



**american securities association**

*America's Voice for Main Street's Investors*

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**Written Testimony Submission to House Financial Services Committee Hearing  
Entitled “Combatting the Economic Threat from China”**

February 7th, 2023

The Honorable Patrick McHenry  
Chairman  
Committee on Financial Services  
U.S. House of Representatives  
Washington, DC 20515

The Honorable Maxine Waters  
Ranking Member  
Committee on Financial Services  
U.S. House of Representatives  
Washington, DC 20515

Chairman McHenry and Ranking Member Waters:

The American Securities Association (ASA)<sup>1</sup> submits this testimony for the February 7, 2023 hearing of the House Financial Services Committee regarding economic threats to the United States posed by the Chinese Communist Party (CCP).

The ASA has been a leading voice and advocate when it comes to protecting American investors and the integrity of our markets from CCP-controlled companies that are rife with fraud or seek to do harm to the United States and our allies. The ASA commends the Committee for holding its first hearing of the 118<sup>th</sup> Congress on the threats posed by the Chinese Communist Party, which is an affirmation that Congress is ready to address this matter with the seriousness it deserves.

**Overview**

History suggests the free flow of global capital leads to more sustainable investment, helps lift people out of poverty, and brings transparency that strengthens the rule of law. The free flow of capital across borders also serves to strengthen relations among nations, which furthers international peace and stability. However, it is fair to ask whether an authoritarian regime that aggressively and coercively undermines the norms of the open international system adhered to by free societies should continue to reap the economic and financial benefits of accessing this system.

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<sup>1</sup> The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA’s mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.



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As China's great power competition with America intensifies, financial markets have become a frontline battleground. The Chinese Communist Party has methodically exploited the U.S. capital markets while sponsoring cybercriminals that steal the personal and financial information of Americans. This has helped fund China's rise while exacting heavy costs on American investors, the U.S. economy, and the integrity of the U.S. capital markets. This has resulted in a win-win for the Chinese Communist Party.

Thus, the paramount question before this Committee is: Should the Chinese Communist Party continue to access the U.S. capital markets to fund a military, cyber, and geopolitical strategy that undermines the economic and national security of the United States and establishes China as the world's preeminent power?<sup>2</sup>

### **Congress**

By passing the Holding Foreign Companies Accountable Act (HFCAA) in 2020 and the Accelerating Holding Foreign Companies Accountable Act (AHFCAA) in 2022, Congress made an important decision: No company based in China (or any other country) should be able to access our markets and list on U.S. exchanges if they do not comply with U.S. laws.

These HFCAA and AHFCAA are important and long overdue, but Congress, the SEC, and the PCAOB must all remain vigilant because the CCP will stop at nothing to fund its military and economic rise.

### **Bond Index Funds**

Registered investment funds that hold Chinese government bonds or track an index that includes these bonds facilitate a transfer of savings from America's working families, military service members, pensioners, and retirees directly to the Chinese Communist Party. Since modern day China is run as a "Party-State" and funds that flow to the CCP cannot be separated from Chinese industry, one can only assume that this money goes to underwrite everything the Chinese Communist Party touches.<sup>3</sup> This includes factories that use forced labor,<sup>4</sup> re-education camps for

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<sup>2</sup> <https://www.whitehouse.gov/wp-content/uploads/2021/03/NSC-1v2.pdf>. *Interim National Security Strategic Guidance*, March 2021, pg 8. "China has rapidly become more assertive. It is the only competitor potentially capable of combining its economic, diplomatic, military, and technological power to mount a sustained challenge to a stable and open international system."

<sup>3</sup> <https://www.asiatimesfinancial.com/ccp-announces-plan-to-take-control-of-chinas-private-sector> "President issues 'important instructions' to all regions to boost party control over private enterprise and rejuvenate the nation; all firms will need employees from the party to boost law abidance and moral standard".

<sup>4</sup> <https://thehill.com/blogs/congress-blog/homeland-security/522443-countering-chinas-forced-labor-practices>;





the Uyghurs,<sup>5</sup> the destruction of the environment,<sup>6</sup> the rise of its military,<sup>7</sup> and a cyber-army that relentlessly attacks the U.S. and other nations of the free world.<sup>8</sup>

The Committee should examine whether registered investment funds (i.e. mutual funds and exchange traded fund) that own these bonds or track an index that includes them should be available for sale in U.S. markets. As part of that analysis, the Committee should consider that two separate presidential administrations --one Democrat and one Republican-- in control of the U.S. government believe the Chinese Communist Party is committing 'crimes against humanity' and 'genocide' against its own people.<sup>9</sup>

Given the importance many institutional investors place on environmental and social issues, one would expect them to begin to divest their portfolios of any security associated with an authoritarian regime.<sup>10</sup> Until that occurs, the Committee should investigate whether the Chinese Communist Party's access to the U.S. capital markets through these bond funds poses direct economic and national security threats to the United States.

### **The "Passive Index Loophole"**

A regulatory loophole exists which allows passive index funds and index providers to direct American investor dollars into mainland Chinese companies by including them in international or emerging market indices. Inclusion in an index can lead to billions of dollars being steered into opaque Chinese businesses.<sup>11</sup>

Investors often have no idea that by investing in an index fund, they are sending their savings to Chinese companies that avoid basic disclosure, financial reporting, and governance standards or are controlled by the Chinese Communist Party. Many of these Chinese companies, especially

<sup>5</sup> <https://www.bbc.com/news/world-asia-china-51697800>; <https://www.reuters.com/article/us-hikvision-usa-uyghur/u-s-might-blacklist-chinas-hikvision-over-uyghur-crackdown-source-idUSKCN1SS28U>.

<sup>6</sup> *China's Engine of Environmental Collapse*, Richard Smith, Pluto Press, 2020.

<sup>7</sup> <https://www.cnn.com/2020/10/29/asia/us-election-us-military-indo-pacific-intl-hnk-ml/index.html>

<sup>8</sup> <https://www.cnbc.com/2020/07/07/fbi-chief-slams-chinese-cyberattacks-against-us-hudson-institute.html>;

<https://www.justice.gov/opa/pr/chinese-military-personnel-charged-computer-fraud-economic-espionage-and-wire-fraud-hacking>.

<sup>9</sup> <https://www.c-span.org/video/?509661-1/state-department-briefing&live> Biden State Department Spokesman Ned Price: "The PRC also has committed crimes against humanity in Xinjiang against the Uyghurs, who, of course, are predominantly Muslim, and members of other ethnic and religious minority groups, and that includes imprisonment, torture, enforced sterilization, and persecution."; <https://www.msn.com/en-au/news/other/pompeo-chinas-uyghur-policy-perpetrating-genocide-and-crimes-against-humanity/ar-BB1cTU6k>.

<sup>10</sup> <https://www.institutionalinvestor.com/article/b1qs5j405m2qtf/How-the-World-s-Largest-Asset-Managers-Are-Finally-Taking-ESG-Seriously>; *Interim National Security Strategic Guidance*, pg 20. "In many areas, China's leaders seek unfair advantages, behave aggressively and coercively, and undermine the rules and values at the heart of an open and stable international system."

<sup>11</sup> <https://oxfordbusinessgroup.com/overview/indexed-growth-inclusion-global-indices-often-results-greater-flow-funds-capital-markets-it-just-one>





those listed on mainland Chinese exchanges, have turned out to be frauds.<sup>12</sup> Investors have no real understanding of how the governance of a Chinese company functions, but one thing is clear: when the Chinese Communist Party wants to interfere in the company's business and force change, it does.<sup>13</sup>

As if ignoring these risks is not bad enough, index providers also include companies placed on the U.S. government Entity List, Department of Defense list of Communist Chinese military companies, and OFAC Sanctions List in their indexes. A company is generally placed on these lists if it is "acting contrary to the national security or foreign policy interests of the United States" or is a "threat to the national security, foreign policy or economy of the U.S."

A reasonable person might ask 'how could an American investor invest in a company on an exchange or through an index if it is a violation of American law to do business with that company?' We hope the Committee recognizes the absurdity of this reality and would support prohibiting any such company from trading in any financial product in the U.S. capital markets.

In November 2020, President Trump did just that by issuing Executive Order 13959, "Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies." This Order de-listed and de-indexed 31 firms trading in U.S. markets that are owned or controlled by the Chinese military. The Biden Administration has affirmed this Order, which establishes it as a template for how to prevent the Chinese Communist Party from coercing U.S. investors into sending their savings to fund China's military and economic rise. The SEC should go further and strip these companies of their registration so they cannot bypass the listing process and raise capital from unsuspecting American investors in the 'over-the-counter' private market.

Index-related issues require enhanced scrutiny because unregulated index providers can be subject to significant conflicts of interest when selecting index components.<sup>14</sup> The Committee should review the role index providers play in providing Chinese companies with access to the American capital markets and how their interactions with the Chinese Communist Party impact index inclusion or expansion decisions.

This Congress should close the 'passive-index loophole' by (1) forcing index funds to remove and exchanges to delist any Chinese company that is on the OFAC sanctions list, the U.S. Department of Defense list of Communist Chinese military companies, or the U.S. Department of Commerce 'entity list'; and (2) preventing index funds sold in U.S. markets from including

<sup>12</sup> <https://www.reuters.com/article/us-china-stocks-regulation-analysis/chinese-firms-missing-6-billion-tests-regulators-resolve-idUSKCN1SN00T>; <https://www.scmp.com/business/companies/article/3024084/why-kangmei-pharmaceutical-found-have-committed-one-chinas>; <https://finance.yahoo.com/news/one-theme-popping-among-chinese-154155487.html>.

<sup>13</sup> <https://www.cnn.com/2020/12/24/tech/alibaba-china-antitrust-investigation/index.html>; <https://www.asiatimesfinancial.com/ccp-announces-plan-to-take-control-of-chinas-private-sector>.

<sup>14</sup> <https://www.wsj.com/articles/how-china-pressured-msci-to-add-its-market-to-major-benchmark-11549195201>.





opaque and financially questionable Chinese companies listed on mainland Chinese or Hong Kong stock exchanges.

### **Protecting Investors from Fraudulent Chinese Companies**

The ASA is proud to have worked with members on both sides of the aisle on both the HFCAA and AHFCAA. Chinese companies that do comply with U.S. auditing standards will now be kicked off U.S. exchanges after two years, and investors are made aware of non-compliant companies through public lists maintained by the SEC and PCAOB. These laws send a clear message to any non-U.S. company that wants to list in the United States and access investor capital that U.S. laws matter.

On December 15, 2022, the PCAOB announced that for the first time it was able to fully examine audit firms headquartered in mainland China and Hong Kong.<sup>15</sup> While this is major progress, there is no guarantee that every Chinese company will be compliant with U.S. law or that the CCP will maintain its end of this agreement. As PCAOB Chair Erica Williams said when the agreement was announced:

*"Today's announcement should not be misconstrued in any way as a clean bill of health for firms in mainland China and Hong Kong. It is a recognition that, for the first time in history, we are able to perform full and thorough inspections and investigations to root out potential problems and hold firms accountable to fix them."*<sup>16</sup>

Accordingly, the ASA urges Congress to continue its oversight role regarding this matter and ensure that both the SEC and PCAOB are carrying out the HFCAA and the AHFCAA as intended and in a manner that will prevent further investor harm at the hands of the CCP.

### **Geopolitical/Military Investor Risk**

It may also benefit the Committee to examine the types of legal, political, reputational, or investor risks present when U.S. companies do business with the Chinese Communist Party specifically, or in China generally. At a minimum, it would be useful for American investors to understand the scope and potential cost of any liability that could arise from a U.S.-listed company doing business in China under U.S. law, international law, or otherwise.<sup>17</sup>

<sup>15</sup> PCAOB Secures Access to Inspect, Investigate Chinese Firms for First Time in History, available at <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-secures-complete-access-to-inspect-investigate-chinese-firms-for-first-time-in-history>

<sup>16</sup> *Id.*

<sup>17</sup> <https://www.justsecurity.org/74388/genocide-against-the-uyghurs-legal-grounds-for-the-united-states-bipartisan-genocide-determination/>; <https://www.washingtonexaminer.com/news/state-department-china-committing-uyghur-genocide-wont-say-if-ongoing>; <https://cja.org/what-we-do/litigation/legal-strategy/the-alien-tort-statute/>.







This understanding would be especially useful to investors if China decides to invade Taiwan and the U.S. government imposes sanctions that would prohibit American companies from doing business in China and with the CCP, as it did after Russia invaded the Ukraine.

### **Protecting Investors from the China Cyberthreat**

ASA reminds members of this Committee about an ongoing personal and financial privacy threat to every American investor: The vast collection of personal and financially identifiable information (PII) by the Consolidated Audit Trail (CAT).

Last summer, the SEC again delayed the timetable for key implementation provisions of the CAT. This was the latest delay in the decade-long CAT project, which has been plagued by delays, cost concerns and, most important, concerns regarding the collection of the PII of every American investor that trades a share of stock on a U.S. exchange.

For years, the ASA has called on the SEC to remove the collection of *any* PII from the CAT. While the ASA has generally supported the establishment of a market-wide monitoring tool for the SEC to address wrongdoing, there is no compelling reason whatsoever for the CAT to collect investor PII. The SEC has been able to bring enforcement cases for insider trading or other violations for years without collecting the type of information currently contemplated under the CAT, and it continues to do so today.

The CAT isn't just a top target for hackers and state-sponsored cyber entities from China and Russia, it's also the target for cybercriminals who wish to either access a treasure trove of information about millions of Americans or profit from nonpublic trading data. Individuals with access to CAT information will also become high value targets for state-actors and other criminals. Obtaining the PII of American citizens to blackmail them or force them to act as spies is a routine tactic in the statecraft used by our adversaries.<sup>18</sup>

Once the CAT is fully operational, it will become the largest, most vulnerable repository of investor PII ever created. The CCP and other state sponsors of cybercrime will inevitably capitalize on this opportunity to steal the sensitive personal and financial information of Americans to manipulate our markets or blackmail Americans.

If the SEC won't fulfill its duty to protect American investors from this threat by removing their PII from the CAT, then Congress is obligated to act. For these reasons, the ASA strongly supports the Protecting Investors' Personally Identifiable Information Act, introduced last Congress by Representative Loudermilk and Senator Kennedy.

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<sup>18</sup> <https://abcnews.go.com/Business/wireStory/us-charges-chinese-military-hackers-equifax-breach-68884240>





We hope that Congress will work on a bipartisan basis to take up this legislation early during the 118<sup>th</sup> Congress.

### **SRO Responsibility**

American investors rely on self-regulatory organizations (SRO) to carry out their regulatory obligations to protect investors and the market. As a result, this Committee may want to inquire how SROs can allow American investors to trade in any company or fund that includes a company that has not complied with U.S. laws or is named on an official U.S. prohibition list.

SROs have the full regulatory authority from the SEC to protect the U.S. investing public from non-compliant and militarily belligerent firms listing in the United States.

Congress may also want to raise questions with SROs about certain corporate governance mandates that apply to American companies but, strangely, do not apply to Chinese companies. The American people deserve to know why access to capital in the United States is more expensive for American companies than those from Communist China.

### **The Straw Man**

The Committee should be mindful of assertions that warn Congress or the SEC not to take action that prohibits American investors from buying Chinese securities in the U.S.<sup>19</sup> This group makes the absurd claim that any such action will be fruitless because investors will simply buy Chinese securities in other markets.

Those making these claims conveniently forget that institutional investors and asset managers at every level have a fiduciary duty of loyalty to those who entrust them with their savings,<sup>20</sup> and this obligation requires them to conduct diligence on any company or fund in which they invest. In China, the satisfaction of that due diligence requirement is impossible to undertake because the Chinese Communist Party won't allow it.<sup>21</sup>

### **Conclusion**

Twenty years ago, the consensus theory was that as China grew wealthier, it would become a responsible international stakeholder. Unfortunately, that theory never materialized. Today, Communist China seeks to become the world's dominant superpower. To realize that goal, the Chinese Communist Party needs access to Western capital. Those who still believe in the consensus theory are willing to facilitate that access because they profit from it. They will

<sup>19</sup> <https://www.wsj.com/articles/china-has-one-powerful-friend-left-in-the-u-s-wall-street-11606924454>.

<sup>20</sup> <https://www.americansecurities.org/post/asa-letter-to-wsj-real-audits-for-chinese-firms-listed-in-the-u-s>.

<sup>21</sup> <https://foreignpolicy.com/2019/02/07/we-cant-tell-if-chinese-firms-work-for-the-party/>.





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continue to put their own financial interests over the economic and national security interests of the United States until it is no longer legal or profitable to do so.

Loopholes and exemptions have allowed the savings of American investors to fund Chinese companies that are outright frauds, arms of the Chinese Communist Party, and/or engaging in activities that are hostile to American interests for far too long.<sup>22</sup>

A strong bipartisan consensus in Washington has emerged that wants to end the Chinese Communist Party's exploitation of our capital markets and her investors. This Committee can play an important role in passing the policy changes necessary to protect American investors and the integrity of the U.S. capital markets.

We look forward to working with members of the Committee on both sides of the aisle on these important issues.

Sincerely,

*Christopher A. Iacovella*

Christopher A. Iacovella  
Chief Executive Officer  
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<sup>22</sup> <https://healthymarkets.org/archives/2101>; <https://www.americansecurities.org/post/why-are-american-investors-funding-chinese-fraud>.



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