Testimony Before the U.S.-China Economic & Security Review Commission
"China's Information Control Practices and the Implications for the United States"

Paul Dudek, Chief
Office of International Corporate Finance
Division of Corporation Finance
U.S. Securities and Exchange Commission

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Chairman Slane, Vice Chairman Bartholomew, and members of the Commission:

My name is Paul Dudek. I am Chief of the Office of International Corporate Finance in the Division of Corporation Finance at the U.S. Securities and Exchange Commission (SEC). The SEC is responsible for administering the U.S. federal securities laws. One fundamental purpose of these laws is to enhance investor protection by requiring issuers of securities that are publicly sold in the United States to provide complete and accurate information upon which investors can make informed investment decisions.

I am pleased to have the opportunity to discuss the SEC's role in overseeing the disclosure of public companies incorporated in, or having substantial business operations in, the People's Republic of China that seek to sell their securities in U.S. public capital markets. Before I outline the general regulatory scheme and how it applies to Chinese companies, I should note that my remarks represent my own views and not necessarily the views of the SEC, the individual Commissioners or my colleagues on the SEC staff.

Whether a company is domestic or foreign, absent an exemption from registration, it must file a registration statement with the SEC before it publicly offers and sells securities in the U.S. capital markets. After its offering, the company must comply with ongoing public reporting requirements through which it provides periodic information about its business, operations, risks, and financial performance and prospects. Although the filing and disclosure requirements for public companies that are registered with the SEC are largely the same for domestic and foreign companies, the SEC has adopted registration and reporting requirements for foreign companies that recognize the potential conflicting and multiple reporting burdens foreign companies can face when their home country disclosure requirements differ from SEC disclosure requirements. Furthermore, instead of requiring foreign companies to file the same quarterly and current reports that domestic companies file, the SEC requires foreign companies to file the same information they are required to disclose under their home country or exchange requirements, such as press releases, earnings announcements, reports of transactions by insiders, and interim reports. Despite these minor accommodations, like domestic companies, foreign companies must provide full and fair disclosure relating to, among other things, their business, their operations, the risks they face, and their financial performance.

In addition, regardless of whether a company is domestic or foreign, in providing disclosure, it must consider whether, based on the facts and circumstances, a misstatement or omission of a particular fact would be material to a reasonable investor. The Supreme Court has held that information is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available. Companies and their representatives have a strong incentive to make appropriate judgments about materiality in that they may face significant federal securities law liability for disclosure that includes material misstatements or omissions that make the information provided materially misleading. Furthermore, although the SEC does not permit companies to omit from their filings material information investors need to make informed decisions, it will consider requests for confidential treatment of other information, such as that which would competitively harm the company, and in turn, its investors, if the information were made public.

The SEC's Division of Corporation Finance has primary responsibility for overseeing disclosures by issuers of securities. On average, the Division reviews the disclosure of approximately 4,000 of the more than 10,000 public companies that file with the SEC each year. The Division conducts a full legal and financial review of nearly every initial registration statement filed with the Commission, whether under the Securities Act of 1933 or Securities Exchange Act of 1934, to monitor and enhance compliance with applicable disclosure and accounting requirements. In addition, the Division selectively reviews other registration statements, business combination transactions, proxy solicitations, and periodic reports. The staff's review presence does not stop there. As required by the Sarbanes-Oxley Act of 2002, the Division undertakes some level of review of each reporting company at least once every third year and it reviews a significant number of companies more frequently. The Division's review of foreign companies is part of its regular and systematic review of every company that files with the SEC.

The Division performs its primary review responsibilities through eleven offices, each of which has specialized industry, accounting and disclosure expertise. The Division assigns companies to one of these offices based on the company's predominate industry focus. This system allows Division's lawyers and accountants to develop industry expertise to better identify issues that are of particular concern to companies within an industry. The other offices of the Division are specialized by function rather than industry to support the Division's review responsibilities. For example, the staff of the Division's Office of Mergers & Acquisitions assists in the review of business combination transactions. Most relevant for this hearing, my own office, the Office of International Corporate Finance, assists in the review of registration statements and reports filed by foreign companies and foreign governments. Staff in my office will participate in the Division's review of an offering document filed by a foreign company and will evaluate the disclosure with a view towards the home country aspects of a particular foreign company. Otherwise, the review of foreign companies is no different than the reviews of domestic companies.

At the heart of the Division's review of filings is the comment process. As part of the review and comment process, the Division issues comments in the form of a letter to a company about the disclosure made in the company's filings and the comments may take into account other relevant publicly available information. The Division does not independently audit a company under review or examine its operations and the reviews do not include interviews with management or site visits.

Through the review and comment process, the Division may ask a company questions about its disclosure or for information to support the company's disclosure decisions. The Division may ask the company to enhance or clarify certain disclosures, to address inconsistencies within the document or with other publicly available materials, or to revise its disclosure to comply with the specific disclosure standards in the federal securities laws and regulations. Based upon the nature of a company's disclosure and the staff's comments on that disclosure, the staff may ask the company to change or add to disclosure in its publicly filed documents by amending its filings or may ask the company to provide additional disclosure in a future filing.

A company generally responds to a comment letter by providing a written response to the Division and, if appropriate, by amending the document under review. The staff relies on the company's responses to its comments and on the company's legal obligations to respond in a truthful manner. It is important to note that the legal, financial and accounting professionals who are involved in preparing and auditing the company's disclosures have professional obligations and may be subject to legal liability if the disclosures contain material misstatements or omit material information. While a company's response to staff comments will often satisfactorily resolve those comments, the staff will issue additional comments if further explanation or revision is appropriate or required.

When the Division completes its filing review, it will advise the company, by letter, that its review is complete or, if the filing is a registration statement the Division will, at the company's request, declare the registration statement effective, which means that the company is permitted to engage in the transaction covered by that filing and sell the registered securities. The staff will not take this action where it believes the disclosure is not materially complete, accurate, and meaningful. To provide complete transparency about the comment and response process, not less than 45 days after completing a review, the Division makes the filing review correspondence public by posting it to the SEC's Electronic Data Gathering, Analysis, and Retrieval system (EDGAR).

When conducting filing reviews, the Division does not evaluate the merits of a transaction or make any determination as to whether an investment is appropriate for any investor. Rather, the Division focuses on critical financial and non-financial disclosures that appear to conflict with SEC rules or applicable accounting standards or on disclosure that appears to be materially deficient in explanation or clarity. It is very important to note that the Division's review process is not a guarantee that the disclosure is complete and accurate. Responsibility for complete and accurate disclosure lies with the company and others involved in the preparation of the

company's filings – those that have full access and knowledge to the full scope of information which the company uses to make its disclosure decisions.

If, at any time during a review, the Division has significant concerns or becomes aware of information that suggests that a company may have violated the securities laws, staff in the Division of Corporation Finance may refer the matter to the SEC's Division of Enforcement. The Division of Enforcement has broad authority to investigate possible violations of the securities laws and may bring actions against a company if information in a filing proves to have been materially false or misleading.

This is the basic structure that governs the Division's review of filings by any domestic or foreign company that seeks to offer and sell publicly its securities in U.S. capital markets. Now that I have given you an overview of the Division's filing review process, I will discuss the topic you are most interested in, filings made by companies incorporated or having substantial business operations in China. As I noted earlier, more than 10,000 companies file annual and other periodic reports with the SEC. Approximately 950 of these companies are incorporated outside the United States, including about a dozen large companies incorporated in China and several dozen smaller companies that are incorporated in a foreign country outside of China (typically in the Cayman Islands) that conduct substantially all of their business operations in China. Some of these companies disclose substantial ownership by the Chinese government.

The Division's review of filings by companies based in China is consistent with its reviews of any other reporting company. Companies based in China are no less responsive to the staff's comments than other companies. Similarly, companies based in China are no less committed to defending their disclosure decisions. In the Division's view, a company based in China is just another company seeking to take advantage of the unsurpassed depth and liquidity of the U.S. markets and the role of the Division is to seek full and complete disclosure in accordance with the SEC's disclosure requirements.

The comments provided to Chinese companies are similar to those the staff gives to other companies, and in all instances, are designed to elicit improved disclosure on a number of matters, including material trends affecting the company's financial results and material risks to the company's business, such as foreign currency fluctuations and seasonality concerns. While risk discussions often address industry specific factors that could apply to any domestic or foreign company, companies from China typically address other factors as well, such as risks associated with state ownership, the increased role of the Chinese government in the Chinese economy, Chinese regulations restricting foreign ownership of a Chinese company in certain industries, and the less developed state of legal principles and the civil law structure governing business in China. As appropriate, the staff will issue comments to elicit better disclosure on the ongoing changes to Chinese business regulations.

In reviewing company disclosure, the Division of Corporation Finance does not generally reach out to the home country regulator for assistance in conducting the review. As I noted earlier, the Division's work is based on the documents filed with the SEC and the staff assesses compliance

with the applicable accounting and disclosure rules; the assistance of a foreign regulator is not necessary. However, when the Division of Enforcement conducts an investigation, there can be extensive assistance from a foreign regulator, since the SEC's compulsory processes are not effective in foreign countries. The SEC has information sharing arrangements with many foreign securities regulators, including those in China, which provide a framework for the sharing of information between regulators in their efforts to enforce their own securities laws.

In conclusion, I want to make clear that the U.S. federal securities laws require public companies, or companies seeking to become public companies, to provide full and fair disclosure that is materially complete and accurate so that investors in the U.S. markets can make informed decisions. While the SEC has, to a very limited extent, made certain accommodations in its disclosure requirements for foreign companies, these accommodations are not at the expense of investor protection. When it comes to investor protection and eliciting appropriate disclosure, Division staff does not treat companies incorporated, or having substantial business operations, in the People's Republic of China any differently than other companies – domestic or foreign. These companies must provide full disclosure about their business, their historical results, the prospects they seek, and risks they face in the locations they operate, including the risks the home country government, economy or business laws pose. And through the full disclosure program within the Division of Corporation Finance, the staff will ask companies to do so when it believes that they have not complied with both the letter and spirit of the SEC's disclosure requirements.

Thank you and I look forward to answering any questions you may have.