

The Impact of Multi-Level Capital Markets on The Business Transformation of Small and Medium-Sized Investment Banks Under the Beijing Stock Exchange Policy

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Abstract: The Beijing Stock Exchange (BSE) was incorporated on 3 September 2021 as the first corporate stock exchange in China, approved by the State Council and supervised by the China Securities Regulatory Commission. The BSE is designed to serve innovative small and medium-sized enterprises (SMEs), especially the "specialized and new" small giants, and to develop and interconnect with the Shanghai and Shenzhen Stock Exchanges and regional equity markets to form an institutional arrangement that suits the characteristics of SMEs and to explore the path of financial inclusion through capital market support for technological innovation of SMEs. Building a multi-level capital market so as to better serve the real economy is an important goal in the construction of China's capital market, and the establishment of the BSE is an important milestone. In the future, how small and medium-sized brokerage firms will make use of the policy opening brought by the BSE to strengthen the expansion of the corresponding business segments has become a key research direction. This paper will focus on the construction of China's multi-level capital market, compare it with the establishment of the US capital market, study the development path of China's capital market, and thus analyse the transformation path of Chinese small and medium-sized brokerage firms to seize the opportunities of the times.

Keywords: Multi-level capital market, NSE, Small and medium-sized brokers, OTCBB, Transfer mechanism.

1. Introduction to the Fundamentals of The Multi-Tiered Capital Markets in The US and China

1.1. Multi-Level Capital Markets in The US and China By Board

The US capital market system is the largest and has the most complex and rational system. The multi-tiered nature of the US capital markets is reflected in the stratification of the OTC and OTC markets, as well as the stratification of the different segments of the exchanges. The OTC market consists of national exchanges and regional exchanges; the OTC market is more diverse, divided into alternative trading systems ATS, OTC market OTC, and special OTC.

China's capital market has developed since the 1990s and is made up of two parts: the over-the-counter (OTC) market and the capital market over-the-counter (OTC) market. The main board of the OTC market (including the Small and Medium-sized Board), the Science and Technology Innovation Board and the Growth Enterprise Market (commonly known as the Second Board), and the National Small and Medium-sized Enterprise Stock Transfer System (commonly known as the New Third Board), the regional equity exchange market and the counter market dominated by securities companies, together form the multi-level capital market system in China.

1.2. Comparison of the Levels of The Chinese and US Multi-Level Capital Markets

1.2.1. Multi-Tiered Capital Market Structure in the US

Tier 1: Consists of the New York Stock Exchange (NYSE) and the NASDAQ Global Select Market (NASDAQ SM) and

the NASDAQ Global Market (NASDAQ GM i.e. formerly National Market), with higher listing standards, mainly for a national market for super multinational corporations.

The NYSE became the world's largest exchange in 2007 when it acquired Euronext in Europe, and in 2008 when it acquired the All American Stock Exchange (AMEX). The NASDAQ market was further restructured into three tiers: the NASDAQ Global Select Market, the NASDAQ National Market and the NASDAQ Small Capital Market; primarily to create a higher listing standard within the NASDAQ market for the Global Select Market to compete directly with the New York Stock Exchange.

Level 2: The NASDAQ Small-Cap Market (NASDAQ-SC) is a national marketplace for US high-tech companies and US SMEs. Commonly known as the Little Board or Curb Board, the NASDAQ-SC is the world's largest exchange for ETFs and the second largest exchange for stock options (warrants) in the US.

The Nasdaq Small Capital Market, a market dedicated to the listing of small and medium-sized high-growth companies in the United States, has low listing requirements to meet the listing requirements of innovative companies characterised by high risk and growth. Most of China's online technology companies are listed on this market.

Level 3: Constructed by regional exchanges such as the Cincinnati Stock Exchange, the Chicago Stock Exchange, the Philadelphia Exchange, the Boston Stock Exchange, the Midwest Exchange and the Pacific Exchange, it is a market that primarily trades local corporate securities.

Level 4: Composed of the OTCBB, the Pink Sheets Market and the Grey Market, which is part of the Third and Fourth Markets, it is an over-the-counter market primarily for the trading of securities of small companies in the U.S. The

OTCBB has a very low threshold compared to other major U.S. stock exchanges, with essentially no requirements for companies in terms of asset size or financial profitability, but requires companies to maintain filings with the SEC. However, companies are required to maintain filings with the US Securities and Exchange Commission (SEC) and have three or more market makers (Market makers) willing to make a market in the securities in order for the company's securities to be listed and traded on the OTCBB.

1.2.2. Structure of China's Multi-level Capital Market

Level 1: The Main Board of the SSE and the Main Board of the SZSE, both of which follow the approval-based vetting approach. The same conditions of issue and the same vetting channel currently apply to both. If an issuer chooses to list on the SSE, it will be the Main Board of the SSE; if an issuer chooses to list on the SZSE, it will be the Main Board of the SZSE. Other than that, there is no difference.

Level 2: The Science and Technology Innovation Board focuses on supporting new industries such as new generation

information technology, high-end equipment, new materials and new energy. Most of the companies listed on the Science and Technology Innovation Board are companies with strong science and technology innovation capabilities. These companies generally master core technologies, are in line with national strategies and have a high degree of market recognition. They are represented by the computer, communication and other electronic equipment manufacturing industry, specialised equipment manufacturing industry, and software and information technology service industry.

Level 3: GEM mainly serves growth-oriented innovative and entrepreneurial enterprises, supporting the deep integration of traditional industries with new technologies, new industries, new business models and new modes, with more emphasis on promoting innovation and upgrading of traditional industries. Companies listed on GEM have a strong growth potential, and enterprises are mostly characterised by the integration of old and new industries.

Table 1. Comparison of the layers of the Chinese and US multi-level capital markets

	China	Service Users
First level	SSE (1990.11.26), SZSE (1990.12.1) Main Board	Established companies with a traditional bias
Second level	SME Board (2004.6.25)	Six types of high-tech industries and strategic emerging industries
Third level	Science and Technology Board (13.6.2019)	Companies with strong science and innovation capabilities
	Growth Enterprise Market (2009.10.30)	Growing innovative start-ups
Fourth level	NSS (original version 2006.1.16, new version 2013.1.16, the difference is the change from companies in four regions to the National Stock Exchange System)	Micro, small and medium-sized high-tech enterprises nationwide
	NSE (2021.9.3)	Innovative Specialized SMEs

Level 4: The BSE maintains its market positioning of serving innovative SMEs and nurturing a number of specialized and new SMEs; based on the Select Tier, BSE listed companies are generated from the Innovation Tier, maintaining a "tiered" market structure.

1.2.3. Registration versus approval system

The registration system essentially means that when an issuer applies to issue shares, it must make a full and accurate declaration to the securities regulator of all information publicly available under the law. The role of the securities regulator is to conduct a formal review of the comprehensiveness, accuracy, truthfulness and timeliness of the filings, and not to make substantive audits or value judgments on the issuer's qualifications, leaving it to the market to determine the merits of the issuer's shares.

The approval system means that the issue of securities must not only be conditional on full disclosure of the true state of affairs, but must also meet certain substantive conditions suitable for the issue as set by the securities regulatory authority. An issuing company that meets the conditions may

qualify for an issue and issue securities on the securities market only after approval by the securities regulatory authority. The registration system results in lower costs for issuers, more efficient listing and less drain on social resources than the approval system, and allows the capital market to quickly achieve its resource allocation function.

1.3. Comparison of NSS and OTCBB Transfer Mechanism

1.3.1. Similarities and Differences Between the NSS and OTCBB

China: (1) Two years of existence (the conversion of a limited company as a whole may be counted consecutively).

(2) Outstanding main NSS-listed business with a track record of continuous operation.

(3) Sound governance structure and standardized operation of NSS listed companies.

(4) Legal compliance in the issuance and transfer of shares listed on the NSS.

(5) The company's registered address is in a pilot national

high-tech park.

(6) Letter of confirmation of eligibility for listing pilot from local government.

USA: (1) OTCBB has no quantitative requirements for company listing criteria and the listing process is simple. As long as financial reports and relevant legal documents audited by qualified auditors are filed with the SEC and a market maker is available, a listing can be requested.

(2) The market maker system of the US OTCBB

The 154 market maker members of FINRA (formerly NASD) provide quotes for securities listed on the OTCBB. All securities listed on the OTCBB are required to have at least one market maker quoting for them, otherwise the company's listing will be revoked by the OTCBB.

The duties of a market maker are: (1) to cause the listed company to maintain required business records and comply with specified financial reporting compliance requirements; (2) to host trading information for both bids and offers on an ongoing basis and to execute as directed at the best price; (3) to publish valid bids and offers for both bids and offers; and (4) within 90 seconds of each transaction, the relevant market maker is required to publicly disclose to the market the valid bid price, ask price, buy and sell quantity of a security (4) Within 90 seconds of each transaction, the relevant market maker is required to publicly disclose to the market the valid bid price, ask price, buy and sell quantity of a security.

1.3.2. The Transfer Mechanism and Its Importance

The New Third Board market currently under construction in China already has functions similar to those of the OTCBB market in the United States, and a "transfer system" has been contemplated, i.e. a system for the "elimination of winners and losers" of enterprises between different levels of the securities market.

The transfer board system of the New Third Board (NTSB) in China refers to the mechanism of "moving" NTSB-listed companies up and down through the different tiers of the securities market. The current design in China is not exactly the same as the US OTCBB market's "lift board" system, and there is no real "transfer board lift board" system. Both listed and non-listed companies on the third board are required to go through an initial public offering process before they can be listed on the relevant segment of the on-market capital market. In other words, NSE companies can only be upgraded to the Main Board by way of an IPO in accordance with the standards and review process for IPOs.

Although it is more difficult to transfer listed companies to the third board than in the United States, we have taken a significant step forward by learning from it. The "transfer and lift system" is the link between the various levels of the multi-level capital market structure, and is an indispensable link in the capital market. Whether it is building a multi-level capital market or improving a more mature financial market system, it is inevitable that the important issue of building a capital market transfer system will be involved. At present, China's multi-level capital market system has been initially constructed, but there is a lack of organic integration between each other, a bridge between different levels of capital markets has not yet been built to connect them, and there is a lack of a perfect transfer board lift system. This is a key area for us to learn from the US multi-level capital market.

1.3.3. Comparison of Regulatory Mechanisms

China: Under the overall plan of market priority and social autonomy, the National Stock Transfer System Corporation is

authorised to set its own operational guidelines on transfer methods, listing conditions, management of sponsor brokers, etc.

United States: (1) FINRA regulation. The OTCBB is currently regulated by FINRA, which was created in July 2007 through the consolidation of the regulatory, enforcement and arbitration arms of NASD and the New York Stock Exchange. "FINRA regulates nearly 4,800 brokerage firms, approximately 172,000 branches and approximately 646,000 registered securities representatives. Under contract, FINRA also regulates the markets of the NASDAQ market, the National Stock Exchange, the Pacific Stock Exchange and the Chicago Climate Exchange.

(2) Regulation by the SEC. OTCBB issuers of securities must register with the SEC. Issuers of securities created under the Securities Act cannot list on the OTCBB until any interpretive issues with the SEC have been explained and their registration documents have become effective. Issuers that file electronically with the SEC through EDGAR are no longer required to provide a copy of the report to FINRA.

2. A Comparison of The Regulatory Mechanisms of The Multi-Level Capital Markets in The US and China

2.1. Advantages and Disadvantages of The US Regulatory Model

2.1.1. The Overall Strength of The Post-Depression US Securities Regulatory Model

The US Securities and Exchange Commission (SEC) is known worldwide for its high degree of independence, with the SEC operating on a commission basis, independent of the traditional legislative, judicial and executive powers. In terms of personnel independence, the SEC's commissioners are nominated by the President and approved by Congress.

Terms of office are staggered and do not coincide with the presidential term, and commissioners are not allowed to hold other offices or engage in securities-related activities. In terms of financial independence, the SEC has an independent budget, which is submitted by the President to Congress for appropriation. In terms of regulatory independence, the SEC enjoys quasi-legislative and quasi-judicial powers, and the SEC enjoys very broad powers in addition to being subject to the Administrative Procedure Act and the US Office of Administration and Budget (OMB) and the Office of Information and Regulatory Affairs (OIRA) for its activities.

The SEC in the US enjoys quasi-legislative and quasi-judicial powers. As a specialised authority, the SEC has enacted a number of effective laws and regulations and relies on its strong enforcement capabilities to implement them quickly. US securities regulation has taken shape based on the Federal Securities Act of 1933 and the Securities Exchange Act of 1934, with other laws such as the Public Service Holding Company Act of 1935, the Trust Contracts Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Investor Protection Act of 1970, the Bankruptcy Reform Act of 1978, the The Insider Trading Sanctions Act of 1984 is the most comprehensive body of law in the world, with appropriate adjustments and new dominant laws enacted with each crisis. Its special rotating system of committees has led to a more comprehensive and long-term view of the legal system and a

more holistic approach.

The US centralized regulatory model was not established with the intention of destroying the free market, but rather to maintain the good order of the free market. From the very beginning, the US securities regulatory system has been transformed from the "buyer pays" principle to the "seller is responsible" principle, requiring sellers to make statutory disclosures to buyers or the market for the securities they sell, and opposing fraud and information asymmetry. It is hoped that the government will intervene in the process of regulating the disclosure of information by market participants to avoid the imbalance in the market game caused by "information asymmetry". The principle of disclosure has always been the aim of the SEC's legislative enforcement and regulation, not to emphasize scrutiny but disclosure, to protect the interests of public investors and to try to maintain a fair and equitable market.

2.1.2. The Downside of US Regulation in The Financial Crisis

Since the 1980s, an "anti-regulatory" mindset has prevailed, with many academics and experts advocating liberal markets, leading the SEC to relax its sense of regulation under the influence of this mindset, placing too much faith in the self-regulatory function of the market, lifting many initiatives intended to protect investors and strengthen the market, and even abandoning its regulatory position for a time. In 2005, then SEC Chairman Christopher Cox, speaking at the Economist's Club, quoted then Federal Reserve Chairman Alan Greenspan as saying that "the best way to protect investors is to have a thriving economy and stock markets", adding that "all the SEC needs to do is help create an environment that promotes economic growth". is to help create an environment that promotes economic growth In other words, if the growth bubble doesn't burst, don't fix it." Guided by this ideology, he took inaction to the extreme and was blamed by the Wall Street Journal for the financial crisis.

Accounting regulation standards were relaxed. in 1975, the SEC stipulated that the net capital ratio of securities firms' liabilities should not exceed 12 times, and provided for valuation discounts for different financial products based on market measures of trading gains and losses. This regulation was strictly enforced for about 30 years. However, in 2004, the SEC deregulated, allowing brokerages with capital of \$5 billion or more to not have to pay valuation discounts and to have debt-to-net capital ratios of up to 40 times, taking many large brokerages out of the SEC's control.

Inadequate regulation of rating agencies. The Credit Rating Agency Reform Act (CRARA) provides the SEC with the power to revoke or suspend the license of any rating agency for a range of reasons. However, when public credit rating agencies such as Moody's, S&P and Fitch International gave the highest ratings (e.g. AAA) to a pool of securities trapped in \$3.2 trillion of non-performing mortgages between 2002 and 2007, the SEC failed to step up to the plate, leaving many small and medium sized investors to trust the ratings and opinions issued by credit rating agencies that lacked oversight. As a result, many small and medium sized investors lost money by blindly buying complex and risky financial products based on ratings and opinions issued by credit rating agencies that lacked oversight.

Disclosure of information in the OTC market is unclear. "Disclosure First" is an important standard of securities regulation in the United States. It requires securities firms to disclose as much material information as possible in their

financial statements, but the over-the-counter market is a different story. For example, when Lehman Brothers went bankrupt, there were more than two million interest rate swaps (IRS) on its trading book, and it would have taken at least six months to fully withdraw all the financial derivatives on its trading book. And all of this happened under the watchful eye of the SEC and did not surface until after Lehman Brothers' bankruptcy, when it was too late.

2.2. Guidance on the Regulation of The Securities Industry in China

2.2.1. Establishing the Concept of Weaker Government Regulation

China's securities regulation is not as relaxed as that of developed countries in Europe and the United States, and requires strict control. The problem is that there is a lot of administrative intervention in China's regulation, which does not respect the leading role of the market in resource allocation, resulting in the undesirable phenomenon of a "policy market". The reason why there has not been a major financial crisis is not because of how tightly regulated securities are or how well developed the securities market is, but because conservative regulation has inhibited all kinds of financial innovation and many financial derivatives, which are strange and incomprehensible to the Chinese people, have not flourished on Chinese soil. At present, China is in the "deep water" of reform and needs to further play the role of the market; the United States, with its prior knowledge of financial derivatives, has printed money to dilute its debt, further transferring and spreading the evils of the crisis. In the post-crisis era, a new round of international cooperation is becoming more and more extensive, and a new round of competition for interests is intensifying.

2.2.2. Establishment of the SEC as A Reasonable Subject

The shortcomings of China's securities regulation are mainly reflected in the shortcomings of the supervisory body, which is a historical problem inherited from China's transition from a planned economy to a market economy. In this regard, we can learn from the relevant advantages of the US securities regulation and enhance the independent subject status of the Securities Regulatory Commission.

1. Enhance the independence of the legal status of the SFC. In its Objectives and Principles of Securities Regulation, the International Council of Securities Regulators emphasises that regulatory bodies should avoid interference from the political or commercial sphere in the exercise of their powers and duties. Regulators in major economies such as the US, UK, France and Germany are independent bodies, and even two neighbouring countries, Japan and South Korea, have upgraded the independence of their regulators, which shows that the trend is for regulators to become independent and is a necessary part of China's convergence with international standards. The first is to clearly define the SFC as the only centralised and unified securities regulator in China in the Securities Law, directly granting it regulatory powers and changing the status quo of the State Council's indirect delegation of authority, so as to protect the SFC's status from a legal perspective; the second is to free the SFC from the embarrassing situation of being an institution of the State Council but actually exercising administrative functions, and try to develop it into an independent The second is to free the SFC from the embarrassing situation of being an institution of the State Council but actually exercising administrative

functions, and to try to develop it into an independent administrative regulatory body, free from the interference of other administrative organs. In addition, consideration could also be given to learning from the US experience and adopting a staggered system of commissioners appointed from within the legal and regulatory bodies.

2. Reasonable provision for the legal powers of the SFC. In terms of legislation, the legislative function of the SFC will be gradually weakened. In the past, the SFC has been overwhelmed with the formulation of numerous laws and regulations, which has affected the full exercise of its enforcement powers. It is advisable to first strengthen the legislative status of the SFC's Legal Department, so that it can specialise in drafting and interpreting laws and regulations. As the securities market expands, this department could be separated and developed into a special national securities law-making committee, while the SFC would only be responsible for the detailed interpretation of specific provisions under the framework of the laws and regulations formulated, evolving into a special enforcement department. The gradual separation of the legislative and enforcement departments will help to prevent the shortcomings of the US, where legal talent is valued over financial talent, and the SEC can specialise in enforcement without having to dwell too much on how to make the legal provisions exempt from liability.

In terms of enforcement, more powers should be given to the SEC, especially in terms of investigative powers. In this regard can be modelled on the US SEC's enforcement powers, with the following additional powers as appropriate: the power to obtain evidence at the scene of a violation; the power to investigate directly without notice; the power to summon parties; the power to apply for injunctions, the power to restrict the transfer of property, the power to suspend trading and settlement operations; the power to prosecute directly; the power to apply for injunctions, bankruptcy orders, liquidation orders, enforcement orders and restitution orders. In addition, in respect of the power to impose penalties, the power to issue public reprimands should be added to achieve greater fairness and transparency. On the issue of the amount of fines, there should not be a cap set in a specific number, and it is recommended that it be linked to illegal benefits and that the fines be increased in a graded manner.

2.2.3. Regulatory Readiness for New Market Developments

In the post-crisis era, the Chinese financial market will show some new development trends: the business model is increasingly mixed, the business structure is gradually diversified, and the business territory is increasingly international. This will also place new demands on securities regulation. In view of the series of problems of inadequate regulation in the United States under the mixed industry regulation, we should take a lesson from this and do the following two things.

1. Strictly prevent regulatory loopholes. In terms of accounting standards, the industry's permissible range of sensitive indicators, especially leverage, should be reasonably specified, with strict limits on fluctuations. The regulations on complex indicators should be left to the professionals of the SFC's Risk Disposal Office to carry out calculations, drafted by the Legal Department, and promulgated with relevant regulations and rules, giving them an unassailable status. On the disclosure of accounting information, the rules of disclosure should be clarified and strict control should be imposed on both listed and unlisted companies alike. The

powers of the Accounting Department of the SFC may be appropriately increased to allow it to conduct detailed spot checks on the financial statements and other accounting information of securities enterprises at any time and to allow it to require enterprises to amend the format of presentation of financial information, increase or decrease indicators, etc. under the premise of reasonable interpretation according to different rules.

In terms of rating agencies, it is imperative to properly guide the improvement and development of credit assessment systems and sovereign credit rating agencies so that they can establish credibility themselves. On the one hand, it is important to increase the transparency of information on credit rating agencies, including information on their own operations and the process of rating other companies, so as to be fair and transparent. On the other hand, we should improve the legal regulation of credit rating agencies and increase the penalties. If we find any violations of the law, especially if the rating agency and the rated company are working together in private, we should crack down on all parties involved in the case. Establish a credit account to record credit events of rating agencies and securities companies, and if there are any violations of the law, they will be recorded and made public.

In the over-the-counter market, a focused approach can be adopted to prevent and gradually diffuse the regulation of large securities firms that are prone to market turmoil by strictly requiring them to regularly submit to the SFC reports on the types and numbers of financial derivatives they trade and their internal risk control. An over-the-counter (OTC) market supervision department could be set up to collect, collate and analyse information, which could then be gradually spread to a large number of small firms after a certain industry habit has been formed.

2. Eliminate the talent emphasis bias and strengthen the cultivation of specialized talents. The US has fallen on its face in an era of increasingly complex financial markets because of its emphasis on legal talent over financial talent, which shows that the bias in the strength of legal and financial talent can have serious consequences, due to the overlap between the power to draft laws and the power to enforce them. If the two were to be separated, with the law drafting agency favouring legal talent and the enforcement agency favouring financial talent, the law drafting agency would work behind the scenes to improve the legal system, drive the legislative process and regulate the behaviour of the enforcement agency, while the enforcement agency would be on the front line, maintaining great sensitivity and expertise to see the subtle changes in the securities market, and the enforcement agency would then feed back legal advice to the law drafting agency.

In the post-crisis era, the securities market is operating more and more diversified businesses, financial products are becoming more and more complex, financial derivatives are becoming more and more numerous, and the phenomenon of business overlap and business competition between industries is becoming more and more obvious, which puts forward higher requirements for the quality of regulatory professionals. Therefore, the cultivation of talents for securities regulation in China cannot be delayed. The basic methods include: strengthening basic education and school education in law and finance, adding contents such as comparison of international and domestic status quo; carrying out training and examination work for in-service personnel; analysing and examining domestic and international securities regulation cases. It is a long-term and arduous task

to strengthen the cultivation of professional talents. Only by improving the quality of practitioners can we fundamentally eliminate problems such as internal corruption and lack of market sensitivity in the regulatory sector, and provide the regulatory work with talent security.

3. Insights from the Transformation of Small and Medium-Sized Chinese Brokerages

3.1. Overview of The Stages of Development of Small and Medium-Sized Domestic Brokerage Firms

3.1.1. Analysis of The Development of Domestic Brokerage Firms

Placing the opportunities for the development of the securities industry in the macro context of the shift in China's economic growth dynamics, it is easy to see that

The deepening reform of the capital market has brought a new round of development dividends for brokerage firms. As the deepening reform of the capital market continues, the market needs more competitive brokerage firms and the structural reform of the financial supply side will drive the reshaping of the securities industry landscape.

However, the pace of capital market reform has lagged behind the new forms, models and demands that have emerged in economic development, making the role of the capital market ineffective in matching economic development, and the development of direct financing has been slow.

3.1.2. Domestic Brokerage Development Policy Guidance Process

Since 2018, top-level design has drawn a new blueprint for capital market development. In November 2018, General Secretary Xi Jinping announced in Shanghai the establishment of the Science and Technology Innovation Board (STIB), starting with the launch of the STIB and the pilot registration system, a new cycle of capital market reform in China was kicked off.

Since 2019, policies to deepen reforms in the capital market have been introduced frequently, continuously raising expectations for the development of the securities industry. The first 25 companies on the STB were listed and traded on the SSE. Compared with the nearly 10-year gestation period of the GEM, the rapid landing of the STB demonstrates the determination and strength of the government's reform. However, the brokerage, investment banking and capital intermediary businesses of securities companies have not yet been completely detached from their "channel" nature, and the active management scale of their capital management business is small, and they are facing competition from financial institutions such as public funds, private equity funds and bank wealth management subsidiaries.

Since 2020, the full implementation of the registration system for equity issuance has guided high-quality investment banking as a grip to improve the direct financing of society, and the efficiency and quality of direct financing is of great significance to the innovative and transformative development of national industries. Both the purpose and connotation of the national policy guidance are to continue to guide the securities industry towards a virtuous cycle of refining its business, getting bigger and stronger, and supporting the best and limiting the worst, in order to better serve the development of the real economy.

The current round of capital market reform has been strong, prolonged and well received, and the direct financing market has seen unprecedented development, as can be observed from the reform practices of the past three years. It is worth mentioning that the gradual implementation of the basic system, with the "registration system" as the core, marks an inflection point for the transformation of the Chinese capital market.

3.1.3. Market Environment Under China's Multi-Level Capital Market System

The Central Economic Work Conference held in December last year proposed the full implementation of the registration system for stock issuance. At present, a multi-level capital market system of "Main Board + Growth Enterprise Board + Science and Technology Innovation Board + North Exchange + Regional Equity Market + Private Equity" has basically been formed.

The "registration system", which will normalise the supply of assets in the capital markets, will bring about four key changes.

(1) Changes in regulatory thinking and behavior: Regulation will shift from pampering the market to moderate regulation; it will shift from controlling the quantity, quality and price of issue supply to doing compliance review and relaxing profitability requirements. For example, the average review cycle of the Science and Technology Innovation Board is controlled at 3-6 months, which is significantly lower than the review cycle of A-share IPOs.

(2) Changes in pricing and valuation logic: secondary market valuation returns to fundamentals, market value differentiation accelerates, and liquidity of small cap stocks is expected to decrease. At present, the number of breakdowns in the science and technology board has reached more than 8. It is expected that future breakdowns in the science and technology board will be normalized, and listed companies will be consolidated and differentiated.

3) Changes in the behavior of listed companies: Along with the basic establishment of a multi-level capital market system, market valuations have returned to rationality and listing is no longer blindly attractive. Some enterprises with low valuation and poor liquidity will be acquired, and the M&A and restructuring market is expected to be more active, on par with mature markets in Europe and the US.

4) Changes in investor structure and behavior: The investor structure will become more institutionalized and internationalized, and investment behavior will return to value investment.

Looking ahead, the IPO shutdown will no longer occur and China's capital market will have made significant breakthroughs in marketisation, rule of law, internationalization and institutionalization. However, compared to mature capital markets, China's capital market reform still has a long way to go, and key reform measures, including the supporting ecology of the capital market, still need to be steadily implemented.

3.2. Development Opportunities from The East Wind of The North Exchange

3.2.1. Policy Dividend Release Leads to Strength of Head Brokerage Firms

The pilot account management business is expected to enhance the efficiency of customer transactions to achieve asset transfers, reflecting the regulatory support for the

development of brokerage wealth management business.

In early April 2021, the China Securities Association issued the Notice on the Pilot Assessment of the Optimization of Account Management Functions of Securities Firms, which clarified that brokerage firms applying for the pilot should first meet a classification rating of AA in the past year, and also bound brokerage firms that had been penalized for compliance and risk control in the recent year. This announcement is positive feedback to the previous application assessment of the association, and the formal approval of 10 brokerages indicates that account optimization is steadily progressing.

With positive incentives, head brokerage firms with fund investment advisors and account management optimization to create a closed-loop account for wealth management and to promote the sustainable development of wealth management business through asset allocation, the wealth management business will become more competitive.

3.2.2. Regulatory Landing Accelerates Resource Consolidation

Regulatory landing + gradual transfer of residents' assets, equity market enters golden era and brokerage wealth management business accelerates.

Under the influence of policies such as "no speculation in housing and housing" and "breaking the rigid exchange rate" of bank wealth management, the asset allocation of Chinese residents has gradually shifted to the equity market and the concept of wealth management has been upgraded.

The regulatory landing accelerates the integration of client capital resources and improves the business service chain of brokerages, which is expected to promote the formation of a client-centric wealth management system and open up new ideas for business development.

3.3. Development Challenges Arising from The Transformation of Capital Markets

3.3.1. Existing Problems in The Market

The head brokerage firm used its scale advantage to reduce operating costs, resulting in a higher rating from the regulator, and at the same time, the license was delegated at a faster pace, making it easy to lay out the industrial market in advance for comprehensive business development.

As a small and medium-sized brokerage firm, it cannot match the size of the head brokerage firm in terms of the size of its stock of clients. In addition, there is a certain degree of difficulty in cooperating with large public funds and private equity institutions in terms of client capital linkage. For example, in the context of the latest policy to promote the transformation of wealth management business will face

greater competition, the business environment is severe, not fully enjoy the policy dividends.

In recent years, regulatory policies have continued to be implemented, accelerating the consolidation of client capital resources by brokerage firms and the inclusion of mergers and acquisitions in strategic planning by head brokerage firms, resulting in widespread inter-industry mergers and acquisitions and a continued increase in industry concentration. Small and medium-sized securities firms have a lower fault tolerance rate in the market against the backdrop of inferior client resources and market access, and are prone to breakage of their capital chains due to careless operation or strategic mistakes, making the current independent operating environment quite severe.

3.3.2. Business Development Challenges

The small size of the capital market, its low importance in the financial system and excessive regulatory protection, such as the suspension of IPOs nine times in the history of A-shares, have led to a serious imbalance between supply and demand on the asset side and the capital side.

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Increasing debt leverage with rigid expectations and a debt-to-GDP ratio of 250% increase systemic risk as the economy declines and defaults rise.

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