

# United States Senate

WASHINGTON, DC 20510

COMMITTEES:  
APPROPRIATIONS  
FOREIGN RELATIONS  
SELECT COMMITTEE ON INTELLIGENCE  
SMALL BUSINESS AND ENTREPRENEURSHIP  
SPECIAL COMMITTEE ON AGING

June 12, 2019

Mr. Henry Fernandez  
Chairman and Chief Executive Officer  
MSCI Inc.  
7 World Trade Center  
250 Greenwich Street  
New York, NY 10006

Dear Mr. Fernandez:

I write to request information regarding MSCI Inc.'s (MSCI) decisions to (1) include Chinese companies—such as Hangzhou Hikvision Digital Technology Co., Ltd; Zhejiang Dahua Technology Co Ltd; China Unicom (Hong Kong) Limited; AVIC Aircraft Co., Ltd.; and China Shipbuilding Industry Group Power Co Ltd—in MSCI equity indexes, and (2) increase the weighting of Chinese company shares in MSCI indexes. MSCI indexes, which are referenced by exchange traded products that are listed on U.S. exchanges, are made available for trading to American retail investors.

China's economy is purposefully opaque. The Chinese Communist Party uses state-owned, and state-funded enterprises to control its production and compete in global markets. It is no secret that the interdependent nature of the government-business relationship in China is designed to serve and further the Communist Party's mercantilist goals. To this end, Beijing continues to openly disregard the rules of responsible involvement in global capital markets, and actively shields Chinese companies listed for trading on U.S. exchanges from complying with American disclosure and transparency obligations. This contempt for, and indifference to, complying with U.S. laws puts American investors at risk.

The Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) have made clear that “for investors—both U.S. and non-U.S. investors—a U.S. listing carries with it the assumption that U.S. rules and regulatory oversight apply.” While the PCAOB regularly inspects audits of U.S.-listed firms at home and abroad, Beijing consistently and systemically challenges those efforts.<sup>[1]</sup>

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<sup>[1]</sup> SEC Chairman Jay Clayton, SEC Chief Accountant Wes Bricker, PCAOB Chairman William D. Duhnke III, *Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China*, U.S. Securities and Exchange Commission (December 7, 2018), <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other>

In fact, the SEC and PCAOB recently issued a joint warning to investors about the challenges that American regulators face when attempting to conduct oversight of U.S.-listed companies whose operations are based in China and Hong Kong.<sup>2</sup> This warning pointed out some of the glaring conflicts between U.S. and Chinese law, including how Chinese law requires the books and records of a Chinese company to remain physically in China.

The Communist Party has routinely used this law, as well as national security and state secrecy privileges, to restrict U.S. regulators from obtaining the basic accounting information of Chinese companies.<sup>3</sup> This is just one example of how the Communist Party's disdain for complying with U.S. laws is designed to hide the truth from America's retail investors. These purposeful efforts severely undermine the disclosure and transparency requirements that have made the American capital markets the deepest and most liquid in the world.

In its 2017 annual report to Congress, the U.S.-China Economic and Security Review Commission stated that "U.S. regulators have struggled to deter sophisticated efforts by some Chinese companies to defraud U.S. investors" and cited a report by GeoInvesting, a financial information website focused on small-cap stocks, that "found [that] China-based companies have perpetrated dozens of frauds on U.S. exchanges totaling at least \$5 billion in losses."<sup>4</sup> The dangers of fraud and deceit are far more severe for companies listed on Chinese exchanges. This past April, Kangmei Pharmaceutical Co., a Chinese company included in certain MSCI global indexes, admitted to falsely overstating the value of its cash holdings by approximately \$4.4 billion.

Chinese industrial policy, notably the Made in China 2025 plan, expressly seeks to supplant the U.S. as the global leader in innovation and manufacturing, devastating the American workforce in an effort to place the Communist regime in Beijing, notorious for its surveillance of its citizens and prevalent human rights abuses, at the helm of the global political order. Increasing the percentage weighting of China A shares in MSCI indexes provides an imprimatur that investing in these shares is acceptable. In reality, what MSCI is doing is allowing the Chinese Communist Party controlled market, and its state-owned national champion companies, to access a critical source of capital and clothe itself in a façade of legitimacy.

As you are well aware, the inclusion of the equity of a company into an index can significantly increase the flow of retail and institutional investor money into that company. Given China's willingness to openly flout U.S. laws and its stated intentions to displace American industrial leadership, MSCI's decision to include Chinese companies in its indexes raises serious questions and concerns about the quality and depth of the diligence undertaken throughout its decision-making process.

Accordingly, I ask that you provide my office with responses to the following:

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<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

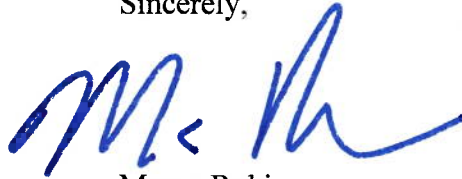
<sup>4</sup> U.S.-China Economic and Security Review Commission. (2017). *2017 Report to Congress of the U.S. China Economic and Security Review Commission*. U.S. Government Publishing Office.

1. Please provide the criteria, beyond what is listed publicly on your website, used to make the decision to include Chinese companies in MSCI indexes.
2. In conducting diligence on Chinese companies included in MSCI indexes, did MSCI ascertain the following information with regard to:
  - a. the identity of the holders of company debt;
  - b. the identity of the owners of company equity;
  - c. any involvement of the owners of equity, debt, or other financial products with the Chinese government or Communist Party and whether any such involvement would allow the Chinese government or Communist Party to assert influence and/or control over the company;
  - d. the relationship between the company and the Chinese government's military and intelligence services, including whether the company, for example, has served as a contractor to the People's Liberation Army (PLA) or Ministry of State Security (MSS);
  - e. the relationship between the company and the Chinese government's systemic and egregious human rights abuses and its creation of high-tech policing and surveillance systems in the Xinjiang Uyghur Autonomous Region; and
  - f. the existence of any past national security or human rights-related abuses by the company (and any of its subsidiaries), including any direct or indirect information that MSCI reviewed linking the company to:
    - (1) illegal island-building and militarization in the South China Sea;
    - (2) militarily-relevant support for North Korea;
    - (3) violations of U.S. sanctions or international sanctions;
    - (4) known cyber hackers or perpetrators of intellectual property theft;
    - (5) advanced weapons manufacturers;
    - (6) ballistic missile proliferators;
    - (7) acts of espionage; and
    - (8) any other abuses that would contravene international norms?
3. In making the decision to increase the weighting of shares in the China A International Index (A-Shares Index), did MSCI face any direct or indirect pressure from (a) large financial institutions, including those on Wall Street, or (b) from the Chinese government and Communist Party?
4. MSCI acknowledges that 58 percent of the constituents in the A-Shares Index are controlled by the Chinese state.

- a. How does MSCI ensure retail investors, in America and other countries, know that any investment they make in an exchange traded product, which references the A-Shares Index, is or has the potential to be a direct capital transfer to the Chinese government and Communist Party?
- b. Has MSCI performed the due diligence necessary to ensure that investments made in an exchange-traded product, which references A-Shares Index, are not used to further the Made in China 2025 plan or similar industrial policies?

I remain committed to ensuring American investors are better informed about their exposure to the financial risks, including material and asymmetric risks, of any direct or indirect investment they make in Chinese companies. I also remain devoted to preventing Chinese companies that flaunt investor protections from entering and remaining in our capital markets. As Congress considers these important matters, I look forward to your timely reply.

Sincerely,



Marco Rubio  
U.S. Senator

CC: Secretary of the Treasury Steven T. Mnuchin  
Securities and Exchange Commission Chairman Jay Clayton