The Dilemma of Cross-border Financial Supervision—Based on the Operational Analysis of China’s New Securities Law

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Abstract. With the new securities regulatory law promulgated by the Securities Regulatory Commission coming into force on March 1, the long arm jurisdiction clause in the new securities law of China has come into force. The entry into force of the legal clause provides legal sanctions for the examination and approval of the financial fraud event of Lucky Coffee. However, the current long arm jurisdiction clause has only its framework content, and the lack of detailed rules for its implementation increases the difficulty of legal implementation. This paper analyzes the domestic and foreign regulatory laws of the Lucky Coffee case, and analyzes the imperfections of the current securities law and cross-border in China, and puts forward feasible suggestions for better protecting the rights and interests of investors at home and abroad, and improving the current cross-border financial supervision in China.

1. Legal Background and Case Introduction
The "Securities Law of the People's Republic of China (Revised Draft)" is the new securities law, which was reviewed and passed on December 28, 2019, and came into force on March 1, 2020. The current new securities law conforms to the current trend of market globalization and capital globalization, and refers to international investor protection practices. In response to the current new financial situation, illegal cross-border financial transactions and other phenomena, the new law first proposes "long-arm jurisdiction" to cope with new situation and protect investor interest. Those stocks and trading activities issued outside the People's Republic of China disrupt the order of the domestic market and damage the legitimate rights and interests of domestic investors will be held accountable.

The promulgation of this clause provides a certain degree of legal support for the handling of the current Luckin Coffee incident, and has changed the phenomenon of lack of overseas supervision laws in the past. However, whether this law is applicable to the Luckin incident is still a major controversy. The current lack of corresponding implementation rules for this clause has also created a certain degree of difficulty for the actual operation of the law[1].
In contrast to the Luckin Coffee incident, on April 2, Luckin Coffee chose to explode financial fraud under pressure from Ernst & Young Hua Ming, and regulatory agencies such as the China Securities Regulatory Commission (CSRC) and the United States Securities and Exchange Commission (SEC) made separate solemn statement. Stern statement and series of responses. The total sales of Luckin Specialty Coffee’s stocks that began to conduct counterfeit transactions in the second quarter of 2019 totaled approximately 2.2 billion yuan, which caused the stock price of Luckin Coffee to fluctuate sharply in the morning, with a drop of 80%, from 26.2 per share. The U.S. dollar fell to 4.6 U.S. dollars. This is undoubtedly the biggest fraudulent transaction event in China's Concept Stock Market, which has brought a huge credibility crisis to China’s Concept Stock Market.

After the financial fraud broke out, what is waiting for Luckin Coffee will be a class action lawsuit by foreign investors and penalties by the United States Securities Regulatory Commission (SEC). The company and its senior management will face the legal risk of bearing huge civil claims.

But behind Luckin Coffee’s fraud, the protection of investors’ rights, and how Chinese companies should be governed after they go public in the United States, this series of follow-up issues are worth discussing. The current problems need to be improved to prevent them. With the globalization of capital operations, domestic long-arm jurisdiction clauses will continue to be improved over time, and continue to be refined to meet the need of current capital operations[2].

2. The "Long Arm Jurisdiction" Dilemma of the New Securities Law

Lacking of specific implementation rules in the law and extraterritorial jurisdiction regulations are general. The new "Securities Law" came into effect on March 1, 2020, and its newly added "long-arm jurisdiction" clause is to respond to the current capital globalization, and cope with the trend that Chinese-funded companies' listing in the United States. However, the current corresponding legal clauses only have the corresponding legal framework content, and the lack of legal interpretation of its implementation rules makes it difficult for law enforcement agencies to conduct corresponding investigations.

Article 2 Paragraph 4 of the Securities Law: The sale and transaction of securities outside the People's Republic of China disrupts the domestic market order of the People's Republic of China and damages the legitimate rights and interests of domestic investors. They shall be dealt with and investigated in accordance with the relevant provisions of this Law. Whether or not the clause sets forth two criteria for the management of the issuance and trading of overseas securities, whether it interferes with the domestic market order and whether it causes damage to the legitimate rights and interests of domestic investors. Judgment based on these two standards has become the key to whether to pursue legal responsibility. The "Securities Law" has added this paragraph to provide the possibility for the securities regulatory authorities to crack down on illegal activities in overseas securities to protect the legitimate rights and interests of domestic investors[2]. However, in the Luckin coffee incident, the issues applicable to this paragraph have the following two aspects:

According to the specific provisions of Article 2(4) of the Securities Law, judging whether the jurisdiction is a substantive interest, in essence, depends on the actual interest involved in applicability. It means whether it constitutes "disturbing the order of the domestic market or harming the legitimate rights and interests of domestic investors". However, there is currently a lack
of corresponding judicial interpretations, and there is no quantitative standard at the time that damages the legitimate rights and interests of investors, making law enforcement more difficult.

Integrating with statement on April 3, the China Securities Regulatory Commission issued a statement on overseas Chinese concept stocks for the first time. It will be verified in accordance with the law. Luckin Coffee is registered in the Cayman Islands and registered by overseas regulatory authorities to issue securities, and is listed on the Nasdaq stock market in the United States. Listed in accordance with the cooperation arrangement of the International Securities Regulatory Commission. Luckin Coffee is listed on the U.S. stock market and adopts the structure of vie (variable interest entity, that is, agreement control, variable interest entity). Therefore, it is not a Chinese company in nature. Its financial fraud occurred in the US stock market.

Based on the registration place and listing structure of Luckin coffee, the view that China has jurisdiction over the Luckin coffee case is currently controversial in academic circles. It is believed that the China Securities Regulatory Commission's view of its jurisdiction is based on the expanded interpretation of the current securities market. Both the general domestic market economic environment can be called the domestic market order, but in accurate and strict sense, because Luckin coffee is listed overseas, the extent of the substantial damage to the interests of domestic investors by its fraud incidents is difficult for domestic regulatory agencies to understand. Whether long-arm jurisdiction is implemented and whether it meets the implementation of extraterritorial jurisdiction is subject to question[4].

In summary, the essence of this article is just a formal provision, which provides the possibility for the Securities Regulatory Commission to extend its arms abroad in the future. At the moment when this clause is just introduced, there is no applicable Reality and feasibility.

2.1. The Dilemma of Cross-border Collaborative Supervision

Although China has established multi-modal cross-border supervision cooperation, international cooperation and cross-border supervision are more difficult. At present, China securities cross-border regulatory cooperation is mainly divided into multilateral and bilateral regulatory cooperation. Multilateral regulatory cooperation is realized through global and regional regulatory cooperation, while bilateral regulatory cooperation is realized through judicial assistance or a memorandum of understanding[3]. The two parties' regulatory cooperation model is detailed below.
Due to the differences in China's political, economic, and cultural factors, the authority and management system of China's regulatory agencies are significantly different from those of foreign countries. The unequal authority of regulatory agencies has affected the breadth, depth and effectiveness of international cooperation in securities supervision to a certain extent. For example, the authority of the China Securities Regulatory Commission is quite different from the United States Securities Regulatory Commission. The enforcement authority and types of enforcement in the China Securities Regulatory Commission are too few. The United States Securities Regulatory Commission sec has compulsory summoners in the law enforcement process, applying for investigation orders, prosecution rights, and criminal cases[3]. The transfer rights, administrative fines and other powers, the law enforcement is more flexible.

In the Luckin incident, the China Securities Regulatory Commission issued a statement on April 3 that China will verify relevant matters in accordance with the cooperation arrangements of the International Securities Regulatory Commission. Article 177 of the current new Securities Law makes it clear that the Securities Regulatory Commission can discuss with other international or regional securities regulatory commissions. Establish a cross-border management cooperation mechanism for supervision and management.

In contrast to the history of cross-border financial supervision, as early as April 1994, the China Securities Regulatory Commission and sec signed a relevant cooperation agreement. The cooperation was upgraded in 2006. The key issues of the previous company's financial report were particularly emphasized in the cooperation clause. So far in November 2020, the China Securities Regulatory Commission has reached a memorandum of understanding with 64 countries or regions including the United States and Singapore, and jointly signed securities regulatory cooperation with the United States and Singapore. In addition, the China Securities Regulatory Commission actively participates in cooperation with international organizations, such as participating in a number of framework cooperation such as the World Bank and the WTO.

Regarding the bilateral agreement on securities regulatory cooperation between China and the
United States, the memorandum of understanding between China and the United States can be traced back to the "Memorandum of Understanding on Sino-US Securities Cooperation, Consultation and Technical Assistance" signed in 1994, and most recently it was the Ministry of Finance and the China Securities Regulatory Commission, they signed in 2013 about the law enforcement cooperation memorandum. The details of the memorandum of understanding and cooperation agreement signed between China and the United States are shown in the table below.

Table 1. China-US Memorandum of Understanding and Cooperation Agreement.

<table>
<thead>
<tr>
<th>Document Name</th>
<th>Time</th>
<th>Signed object</th>
</tr>
</thead>
<tbody>
<tr>
<td>Memorandum of Understanding on Futures Regulatory Cooperation</td>
<td>2002-01-18</td>
<td>U.S. Commodity Futures Trading Commission</td>
</tr>
<tr>
<td>China Securities Regulatory Commission and the United States Commodity Futures Trading Commission Cooperation Terms</td>
<td>2008-02-12</td>
<td>U.S. Commodity Futures Trading Commission</td>
</tr>
<tr>
<td>Agreement between the United States and China for Inspection</td>
<td>2012-09-21</td>
<td>Public Company Accounting Oversight Board</td>
</tr>
<tr>
<td>Memorandum on Law Enforcement Cooperation</td>
<td>2013-05-07</td>
<td>Public Company Accounting Oversight Board</td>
</tr>
</tbody>
</table>

In general, although China’s cross-border regulatory cooperation involves a variety of cooperation methods, according to the "Memorandum of Understanding Guidelines" promulgated by IOSCO in 1991[3], the cooperation methods for the further establishment of bilateral cooperation memorandums of understanding are the most common, but effective cooperation methods are relatively quit few. For example, the "Memorandum of Understanding on Sino-US Securities Cooperation, Negotiations and Technical Assistance" only stated in general terms: "The competent authorities hereby express their intention to provide assistance to each other in obtaining information and securities materials in order to implement their own securities laws and regulations." The memorandum of understanding usually has less content on the scope of operation and lacks targeted and forward-looking realizable regulations.
3. Policy Recommendations

3.1. Improving Overseas Regulatory Regulations of the Securities Law

At present, China’s financial regulatory laws and mechanisms are in urgent need of improvement. The Luckin case occurred in the United States, China's concept stocks and related laws for overseas listings now need detailed supporting laws to resolve. The long-arm jurisdiction clause of the new securities law only has basic jurisdiction cogitation, many clauses need to be more detailed and specific to enhance their practicality[3]. Corresponding legal interpretation have to publish as soon as possible to prompt its enforcement. All regulations should be improved as soon as possible to determine the scope of application of this law. The author believes that the relevant regulations of specific jurisdictions should be quantified, and similar principles or standards can be referred to, such as the "effect standard" of the extraterritorial jurisdiction of the US securities law, or similar provisions of the extraterritorial jurisdiction of the US securities law to better judge the application of the law range.

3.2. Promote the Mutual Recognition System of International Equivalent Independent Audits

The mutual recognition system of independent audit means that both parties believe in the audit rules between countries and can trust the final audit results, which is more convenient for supervision and reduces the repeated audit of supervision resources. It is also conducive to an efficient international audit system and makes supervision implemented efficiently. The European Commission (European Commission), which recognizes the equivalent of third-country audit regulatory systems, passed a resolution in February 2011, recognizing for the first time in history that a total of ten third-country audit regulatory systems are equivalent. This resolution is beneficial to strengthen the path of financial cooperation between EU member states and declared equivalent third countries, making them mutually dependent on self-regulated accounting firms.

3.3 Enhancing the Law Enforcement Power of the China Securities Regulatory Commission and Strengthening Bilateral and Multilateral Regulatory Cooperation

At present, China's Securities Law is not clear enough on the definition of the authority of enforcement agencies. There are no clear provisions on the scope of cross-border supervision cooperation rights, the specific procedures and exercise methods of restrictions on supervision cooperation rights. Clear and strong supervision authority is a necessary condition for improving efficiency supervision. Under the premise of multiple cooperative supervision, the law enforcement power and scope of domestic supervisory agencies should be improved to better cooperate and help overseas supervisory agencies to conduct investigations. Currently, China’s Securities Regulatory word should base on the relevant work benchmarks of IOSCO, according to the current development of the domestic securities market, Implement relevant work to coordinate to maintain the domestic market order, deepen bilateral cooperation, and sign more depth of cooperation. The specific and operational memorandum aims to strengthen the supervision of the two countries, strengthen the disclosure of cross-border financial information, and reduce the occurrence of financial fraud.

References


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