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SEC Scrutiny Awaits Chinese, Foreign Companies Operating in U.S.

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The Bottom Line

- The SEC's cross-border task force signals an intent to crack down on malfeasance by foreign businesses, particularly in China.
- Redefining who is a foreign private issuer will balance market attractiveness with greater regulation and oversight.
- SEC Chairman Paul Atkins is continuing a decade-long tradition by the commission to try tightening regulations on China.

Recent enforcement and rulemaking efforts by the U.S. Securities and Exchange Commission demonstrate a clear focus on foreign companies and their gatekeepers.

The SEC's creation of the Cross-Border Task Force, along with statements by SEC Chairman Paul Atkins, signal the SEC will target enforcement efforts on potential securities laws violations of foreign companies as well as their auditors and underwriters. The SEC also is considering changing the definition of a foreign private issuer, which could trigger more regulatory oversight of foreign companies operating in the U.S.

Task Force Launch

The [creation](#) of a Cross Border Task Force highlights several SEC enforcement priorities under Atkins and Enforcement Director Margaret Ryan, including cracking down on materially false and misleading disclosures, accounting fraud, insider trading, and market manipulation.

The task force announcement references market manipulation in the form of "pump-and-dump" and "ramp-and-dump" schemes, emphasizing the SEC's focus on fraud and market manipulation by foreign issuers and their gatekeepers.

These schemes often involve individuals either spreading false or misleading information, or trading in stock market manipulation, that will drastically increase stock prices. This allows individuals to sell at an inflated price, which then typically causes a stock price collapse that leaves other investors with unrecoverable losses.

The announcement comes on the heels of the Department of Justice's [reprioritization](#) of Foreign Corrupt Practices Act [enforcement](#) to focus on potential violations of foreign-based companies operating in the U.S. that may put domestic companies at a disadvantage in those foreign jurisdictions. We think the SEC may follow suit.

While the announcement was aimed broadly at companies from foreign jurisdictions that may “pose unique investor risks,” the only foreign jurisdiction expressly named was China. Singling out China follows recent regulatory focus on China-based companies in likely forthcoming rulemakings by the SEC and Nasdaq Stock Market relating to higher listing standards for companies principally operating in China.

Since 2020, the staff of the SEC Division of Corporation Finance has raised concerns and provided guidance calling for, among other things, more prominent, specific, and tailored disclosures by companies based in or with the majority of their operations in China. Recently, FINRA [announced](#) that it is conducting a review of member firms that have been involved in initial public offerings for small-cap, foreign companies between January 2023 and September 2025. The announcement named China as an example of a foreign jurisdiction with businesses being reviewed.

Atkins pulled together these threads during a Sept. 10 [speech](#) about the SEC’s cross-border enforcement priorities and the role of gatekeepers. He noted, however, that “we should not lose sight of the bedrock beneath any effective regulatory regime: High-quality accounting standards and financial materiality.”

He said recent EU laws, such as the Corporate Sustainability Reporting Directive and the Corporate Sustainability Due Diligence Directive—as well as the International Sustainability Standards Board, a new board under the International Financial Reporting Standards Foundation—may divert this focus.

Atkins emphasized the need for a global focus on reducing nonessential reporting burdens. U.S. businesses need clear rules so they can thrive and “work strategically with international partners who share our commitment to innovation and to regulatory clarity” in relation to cryptocurrency and artificial intelligence, he said.

FPI Definition Revisions

The SEC also made clear it’s looking to strengthen guardrails on foreign companies that seek to list their securities in the U.S. and [published](#) a concept release in June soliciting comments on potential changes to the definition of foreign private issuers.

Foreign portfolio investments benefit from certain accommodations and exemptions from U.S. disclosure, governance, and filing requirements. Known as FPIs, they are broadly defined as foreign companies whose ownership is held more than 50% by non-U.S. residents or whose board and management is majority foreign, majority of the assets are outside the U.S., and the business is administered principally outside of the U.S.

Atkins said that “[a]ttracting foreign companies to U.S. markets and providing U.S. investors with the opportunity to trade in those companies” must be balanced against other considerations, such as providing material information about these foreign companies and ensuring U.S. regulatory requirements don’t competitively disadvantage domestic companies.

To do this, the SEC must first determine which foreign companies should qualify as FPIs and thereby avail themselves of the accompanying special accommodations.

The SEC’s potential changes to the FPI rules include updating existing eligibility criteria, implementing foreign trading volume requirements, requiring FPIs to be listed on a major foreign exchange, incorporating an SEC assessment of the foreign regulation applicable to the FPI, establishing new mutual recognition systems, and/or requiring foreign jurisdiction information sharing arrangements with the U.S.

Given that many existing FPIs are in jurisdictions with limited regulations, some proposed updates to the FPI definition aim to eliminate perceived regulatory loopholes used by the current FPI population. For example, the SEC has focused on China-based companies that are incorporated in the Cayman Islands when the majority of their trading volume is occurring in the U.S.

History as Instruction

For at least the last decade, SEC chairs have discussed the balance between regulatory oversight of foreign issuers and maintaining a focus on the global market to drive innovation, economic growth, and job creation. China-based issuers and auditors have consistently been in the spotlight during that time.

Chair Mary Jo White (April 2013-January 2017). White acknowledged “the role of the SEC in an increasingly global financial and regulatory system” in her [first speech](#) as SEC chair in 2013 and noted in 2016 that the “centrality of international issues to financial regulation and the SEC ha[d] not changed during the last three and a half years.”

She also [established](#) a cross-border working group similar to the cross-border task force, focused on accounting fraud cases against foreign issuers participating in the U.S. capital markets. The [cases brought](#) were nearly all standalone SEC cases against issuers, officers, directors, and auditors.

The working group was the impetus behind several [investigations](#) of China-based issuers, particularly focusing on businesses that accessed US markets through reverse takeover transactions.

In June 2013, private equity investors considering take-private transactions of these kinds of companies were particularly interested in this enforcement agenda. The SEC also individually pursued senior executives allegedly behind these frauds, making it particularly risky to conduct take-privates when the target’s executives were slated to remain with the entity.

Chairman Jay Clayton (May 2017-December 2020). Clayton supported the [release](#) of the Report on Protecting United States Investors from Significant Risks from Chinese Companies and thereafter directed the SEC staff to provide assistance to investors as appropriate and draft proposals in accordance with the recommendations. Enhanced exchange listing standards was seen as particularly important, as was providing the Public Company Accounting Oversight Board with access to audit work papers.

Chair Gary Gensler (April 2021- January 2025). Gensler galvanized the PCAOB during his term to [ensure](#) that, for the first time, Chinese authorities would allow the PCAOB to inspect and investigate audit firms in China in accordance with U.S. standards as required under the Sarbanes-Oxley Act.

In 2022, the PCAOB [announced](#) it could investigate issuer audit engagements of PCAOB-registered public accounting firms headquartered in China and Hong Kong. If Chinese authorities stopped offering complete access to the PCAOB, the SEC would prohibit trading in the securities of issuers who engaged those audit firms.

While this initiative addressed the ability to access these audit firms, it didn’t address the quality of the audits taking place, and several deficiencies were identified.

The PCAOB made recommendations to these audit firms and required “specific and prominent disclosures about the heightened operational and legal risks” faced by Chinese-based companies in U.S. markets. These disclosures included the extent of governmental ownership, any Chinese Communist Party participation, and risks associated with the China-based variable interest entity structure.

Key Takeaways

As foreign-based issuers, their auditors, and other gatekeepers evaluate the latest SEC developments, they should prepare for scrutiny and potential rule changes. This includes examining disclosures, internal controls, and risk management to ensure disclosures are accurate, consistent, and substantiated with supporting documentation.

Issuers should prepare for greater scrutiny by gatekeepers such as auditors, accountants, and underwriters when seeking to access the U.S. capital markets in response to renewed focus on the gatekeepers' roles in working with foreign companies.

The gatekeepers particularly will be looking for indications of fraud, insider trading, rapid changes in stock price and accounting, disclosure, and/or controls issues. Gatekeepers such as auditors and underwriters of foreign issuers should continue to follow robust internal processes to mitigate the risk of this enhanced scrutiny.

Despite the dearth of guidance for jurisdictions other than China, foreign issuers should review and consider how such guidance could apply to companies in other foreign jurisdictions, where applicable, based on the principles raised.

It will be important to monitor developments on definitional changes to FPI as proposed by the SEC. While a transition period for any adopted changes is likely, certain changes could require significant work or lead time.

Understanding potential effects of the proposed changes to the FPI definition on current offering, reporting, and corporate governance obligations is crucial. For example, more U.S.-listed foreign companies may no longer qualify for the [Exchange Act Rule 12g3-2](#) exemption and become subject to SEC reporting requirements.

While the SEC won't stop policing misconduct of U.S.-based companies, these steps clearly reflect a prioritized focus on foreign-based companies, which will play out over the next several years.

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If you have questions concerning the contents of this alert, or would like more information, please speak to your regular contact at Weil or to any of the following:

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