistic, world-wide financial
reporting system, thereby promoting the ability of American businesses to efficiently raise capital and sell goods and services on an unprecedented scale. However, such a system will take years, if not decades, to create, and it will not itself provide for the requisite regulatory cooperation that is the subject of your hearing today.

Before I get to the issue at hand—the need for Chinese and American regulators to cooperate regarding financial reporting—it is important to understand that this impasse cannot be viewed in a vacuum.

The Great Depression was monumental in scale because trade protectionism seized up the international and domestic engines of growth. Today, the threat of regulatory over-reach across borders is threatening to create international barriers that may also harm long-term domestic and international growth. The proposed extra-territorial application of U.S. derivative regulations is raising alarm bells that may curtail international trade. Similarly, the French application of a financial transaction tax upon financial activities in the United States is also raising similar anxiety. A failure to reach an agreement will force the United States and China to take regulatory action that each will deem to be extra-territorial. All of these issues combined may undoe the efforts of the G-20 to enhance cross-border regulatory cooperation and prevent another financial crisis.

It is for these reasons that the Chamber and the American business community have become increasingly alarmed at the continued standoff between American and Chinese regulators to resolve the impasse over the sharing of audit work papers.

Failure to resolve this issue could result in significant economic harm to China and the United States, damaging the broader bilateral relationship.

In particular, failure to reach an agreement may leave the U.S. Securities and Exchange Commission (“SEC”) with little choice but to delist Chinese companies publicly traded in the United States as required by the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”). SEC action, in turn, would likely precipitate Chinese retaliation against American businesses operating in China. With $70 billion in direct investments in China, American companies operating in China are vulnerable to Chinese retaliation which could cause serious economic harm here at home.

Regrettably, a process is now underway that would lead to a worst case scenario for both sides. On some level this has already started. The SEC has instituted unilateral disciplinary proceedings against Chinese accounting firms for their failure to produce materials to the SEC. That failure is a direct result of explicit directives from the Chinese authorities that the firms not provide the materials. At some point soon,
those audit firms could face debarment from practice before the SEC. Because the Chinese companies will not be able to disclose financial statements audited by an accounting firm in good standing to practice before the SEC, the companies will effectively be prohibited from having their securities traded in the U.S.

Moreover, even if the Chinese do not retaliate, the SEC’s current litigation against the Chinese accounting firms could have significant and long-lasting impact on U.S. business interests. Large U.S. multinational corporations with significant operations in China may, just like Chinese companies whose securities are listed in the U.S., be unable to have their financial statements audited by firms in good standing to practice before the SEC. U.S. multinational parent companies must have their Chinese operations audited by Chinese licensed auditors and if their Chinese auditors have been barred by the SEC, those companies will not be able to produce consolidated audit financial statements. Let me emphasize that point—without the ability to have significant Chinese operations audited in China by Chinese licensed auditors and incorporated into the consolidated accounts of the parent company, audited financial statements suitable for filing with the SEC cannot be prepared. This would unnerve investor confidence, undermine the credibility of Chinese markets, and harm the capital formation of American businesses.

In short, both sides lose.

The Chamber believes that there are at least four incentives that should spur the two governments to reach an agreement.

First, the Chinese government has stated its commitment in the 12th Five-Year Plan to improving capital allocation through deeper, well-functioning capital markets and expanding the role of services in the economy to promote economic rebalancing and achieve sustainable long-term growth. To achieve these objectives, China needs stronger corporate governance and effective financial reporting policies that promote transparency in its capital markets. Willingness by the China Securities Regulatory Commission (“CSRC”) to share information on Chinese companies listed in the United States with U.S. regulators would indicate an increased commitment by the Chinese government to ensuring that listed companies, whether in China or the United States, are well-managed with reliable financial statements. An agreement would also be an important indicator of Chinese commitment to deepen reform and increase transparency of its domestic capital markets, which has been a long-term policy objective of the U.S. government. Conversely, failure to conclude an information-sharing agreement will feed the perception within China and globally that China’s capital markets are a parlor game thereby inhibiting stable access to capital for
their businesses causing a misallocation of resources that may harm the Chinese economy.

Second, with two-way capital flows continuing to increase exponentially, it is essential that the SEC and the CSRC, the market regulators of the world’s two largest economies, have agreements for information sharing that substantiate the credibility of market actors. In the increasingly interdependent U.S.-China economic and commercial relationship, neither regulator can have a full view of matters under its jurisdiction. A failure of the SEC, PCAOB, and CSRC to cooperate will allow bad actors to operate in the shadows, create regulatory dead-zones and provide opportunities for regulatory arbitrage.

Third, given the trend of rapidly increasing Chinese investment in the United States, Chinese companies, including large state-owned and state-supported enterprises, which are listed on U.S. exchanges, have an abiding interest in promoting increased transparency and information sharing between regulators. Action—or inaction—by the Chinese government that stymies information sharing between regulators can only serve to perpetuate questions about the corporate governance and financial statements of China’s emerging multinational companies that are striving to succeed in global markets, including the United States. The Chamber is committed to increasing two-way foreign direct investment between the United States and China. However, Chinese investment in the United States will become more challenging if U.S. regulators are blocked from accessing information on Chinese companies listed on our markets.

Accordingly, the Chamber has met privately with top leaders in both countries as well as senior officials at the SEC, the PCAOB, the Treasury Department, the CSRC, and the People’s Bank of China, to communicate our concerns and advocate a mutually satisfactory solution. In mid-December 2012, the Chamber’s senior vice president for international affairs Myron Brilliant and Center for Capital Markets Competitiveness’ CEO and president David Hirschmann sent a letter to then SEC Chairman Schapiro and CSRC Chairman Guo Shuqing, with copies to then Treasury Secretary Geithner and Chinese Vice Premier Wang Qishan, urging a bilateral agreement to avoid the significant damage that will occur if the dispute deepens (see attachment).

Fourth, a failure to reach bilateral information sharing agreements is also likely to cause other regulators, particularly in Europe, to more closely scrutinize Chinese financial reports. If they face similar roadblocks, they may be forced to take actions similar to the SEC, further undermining the credibility of China’s emerging class of multinational companies. Moreover, and as noted above, an intensification of this
dispute will give investors pause as they weigh investment opportunities in Chinese businesses listed abroad, thereby impairing their capital formation and credibility in global markets.

Currently, the ball is in the court of the Chinese government. The Chamber anticipates that new proposals will be exchanged later this spring following the conclusion of China’s National Peoples’ Congress. We are hopeful that the magnitude of what is at stake for both sides will allow the regulators to reach an expeditious solution.

An agreement between the SEC, PCAOB, and CSRC should be based upon existing structures and mutual recognition similar to other agreements that the United States has with its major trading partners. Such an agreement would also have to take into account Chinese law and the ability of the CSRC to regulate and oversee activities within its jurisdiction. The same can be said for Chinese recognition of U.S. laws and the SEC. Thereby, through its reciprocal nature, an agreement would give Chinese and U.S. regulators the ability to review information necessary to promote policies related to the safety and soundness of their financial markets. A failure to have such an information sharing agreement could touch off extra-territorial actions that are inherently protectionist in nature.

While auditing policies may not be the most exciting of topics, the Chamber and our members view resolution of this issue as a top priority in the bilateral relations. Beyond stemming the fallout from the ongoing dispute, a strong agreement between regulators to share financial information would signify important progress in China’s commitment to increasing transparency and strengthening corporate governance. This would increase trust in the bilateral economic relationship, thereby benefitting investors on both sides of the Pacific and laying the foundation for a stronger, mutually beneficial commercial relationship in the coming years. Failure to reach an agreement will only fuel mistrust and lead both nations down a path that will harm both economies and undermine investor confidence on both sides of the Pacific.

The Chamber will continue to vigorously advocate for an agreement that upholds the principles of effective regulatory policies and cross border coordination needed to promote capital formation on a bilateral basis. We stand ready to support the efforts of both governments toward that end.

I am happy to take any questions that you may have at this time.