The Hybrid Regulatory Regime in Turbulent Times: The Role of State in China's Stock Market Crisis in 2015-2016[*]

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Abstract

The hybridization of socialist state control with increasingly complex financial markets has generated unusual features in China's financial regulatory regime. Using the 2015-2016 stock market crisis as a case study, this article draws on the Legal Theory of Finance (LTF) to analyse the state-market interface and crisis governance in China's stock market. It illustrates the shift of China's stock market governance away from traditional administrative hierarchies to more plural and hybrid forms of ownership, control and regulatory governance. By examining the policy process, market dynamics and crisis management in the evolution of China's 2015-2016 stock market crashes, it identifies the endogenous dilemmas of regulatory elasticity and campaign-style enforcement in China's hybrid regulatory regime, which have amplified policy noises and led to a destabilizing feedback loop between policy-induced market turbulence and market-induced organizational turbulence inside the regulatory bureaucracy.

Key words: financial regulation, hybridization, stock market crisis, governance, China's financial reform

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1. Introduction

In 1992, during his famous 'southern tour' which reaffirmed China's market-oriented reforms, the late Chinese leader Deng Xiaoping once questioned: "are securities and the stock market good or bad? do they entail any dangers? are they peculiar to capitalism? or can socialism make use of them?" His answer then was "we must try these things out": if securities and stock market prove feasible after experimentation, the state can expand it; otherwise, the state can correct mistakes, put a stop to them and be done with it: "we can stop them all at once or gradually, totally or partially. What is there to be afraid of?" (CSRC 2008:9). Deng's pragmatic and experimentalist approach has shaped the pathway of China's financial reforms. Within less than three decades, China's stock market has grown rapidly from a negligible size to be the world's second largest market in terms of market capitalization and the largest market in terms of total equity funds raised by listed companies.

Between 2014 and 2016, however, China's stock market experienced a massive boom and bust, which led to China's first major stock market crisis characterized with extensive margin-financing activities. Over 50% of China's listed companies filed for suspension of trading in July 2015. In managing the crisis, the Chinese state adopted extraordinary interventions such as suspending IPOs (initial public offerings), changing market trading rules, restricting large shareholders of listed companies from selling their shares, and directly coordinating share purchases to bail out the market. A constellation of state organs and market entities were mobilized to participate in the bail-out, which later evolved into a 'regulatory windstorm' to rectify China's financial governance regime.

The stock market crisis in 2015-2016 has raised profound questions on China's financial stability and governance reforms. The institutional hybridization under bureaucracy-led gradualist reforms has successfully created a rapidly growing stock market in China, but it has also imprinted China's stock market with unique governance features (Pistor & Xu 2005a, b; Bell & Feng 2009). Over the past decade, China's financial markets have become increasingly complex and liberalized, posing new regulatory challenges (Liao et al 2016). On the one hand, market-based finance has inherent instability characterized by periodic booms and busts (Minsky 2008), on the other hand, the process of financial liberalization typically brings additional risks and major swings in asset market prices (Stiglitz 2000; Tornell & Westermann 2005; Palma 2010). To what extent can China's financial regulatory regime cope with these challenges within the parameters of state control? How does hybridization shape the evolving regulatory incentives, policy process and market dynamics in China's stock market? To what extent does it mitigate, generate or exacerbate financial instability?

This article examines the operation and performance of China's hybrid financial regulatory regime in turbulent times by analysing the role of state in China's stock market crisis in 2015-2016. While there is a growing literature in economics and legal studies on China's recent stock market crashes, they primarily focus on analysing the role of margin-trading and de-leveraging *per se*, or evaluating specific government interventions during the crisis (Huang et al 2016; Lu & Lu 2017; Bian et al 2018). This article contributes to an emerging body of research (Arwey 2015; Pistor et al 2016; Sheng 2019) which takes a political economy perspective to analyse how the organizational-institutional features of China's financial regulatory regime shape the dynamics of its crisis governance. It uses data and evidence from a variety of sources, including databases we created on 1) the ownership structure of China's major securities firms and fund management companies; 2) the personnel information of the top-level financial regulatory officials as well as top-level executives and board members of major stock market financial intermediaries; 3) the policy documents and yearbooks of regulatory agencies, stock exchanges and major financial sector trade associations, key decision makers' policy speeches, as well as reliable media reports. It also draws on semi-structured interviews we made between 2016 and 2019 with investment bankers, fund managers, securities lawyers, government officials and policy advisors in China.

In what follows, we first draw on the Legal Theory of Finance (LTF) to analyse the hybridity in China's stock market regulatory regime. We then proceed to examine the role of state in the origin and evolution of China's stock market crisis in 2015-2016, illustrating a destabilizing feedback loop between policy-induced market turbulence and market-induced organizational turbulence inside the regulatory bureaucracy. We further identify and analyse two pathological features of China's hybrid stock market regulatory regime which amplify policy noises and produce turbulence in the state-market interfaces: 1) regulatory elasticity dilemma; 2) campaign-style enforcement dilemma, and discuss how they constrain China's financial stability and regulatory effectiveness.

2. Financial Regulation and Governance in Turbulent Times

While there is a vast scholarship from different disciplines concerning financial regulation and governance, there is only limited dialogue among the different approaches in the economics, law, political science and organizational studies literatures (Arellano-Gault et al 2013; Pistor 2013; Armour et al 2016; Ansell et al 2017; Avgouleas & Donald 2019). Neo-classical economics makes highly reductionist and unrealistic assumptions about the public sector institutional structure underlying the market order, such as assuming efficient law enforcement under complete law, i.e., laws could unambiguously stipulate all future contingencies for all individuals and law enforcers, efficiently deterring harmful actions (Pistor & Xu 2004; Arwey 2015). While the conventional Law & Finance scholarship examines how the quality of legal frameworks influence the patterns of financial market development (La Porta et al 1998, 2008), its analytical approach downplays the role of public administration and treats public governance institutions as exogenous to financial systems (Nee & Opper 2009). Overlooking how law and politics interact with financial instability, the mainstream Law & Finance literature is essentially "a theory for good times in finance, not one for bad times" (Pistor 2013: 325; Arwey 2015). While there is an expanding literature that examines how financial markets are embedded in and shaped by broader socio-political structures, the organizational-institutional dynamics underlying financial market turbulence remains under-researched (Abolafia 1996; Lounsbury & Hirsch 2010; Avgouleas & Donald 2019).

Turbulence in governance can be broadly defined as "interactions of events or demands that are highly variable, inconsistent, unexpected or unpredictable" (Ansel et al 2017: 3). Crises are essentially severe situations of turbulence which pose urgent threats to a system's sustainability amid profound uncertainties (Boin et al 2005). While turbulence in governance is often generated by exogenous shocks from external environment, it may also be the endogenous property of institutions and organizations. Recent organizational studies literature has challenged the dichotomous distinctions between organizations/institutions on the one hand and their environments on the other. It calls for paying particular attention to "how the layering, coupling, alignment, or cooperation of organizations or institutions may produce diffusion, unintended consequences, interdependence, or even cascading dynamics that propagate across levels, causing governance dilemmas" (Ansell et al 2017:10).

In the context of financial system, we can conceptually distinguish turbulence at two levels: 1) market turbulence (also including crises facing individual financial intermediaries as market participants) and 2) organizational turbulence in the public sector institutional structures that support, regulate and backstop financial markets. Market turbulence is typically characterized by a shape fall in asset prices, sudden shrinkage of liquidity and bankruptcies of market participants. Public organizational turbulence typically involves policy messes, coordination and enforcement failure, as well as substantial depletion of regulatory credibility and public resources. How financial markets and public sector institutional structures are organizationally and institutionally connected will arguably shape how different types of turbulence in financial governance are generated and transmitted. While the boundaries between financial markets and their underlying public sector institutional structures are often blurred, an investigation on how turbulent processes at the two levels play out and may interact with each other is crucial to understand and evaluate the state-market relations in a given financial system, as turbulent times tend to stretch a governance regime to its limit and reveal most clearly its underlying tensions and fragility.

While conventional analyses tend to emphasize the conceptual dichotomy of state versus market, public versus private in financial regulation and governance, recent literature on the Legal Theory of Finance (LTF) has developed a more robust and realistic framework to examine how financial instability is generated and governed under different institutional structures (Pistor 2013; Awrey, 2015). Contrary to neo-classical economics, LTF starts with the premises that modern financial system is characterized by the fundamental features of uncertainty, liquidity constraints and potential instability. It holds that financial markets occupy "an essentially hybrid place between state and market, public and private" (Pistor 2013: 315). The analytical framework of LTF has four key elements. First, financial markets are characterized as rule-bound systems that comprise a complex web of inter-locking commitments and contractual obligations, coordinating and disciplining various market entities' interests and behaviours over time. Financial markets are legal constructions built upon and intertwined with the governance institutions that generate and enforce relevant laws, regulations, policies and contracts. Second, financial systems are not state or market, public or private, but essentially a hybrid of both. In times of crisis, the state (as 'the lender of last resort') provides the ultimate backstop to protect financial markets from self-destruction by suspending the full enforcement of law and relaxing the survival constraints facing some financial entities. In this process, the state stands as the ultimate guarantor of the complex web of rights and obligations in the financial markets. Third, law and regulation can be a source of financial instability. On the one hand, in turbulent times, rigid full enforcement of law and regulatory policies can exacerbate instability under uncertainty and liquidity constraints, on the other hand, in normal times, some aspects of law and public policies may distort incentives, spur regulatory arbitrage and breed financial instability. Fourth, financial system is inherently hierarchical and power is a salient feature of financial governance. The enforcement of rules is uneven in financial markets, especially in the context of crises. In general, rules tend to be relatively elastic at the apex of a given financial system, but hard on its periphery (Pistor 2013; Awrey 2015; Pistor et al 2016).

Using the LTF framework, the key issue is not debating the state versus market, public versus private, but investigating how particular forms of hybrid governance emanate from different institutional structures and how they shape, manage and interact with financial turbulence. To the extent that hybridity, hierarchy and power are essential features of modern financial governance, it's critical to analyse what the specific sources, features and implications of hybridity are at the organizational-institutional level, as well as how power is distributed and exercised (and to whose benefit) in a regulatory regime. The LTF framework can be further expanded by drawing insights from the political science and organizational studies literature on hybrids. Political scientists and sociologists have long recognized the importance of hybrid governance, which combines various distinct institutional logics, organizational forms and governance mechanisms (Greenwood et al 2011; Battilana et al 2017). Hybrid governance typically responds to administrative dilemmas generated by complex institutional ecologies. It may endogenously create and manage turbulence with the co-existence and tensions of multiple institutional logics (Ansell et al 2017).

3. Bureaucracy-led Gradualist Reforms and China's Hybrid Stock Market Regulatory Regime

China's gradualist financial reforms have been carried out under the control of its existing party-state bureaucracy. Unconventional forms of institutional adaptation and hybridization have featured prominently in China's reforms and transition (Nee 1992; Heilmann 2009). Driven by an intertwined process of state building and market building, China's stock market development has been governed by an evolving hybrid regulatory regime, which has used, repurposed and refined existing governance mechanisms of socialist state control, with new forms of financial organizations, instruments and relations layering upon existing institutional elements (Walter & Howie 2009, 2012; Pistor 2012; Allen & Shen 2012). Crises and elite-bureaucracy interaction in the reform process have played key roles in shaping the momentum of institutional change in China's stock market (Bell & Feng 2009). In this section, we sketch the hybridization of ownership, control and regulatory governance mechanisms in the recent architecture of China's stock market regulatory regime within which the 2015-2016 crisis originated and unfolded.

While China's stock market was mainly used by the state as an instrument to facilitate state-owned enterprise (SOE) reform in the 1990s and early 2000s (Green 2004; Walter & Howie 2009; Li 2015), it has increasingly taken up more diverse policy missions during the recent decade and combined multiple policy rationales in serving various state-led developmental strategies (such as 'supporting innovative small-and-medium enterprises', 'supporting national manufacturing development', and serving the 'Mass-innovation, Mass-entrepreneurship' policy campaign). Over the past decade, the Chinese state has also taken a more permissive stance towards financial liberalization and increasingly repositioned itself as a shareholder and institutional investor that harnesses financial means to manage the economy (Wang 2015; Liao et al 2016). In this environment, China's stock market governance has further shifted away from traditional administrative commands to new, more plural and hybrid forms of ownership, control and regulatory governance.

The overall architecture of China's stock market regulatory regime can be characterized as a hierarchical institutional network, with Shanghai and Shenzhen Stock Exchanges, key financial market trade associations such as the Securities Association of China (SAC) and the Asset Management Association of China (AMAC), as well as major securities firms and asset management companies, nested under the China Securities Regulatory Commission (CSRC) which is subordinate to the State Council and ultimately the Communist Party centre.[i] Its hierarchical features are apparent both in terms of regulatory framework and political control which stem from the top-down authority structure of China's party-state. However, it is not a pure administrative hierarchy dominated by vertical commands as in a traditional planning system, but a complex institutional network linking multiple layers of market participants with the central party-state bureaucracy and local governments. Major stock market financial institutions are typically strategically linked by equity ownership with various state institutions and non-financial state-controlled enterprises at both the central and local levels. There are extensive cadre personnel-transfers, joint-appointment and rotation among CSRC, stock exchanges, major financial intermediaries and trade associations, creating dense network linkages that facilitate information flow, relational exchanges and collaboration across institutions.

Figure 1.

Figure 1. illustrates the state shareholding network of China's twelve largest securities firms (ranked by total assets in 2015) and twelve largest asset management companies (ranked by the market capitalization of their stock market fund portfolios in 2015). Compared with China's non-financial state business groups under the State-Owned Asset Supervision & Administration Commission (SASAS), the shareholding structure of China's major securities firms and asset management companies is more multi-layered and dispersed. Major securities firms in China have all been publicly listed in stock markets, with substantial equity held by non-state investors. While state capital still dominates, the ownership is fragmented among various central state-controlled corporate entities (such as Central Huijin and large SOEs under central SASAC) and local governments. Between 2012 and 2015, spurred by CSRC's policy campaign for financial innovation and liberalization, major securities firms vigorously competed in raising new capital to expand their balance sheets. In just three years, driven by capital raising, the total net asset of China's securities firms increased from RMB0.69 trillion in 2012 to RMB1.45 trillion in 2015 (SAC 2013; 2016). This wave of equity financing contributed to the further diversification of the state shareholding structure. By 2015, none of the twelve largest securities firms in China have any single state-controlled shareholder directly

holding absolute majority shares. As shown in Figure 1, there is a complex web of equity interests involving central state capital and local government capital in China's major securities firms and asset management companies. In some cases, it is a deliberate strategy for top executives in these firms to maximize their insider control by seeking to diversify their state-ownership structure. While they continue to reply upon and leverage on state capital, they also try to maintain and expand their managerial autonomy by advocating for and taking advantage of a more dispersed state shareholding structure.[ii]

Despite the centrifugal forces of financial liberalization and ownership diversification, major securities firms and asset management companies remain integral nodes of the vertical authority structure of China's financial market governance. Formally designed as a regulatory agency, CSRC does not exercise equity ownership rights in major stock market financial intermediaries on behalf of the state like the case of SASAC in governing non-financial state business groups. Instead of relying on direct ownership and corporate control, CSRC serves as an integrator of China's stock market regime by combining three key mechanisms: 1) administrative supervision and regulatory governance through multiple interfaces with the market; 2) the political and personnel control of the Party organizations; 3) legal governance mechanisms.

First, during the recent two decades, CSRC has consolidated and centralized its administrative authority in stock market governance over other state institutions (especially local governments). For example, by replacing IPO quota-system with registration-approval system in 2001, CSRC concentrated the authority of screening enterprises to get listed in stock market at the expense of local governments. In supervising major securities firms and asset management companies, CSRC has maintained extensive administrative authority in regulating their business scopes and licenses, vetting their personnel appointment and professional qualification requirements, as well as inspecting and restricting their daily business operations. Apart from direct enforcement, it has also developed and utilized multiple institutional interfaces deemed more ‘market friendly’ to informally exert its influence, including ‘window guidance’ on major financial institutions through securities exchanges and key financial market trade associations. Since 2009, CSRC has further developed a performance rating and ranking system to stimulate yardstick competition among securities firms by rewarding and punishing them on the basis of their relative performance in compliance, market competitiveness and risk management. It applies different regulatory policies to different classes and ranks of securities firms, which heavily affect their businesses.

Second, alongside the administrative-regulatory mechanisms, CSRC also continue to function as part of the transmission belt of the Party’s political and personnel control. The party committee and party disciplinary group in CSRC oversee the party cells in stock exchanges, key financial market trade associations and other financial institutions directly managed by CSRC. The party committee is in charge of the key personnel appointments inside CSRC bureaucracy and carries out the Party centre’s policy lines. It serves as the bedrock of the vertical authority inside CSRC’s organizational hierarchy. While this mechanism is relatively dormant in normal times, it becomes dominant when the Party initiates major policy campaigns and may override the regular exercises of administrative mechanisms.

Third, CSRC also possesses critical quasi-legislative and quasi-judicial authority. Over the past decade, China has made major strides in formalizing its financial regulatory regime and improving the legal framework. The actions of CSRC are now bound by key legislations such as *Securities Law* and *Securities Investment Funds Law*, which is consistent with the logic of market-oriented liberal reforms in calling for greater roles of legal governance. Looking at the formal laws, China seems to be increasingly mimicking stock market regulatory regimes in Western market economies. However, underlying the apparent convergence, the development of legal mechanisms in China's stock market governance has maintained its peculiar features. CSRC faces fairly weak constraints from the legislature and courts and in some aspects functions as their substitute. As a legislative strategy, *Securities Law* leaves CSRC with extensive authority and in some areas contains additional exemption clauses to enhance CSRC's policy space. The administrative rules and policy directives issued by CSRC serve as quasi-laws and dominate stock market governance. Moreover, the courts only selectively hear securities market lawsuits, which provides CSRC with substantial *de facto* quasi-judicial authority as well.[iii]

Apart from formal governance mechanisms, there are also extensive informal network linkages created by personnel flows among CSRC and major financial intermediaries. To investigate such personnel linkages, we compiled a database on the network of top-level corporate elites in China's twelve largest securities firms (ranked by total assets in 2015) and twelve largest asset management companies (ranked by the market capitalization of their stock market fund portfolios in 2015), based upon data hand-collected from annual reports and fund offering documents of these institutions. The database includes 460 persons who occupied positions as top executives, board members or supervisory board members at these institutions in 2015 (independent directors are not included). Among them, a total of 33 have served at CSRC before taking up top leadership positions in major securities firms and asset management companies. For example, Qu Qiuping, CEO of Haitong Securities, was the Director of CSRC's Department of Non-Exchange-Listed Public Company Supervision; Chen Gongyan, Chairman of China Galaxy Securities, was the Deputy Director of CSRC's Department of Financial

Intermediaries Supervision. A total of 17 have concurrent appointments or transfers across top leadership positions among major securities firms and asset management companies. For example, Yang Minghui served both as the Chairman of China Asset Management and Executive Director of Citic Securities. These interlocking positions only provides a glimpse at the web of personnel ties underlying China's stock market regulatory regime. Directly or indirectly through stock exchanges and trade associations, CSRC has nurtured dense elite ties in information sharing and collaboration by convening regulator work meetings and training programs for top leaders of major financial institutions in securities markets.[iv]

In sum, China's stock market regulatory regime has evolved into a hybrid organizational architecture which has interwoven multiple forms of ownership, control and governance mechanisms. This structure has combined both hierarchal and network features, with extensive institutional layering that combines new governance forms and practices with the old. As suggested in the organizational studies literature, the co-existence and hybridization of different modes of governance can be seen as an advantage in some cases as actors may be able to switch among different modes of governance to facilitate more effective responses to turbulence, but in other cases, such hybridity can exacerbate fragility and create turbulence endogenously (Ansell et al 2017).

4. Policy Mobilization, Financial Innovation and Crisis Management in China's Stock Market

In what follows, we examine the role of state in the origin, evolution and management of China's stock market crises in 2015-2016 as a two-stage process: 1) policy mobilization, financial innovation and bubble formation between 2012 and 2015; and 2) market crashes, bailout and crisis management in 2015-2016.

4.1 Policy Mobilization, Financial Innovation and Bubble Formation

In 2012, against a prolonged bear market, the Party centre and the State Council (hereafter 'the Centre') convened the 4th National Financial Work Conference which laid out its financial policy goals and priorities for the subsequent five years including strengthening capital market development to serve the real economy, improving stock market confidence and promoting financial innovations. Following the Party's leadership succession in 2012, the new administration aimed at simultaneously enhancing the role of markets in the allocation of resources and strengthening the Party's centralized political control. A series of financial liberalization reforms were launched together with major policy efforts to mobilize resources from financial system to achieve the state's various policy goals, such as the initiatives to 'mobilize financial system to support small and micro-enterprises' and 'promote enterprise mergers, acquisitions and restructuring', as well as major policy campaigns in 2014-2015 under the slogan of 'Mass-innovation, Mass-entrepreneurship' which mobilized the entire state bureaucracy to generate policy innovations to stimulate entrepreneurship.

China's financial regulatory bureaucracy was extensively mobilized in this process. The Centre reshuffled top-level cadres among the financial regulatory agencies and state-controlled financial institutions. There was active policy mobilization across the financial regulatory bureaucracy in the forms of work meetings, party cells learning sessions, research trips and pilot policy schemes to study and implement the 'spirit' of the Centre's policy lines. To various extent, CSRC, CIRC (China Insurance Regulatory Commission) and CBRC (China Banking

Regulatory Commission) all promoted financial liberalization reforms and relaxed regulatory control, which bred the rapid expansion of shadow banking activities. In particular, CSRC launched an unprecedented policy campaign pushing for securities industry innovations, encouraging and supporting securities firms and fund management companies under its supervision to develop innovative financial products and business practices (SAC 2013). It initiated new policies to promote entrepreneurial finance, relax regulatory supervision and speed up the growth of SME (small-medium-sized enterprise) Board and ChiNext Board (a NASDAQ-style board of the Shenzhen Stock Exchange). It also relaxed administrative control over the business scopes of securities firms and supported them to grow 'innovative' margin-financing and asset management businesses which further connected securities firms with shadow banking activities. This process brought about an increasingly accommodative regulatory environment that allowed a proliferation of financing tools such as margin-financing, stock pledged lending and internet-based borrowing platforms in China's stock market.[v]

With CSRC's big push for financial innovations and regulatory loosening, China's major securities firms and fund management companies seized the new opportunities and rapidly expanded their 'innovative businesses'. In particular, there was an explosive growth of margin-financing businesses which was not permitted in China before 2006. After four years of small-scale experiments, CSRC launched a pilot margin-trading system in 2010, which allowed qualified investors to use margin financing and short selling with a few selected securities firms, but the transactions were limited by strict regulations and the volume was small. Between 2012 and 2015, however, CSRC encouraged the rapid expansion of margin-trading system with more and more securities firms and investors allowed to trade on margin. From 2011 to 2012, the securities firms' revenue from margin-financing business more than doubled and reached RMB 7.1 billion, accounting for 5.5% of the total revenue of China's securities firms (SAC, 2013).

By 2015, revenue from margin-financing business accounted for over 20% of the total revenue in all of China’s ten largest securities firms by total assets. As an example, Haitong Securities, China’s second largest securities firm by total asset, generated nearly 40% of its revenue in 2015 from its margin-financing business (SAC, 2016). In addition to official margin financing accounts provided by regulated securities firms, investors increasingly used alternative channels of borrowing through the shadow banking lenders, including trust company products, internet-based peer-to-peer lending platforms as well as semi-legal *Peizi* (money-matching) companies. Shadow borrowing outside the regulated margin trading systems of securities firms generated multiple and opaque layers of leverage that were difficult for the regulators to monitor.

Through financial innovations to expand their business linkages with commercial banks and trust companies, securities firms and asset management companies increasingly intertwined China’s stock market with the shadow banking system. In 2012, the total size of customer asset under management by securities firms in China reached RMB 1.9 trillion, an increase of 570% compared with the level of 2011, and then further grew around 300% to nearly RMB 8 trillion in 2014 (SAC 2013). They were actively engaged in regulatory arbitrage, exploiting inconsistency and gaps in the existing regulations and state policies. It was estimated that the shadow loans made by trust companies and *Peizi* companies could be as high as RMB 3 trillion in June 2015, with some offering leverage as high as 10 times at above 10% interest rates. To evade regulations, shadow lenders widely deployed complex and innovative legal-financial structures such as ‘the Umbrella Trust’ to pool money and channel credit to the stock market (Wu 2016; Lu and Lu, 2017; Sheng, 2019). Moreover, there was rapid growth in stock pledged lending after 2013. Key shareholders and senior management of many public listed companies (primarily non-SOEs) pledged their shareholding as collaterals to borrow from securities firms.

By March 2015, over RMB 1.2 trillion market capitalization of stocks were pledged for loans from securities firms. Rapid growth of stock pledged lending rendered both large shareholders as borrowers and securities firms as lenders vulnerable to falling equity prices and the risk of forced liquidation.[vi]

Apart from CSRC, other relevant state agencies also vigorously responded to the policy mobilization. In 2014, the state-controlled propaganda media, such as *the People's Daily* and *Xinhua*, increasingly published bullish commentaries on the stock market, encouraging investors to buy shares. PBOC also loosened monetary policies by cutting interest rates and lowering the required reserve ratios. Under this policy environment, there formed widespread expectations among investors that the state endeavoured to generate a bull stock market and maintain rising stock prices to achieve its economic policy goals. From July 2014 onwards, China's stock market started a continuous rally. The stocks of small-medium tech-related companies involving the policy themes of promoting 'Mass-innovation' and 'Mass-entrepreneurship' (mostly listed in the SME Board and ChiNext Board in the Shenzhen Stock Exchange) became extremely popular and their share prices soared. As the stock market boomed, margin financing grew explosively. With only a negligible size in 2013, the total outstanding balance of margin trading surged and exceeded RMB 2 trillion in May 2015. By the end of 2014, China's stock market had ranked among the highest globally in terms of the ratio of margin trading balance to stock market capitalization (Cui et al 2015). Between July 2014 and June 2015, the ChiNext Market Index almost tripled and the Shanghai Composite Index increased over 150%. At the bubble's peak, over 55% of the stocks listed in the Shenzhen Stock Exchange had P/E (Price/Earning) ratios above 100 and over 40% of the stocks listed in the Shanghai Stock Exchange had P/E ratios above 100.

4.2 Market Crashes, Bailout and Crisis Management

The stock market boom was achieved by a rapid building up of leverage and risks, with a variety of shadow borrowing channels blossoming in China's stock market between 2012 and 2015. As the stock market continued to rally, CSRC grew more concerned about risks. It decided to tighten regulations over shadow margin lending in June 2015, which triggered a market crash. Both Shanghai and Shenzhen markets dropped over 40% in two weeks, with numerous investors suffering margin-calls and forced to liquidate their positions, worsening price collapse. Over 1,440 listed companies filed for suspension of trading on 8 and 9 July, which accounted for more than 50% of all the listed companies in the Shanghai and Shenzhen Stock Exchanges. By then, China's stock market had stopped much of its functioning due to the chaotic process of deleveraging. CSRC's initial response to the market crash in the late June was an announcement that the crash represented a healthy market self-correction, implying no need for the state to intervene,[vii] but as the market crash continued for a few more days, CSRC's policy stance drastically switched to a bailout mode to shore up the markets with administrative interventions. Among others, it suspended initial public offerings (IPOs) and secondary market fundraising, restricted key shareholders, board directors and senior management of all listed companies from selling their shares for six months, and dampened short-selling in the stock index future market. It conducted extensive 'window guidance' to major financial institutions through stock exchanges and its subsidiary financial market trade associations to stabilize market trading.[viii] A total of twenty-one major securities firms were orchestrated to invest 15% of their total net asset (around RMB120 billion) in buying stocks and committed not to reduce their proprietary trading positions until the Shanghai Composite Index returns to a given level (SAC 2016).

CSRC also directly coordinated liquidity injection and stock purchases to bailout the market through its subsidiary company China Securities Finance Corporation Limited (CSF). CSF was initially established in 2011 to provide margin financing loans services to support securities firms to develop their margin trading businesses. As part of CSRC-led efforts to promote financial innovation and market development, CSF was envisaged as 'a central bank for securities firms' in terms of providing market liquidity as a financing counterparty to securities firms. Affiliated under CSRC with major stock and future exchanges as its shareholders, CSF's official mandate included "other duties approved by CSRC" in addition to its main business of providing margin financing loan services to securities firms (CSRC 2016:66). Before the crash, the role of CSF was somewhat peripheral in China's stock market as securities firms had multiple channels of financing to support their business activities and their transactions with CSF were limited, but after the crash, CSRC improvised and used CSF as the central vehicle to orchestrate the market bailout actions and directly purchase shares. Backed by the support from the State Council, the CSRC and CSF raised a total of over RMB2 trillion through a variety of financing channels, including capital injection, issuance of short-term notes, funds committed by the twenty-one major securities firms as well as credit from the People's Bank of China and state-controlled commercial banks. Over the two trading days of 7 and 8 July, the CSF spent over RMB40 billion buying blue chip SOE shares to counter with the market selling pressures. As the crash continued in the ChiNext Board, CSRC expanded bailout actions from buying blue chip shares to small-medium cap stocks, with CSF extending RMB260 billion credit quota to major securities firms to purchase more stocks. Centred around the CSF, CSRC orchestrated a 'National Team' of state-linked financial institutions to buy stocks and shore up the market. While there were similar practices in other countries to purchase blue-chip stocks to bail out the market, it's peculiar for China's 'National Team' to buy equities of many small and medium-cap companies (including technology start-ups) listed in the SME Board and

ChiNext Board to maintain market stability. The arbitrary selectivity and lack of transparency in bailout decision making imply that there was substantial space for actors with insider information and influence to potentially abuse their positions for private gains.

Apart from CSRC, a constellation of other state organs were also mobilized to intervene and help stabilize the stock markets as the crash deepened and bailout policy decision making further escalated in the ranks of the state bureaucracy. The People's Bank of China (PBOC) stepped in by further cutting benchmark interest rates and reducing the reserve requirement ratios (RRR). Later it committed to provide ample liquidity to support the CSRC's bailout efforts. The Ministry of Human Resources & Social Security and the Ministry of Finance issued draft policies to allow pension funds managed by local governments to invest up to 30% of their net value into the stock market, which could provide potential new fund inflows (up to about RMB600 billion). China Insurance Regulatory Commission (CIRC) required insurance companies to keep net buying stocks and relaxed regulations to encourage insurance companies to buy more stocks. China Banking Regulatory Commission (CBRC) also relaxed regulations to allow banks to roll over matured loans pledged by borrowers with stocks and encouraged commercial banks to provide liquidity support to the CSRC's bailout efforts. Central Huijin, a key subsidiary of China's sovereign wealth fund, directly intervened to purchase RMB12 billion shares in the form of exchange-traded funds (ETFs) and committed not to reduce its shareholding positions. SASAC and the Ministry of Finance also ordered China's largest state-owned enterprises and state-owned financial institutions to buy back the shares of their listed companies to shore up the market and not to reduce existing equity holdings. Even the Ministry of Public Security and the police force were called forward to commit their support to market stabilization efforts and investigate the so-called 'malicious short-selling' activities (SAC 2016).

After consuming massive bailout funding, China's stock market showed signs of stability in August. However, amplified by concerns about RMB depreciation triggered by the PBOC's actions to reform RMB exchange rate regime in August 11, investors fell into panics and China's stock market collapsed again, with the Shanghai Composite Index further crashing around 20%. Burdened by the unsatisfactory outcomes of its earlier interventions, CSRC was politically more constrained in dealing with this round of collapse and focused on buying blue-chip SOE stocks to shore up the market through the CSF. The market only gradually stabilized towards the end of 2015 as sharp sell-offs diminished and the amount of margin financing declined substantially. Then CSRC started to partially unwind the emergency policy measures implemented during the bailout, including restarting IPOs in November 2015. It also launched new policy experiments to mitigate market instability and introduced 'circuit breaker' mechanisms to curb panic selling by automatically halting trading once the price movement hit threshold levels. While various forms of circuit breakers had been applied in mature stock markets including the US and Europe, CSRC's circuit breaker experiments turned out to be a policy disaster in China's market context. Within four trading days after its launch, circuit breakers were triggered four times. Instead of reducing market volatility, it was widely blamed for triggering flash crashes and magnifying market panics. Pressured by this new round of market crashes, CSRC suspended circuit breakers on January 08, 2016, only a week after its launch.[ix] Amid messy policy changes, China's stock market experienced another meltdown, with the Shanghai Composite Index and ChiNext Market Index falling over 20% and 25% respectively in January 2016 before they bounced back and gradually stabilized for the rest of the year.

The extraordinary actions and inconsistent policy commitments of China’s financial regulatory bureaucracy between its pre-crash market stimulus and post-crash market bailout undermined the credibility of China’s financial regulatory regime and market-oriented reform programs. The policy-induced market turbulence also triggered organizational turbulence inside the hierarchical institutional network of China’s stock market regulatory regime, disrupting the relations among the Centre, CSRC and major stock market financial institutions. Trying to identify and punish culprits deemed responsible for the crises, CSRC initiated large-scale crackdown of shadow borrowing platforms and launched investigations against ‘malicious short selling’. It also launched investigations against major financial institutions in the ‘National Team’ on non-compliance and insider trading. CSRC punished over 760 institutions and individuals in 2015, more than doubled from 2014. The fines that CSRC charged in 2015 against malpractices exceeded RMB5.4 billion, 150% more than the total fines that CRSC charged over the previous ten years (CSRC 2016).

By the end of 2015, six of the twenty-one securities firms in the ‘National Team’ were under investigation by CSRC for short selling. The Party’s disciplinary forces also started scrutinizing the conduct of top cadre-officials at the CSRC and state-owned financial institutions involved in the stock market crisis and bailout. As the probes deepened, the authorities arrested a number of senior officials in CSRC (including its vice chairman and assistant chairman) on suspicion of severe disciplinary violations and senior executives from major securities firms (such as Citic Securities, the largest state-controlled securities firm in China) that had played importance roles in the bailout. It was reported that some CSRC officials were suspected of leaking information on bailout to senior executives in securities firms to seek profits (Sheng 2019).

5. **Pathologies of China's Hybrid Stock Market Regulatory Regime**

Based on our anatomy of the crisis, we now assess China's stock market regulatory regime in the lens of the Legal Theory of Finance (LTF). At the heart of the LTF framework lies four interwoven propositions: 1) financial market is a rule-bound system supported by law and institutions; 2) finance governance is essentially a hybrid between the state and market, public and private; 3) laws, regulatory rules and public sector institutions can be a source of financial stability; 4) financial governance is inherently hierarchical. In what follows, we discuss China's stock market regulatory governance along each of these dimensions with reference to the 2015-2016 crisis.

First, China's stock market development does not operate outside rules, but has experienced increasing codification and legalization of rules in the forms of basic legislations, administrative regulations and rules. Like their counterparts in the West, China's stock market financial intermediaries have made extensive use of contractual devices (including complex instruments such as 'the Umbrella Trust') and collaterals (including margin-financing and stock pledged lending) to expand their businesses, often front-running the regulators by circumventing existing regulations. This indirectly suggests the strength of some existing rules in China's stock market as otherwise market participants would not need to develop innovative contractual responses to go around these rules. On the other hand, the mechanisms of formulating and implementing rules in China's stock market regulatory regime have provided the state bureaucracy with extensive discretionary authority under top-down political control. CSRC can selectively and elastically apply and alter both regulatory and market rules within the expansive policy space provided by the legal framework. While this provides flexibility for state actions, it also distorts the expectations and behaviours of market participants, who can strategize their reactions to the perceived signals from the state.

Second, the hybridity between the state and market is essential to China's stock market regime, which manifest as the intertwining of multiple ownership, control and governance mechanisms between the public and private, the state bureaucracy and market. While the presence of state intervention is strong, the state no longer exerts monolithic control over the resource allocation, agent incentives and information communications in the system. The state has to rely on and indeed develop more diverse interfaces to influence the market than traditional administrative commands. To the extent that the state does directly intervene and dominate, its control has become highly porous in dealing with the increasingly complex and active stock market.

Third, the particular motivations and patterns of state actions in formulating and enforcing regulations (or deregulations) are a major source of market instability. In China's hybrid regime, CSRC faces multiple policy tasks with inherent tensions and conflicts. There is continuous mixing of different responsibilities, roles and goals involving different logics such as regulatory governance, macroeconomic control, securities market development, party politics and crisis management, creating peculiar institutional complexity. There are built-in incentives for China's regulatory bureaucracy to encourage a relatively bullish market to reconcile demands from different stakeholders. Given the well-understood weaknesses in China's stock market such as prevalent retail investor speculation, relative lack of long-term institutional investors and trading liquidity in ChiNext Board, the sudden relaxation of certain regulations such as margin-trading and shadow lending can lead to the rapid formation of speculative market bubble, while in reverse the rigid enforcement of certain rules such as margin-calls may lead to market destruction. The state bureaucracy can and was widely expected to intervene and alter the rules to stimulate or bailout the market.

Fourth, China's stock market is highly hierarchical. The Party centre and State Council ('the Centre') are at the apex of the system and maintain extraordinary mobilization capability in crisis management. Nested around the state are multiple layers of financial intermediaries ranked and evaluated by CSRC, with varied strength of linkages with the state. At the core of the system lies CSRC, a few state-controlled financial institutions (such as CSF and Central Huijin) and major securities firms (such as Citic Securities), which served as the 'National Team' and dominated the bailout process with little external oversight. On the other hand, the rankings and relative status of actors in this hierarchical institutional network are also highly contingent during the crisis. Although the bailout funding primarily went into purchasing the blue-chip stocks of large SOEs, the 'National Team' also shored up many small-cap companies and the market actively speculated on the selective purchase decisions of the 'National Team', the discretion of which played a major role in deciding who benefit most from the bailout. As demonstrated in the crisis, the boundary of organizational authority among the Party centre, the State Council, CSRC and major financial institutions are not clearly defined. There is considerable fragmentation of regulatory authority and oversight as well as mismatch of roles among various entities inside the party-state hierarchy both in promoting stock market development and containing the crises. The delegation of authority by the Party centre and the State Council to CSRC in governing stock market is highly incomplete. The Centre maintains the reserve power to intervene by mobilizing resources and redistributing authority in crisis.

The stock market crisis in 2015-2016 has exposed the fragility and tensions accumulated in China's existing hybrid financial governance. We identify two pathological features which has shaped the policy process and market dynamics during the crisis: 1) regulatory elasticity dilemma; and 2) campaign-style enforcement dilemma. Together they have amplified policy noises and led to a destabilizing feedback loop between policy-induced market turbulence and market-induced organizational turbulence inside the regulatory bureaucracy. They also pose fundamental constraints on the gradualist policy tinkering in China's stock market governance.

5.1 Regulatory Elasticity Dilemma

Regulatory elasticity is defined here as the extent to which regulatory rules, standards and policies can be arbitrarily changed and selectively enforced under the administrative discretion of state bureaucracy. As the LTF framework suggests, some forms of elasticity and selectivity in the enforcement of rules is an endogenous property in modern financial governance. On the one hand, consistent, uniform and credible rules are critical to support financial market development. On the other hand, in times of crises, even in the most advanced economies, the state typically steps in as the backstop to protect financial markets by suspending the full enforcement of rules and selectively bailing out some financial entities. This presents an intrinsic dilemma as such elasticity and selectivity tend to breed moral hazard and undermine regulatory credibility.

Consistent with the logic of market-oriented liberal reforms, CSRC has increasingly focused on the formalization and standardization of regulatory rules to supervise market practices over the past decade. However, absent institutionalized constraints on the behaviours of the regulatory bureaucracy, this logic still lacks credibility in the eyes of the market actors. To use stock market as a tool to serve the state's development strategies and the Party's policy lines, CSRC has to maintain the power to unilaterally shape the content and enforcement of regulatory rules, and to selectively support, reward and punish key financial intermediaries at its discretion. In formulating and enforcing rules, CSRC relies extensively on pilot programs, policy experiments and provisional rules first before setting more standardized formal rules. In this process, CSRC controls which securities firms and asset management companies can join the pilot programs, and to what extent certain rules apply to certain types of financial entities. Such regulatory elasticity induces competition among key financial intermediaries and relational exchange between CSRC and key financial intermediaries. It can create pockets of policy favours for selected market actors and generate flexibility for the regulatory bureaucracy to navigate the changing policy environment.

However, market participants can continuously speculate on and game the regulatory elasticity. Knowing well CSRC can unilaterally change and selectively enforce rules, major financial institutions have competed and advocated for favourable policy treatment. Whenever a 'policy window' is open, they tend to act quickly on seizing it, fearing that the opportunity may lapse if policy preferences and rules change again. This tends to generate policy overshooting. When CSRC signals and encourages some loosening, key financial institutions may scurry to loosen. When it signals and demands some tightening, they may scurry to tighten as well. Major financial institutions responded vigorously to CSRC's big push for financial innovations in 2012, which stimulated the market boom. Later as CSRC tightened in 2015 due to concerns about risks, the market quickly reversed its course and collapsed. While CSRC initially restrained from directly changing rules to bail out the market, as the market conditions deteriorated, it soon switched to a 'do-whatever-it-takes' mode to shore up the market.

Regulatory elasticity can alter the market dynamics perversely. Not only does it directly increase uncertainty and inconsistency in investor expectations, but it can also generate a second-order effect in diverting investor attentions towards speculation on elastic and selective policy actions. Investors widely believe that regulatory elasticity reveals the policy preferences of the state and they can infer market trends and profit from acquiring information and trading upon the perceived policy preferences instead of economic fundamentals. As market becomes increasingly complex and active, speculation can rapidly react on policy changes and generate unintended outcomes. This second-order effect not only exacerbates policy noises and weakens the market's pricing and information processing efficiency, but as CSRC's failed circuit breaker experiment indicates, it can also rapidly generate reverse pressure on policy changes, further undermining regulatory credibility.

5.2 Campaign-style Enforcement Dilemma

Campaign-style enforcement is defined here as the type of policy implementation involving extraordinary mobilization of administrative resources under strong political sponsorship to achieve certain policy goals in a short period of time (Liu et al 2015). Policy campaign usually arises when regular administrative mechanisms are deemed unsatisfactory and/or urgent policy responses are required. In the context of regulatory enforcement, it is typically characterized by a period of weak enforcement during which inspections and sanctions are relatively loose and regulated firms are given broad autonomy, then followed by short periods of coercive and intense enforcement during which inspections and sanctions are much toughened, with central regulatory bureaucracy asserting its dominant authority over regulated entities (Van Rooij 2016). Existing literature on China's legal and public administration reforms has linked the origin of campaign-style governance in contemporary China with the institutional weakness of legal system, the top-down political authority structure and the Party's legacy in both mass and bureaucratic mobilization (Perry 2011; Zhou 2012; Liu et al 2015). It seems to fit well with "an authoritarian, but increasingly fragmented and experimental, system of government" in contemporary China (Van Rooij 2016:229).

Campaign-style enforcement featured prominently in China's stock market crisis 2015-2016. Policy campaigns were launched to mobilize resources and encourage innovations from the financial system to achieve the state's developmental policy goals. In the run-up of the crisis, CSRC, CIRC and CBRC were in a race of promoting financial liberalization. The pressure and momentum cascaded down to key financial intermediaries and exacerbated their profit-seeking and regulatory arbitrage behaviours. It fed an increasingly accommodative regulatory and liquidity environment as well as widespread market expectations that it was a state strategy to generate a policy-driven bull market. Consequently, a super-charged 'national bull market' boomed, fuelled by rapid building up of leverage and speculation. As the bubble eventually went bust and market euphoria turned into panics, the market went into a chaotic deleveraging process. Then the regulatory bureaucracy urgently mobilized various entities to stabilize the stock market. Initially it was primarily CSRC orchestrating financial institutions under its supervision to bail out the market. Then as the market further fell and decision-making escalated, the broader state bureaucracy was mobilized to join the bailout as well. In a very short period of time, this constellation of disparate policy actors was all mobilized to come up with *ad hoc* policy responses to help stabilize the stock market, pouring in massive resources and bending existing rules. Alongside the bailout efforts, the authorities also launched coercive enforcement campaigns to search for the culprits, identifying and punishing actors deemed responsible for the crisis and policy messes, including top-level personnel in CSRC and major securities firms.

By mobilizing extraordinary actions in a short period of time, campaign-style enforcement asserts vertical authority, redistribute power and resources, and re-delineate the boundaries of autonomy among various entities in the increasingly fragmented and plural network of institutions in China's hybrid stock market regime. As seen in the wave of pre-crisis financial liberalization reforms, policy campaigns can be a force of overcoming institutional rigidity to stimulate and accelerate changes. By *ex post* cracking down targeted actors and non-compliant activities, it may also help to deter rent-seeking and opportunistic behaviours in an environment of regulatory elasticity, realigning the financial industry's interests with the state's policy priorities. However, it also presents a dilemma of its own due to its arbitrary nature. It can induce severe policy overshooting during the period of intense mobilization. Its deterrence effect is only partial as the market expects policy campaigns to be temporary. To the extent that it overcomes rigidity and drives changes, it tends to imprint big and costly policy swings in the pathway of China's financial liberalization reforms. As a securities firm executive commented, "the government's campaigns can force changes to happen, but the path of changes is filled with cannon fodder in the market".[x] Unlike such policy fields as anti-corruption and environment regulation, the bottom-up responses and feedback process in stock market to campaign-style enforcement can manifest rapidly in the forms of asset price swings and liquidity changes (even pre-empting state actions), which may quickly backfire and bring about turbulence inside regulatory bureaucracy.

6. **Concluding Remarks**

Unlike stock markets in the Western advanced economies, China's stock market was created by the state-led efforts to reform and develop its former central planning economy. Unlike other transition economies adopting the 'big bang' reform strategies, transplanting a standardized institutional blueprint played a much less important role in structuring China's stock market than the gradualist policy tinkering of China's cadre-officials in 'crossing the river by feeling the stones'. Among former central planning economies, China has created the most dynamic and rapidly growing stock market, with a complex ecology of market participants nested around the state bureaucracy and a relatively small group of large state-linked financial institutions. It has developed a distinctive financial regulatory regime hybridizing multiple ownership, control and governance mechanisms. Rule-based regulatory and legal enforcement is layered upon China's traditional party bureaucratic governance characterized by politicized top-down cadre management, policy mobilization and experimentation.

It's well acknowledged in China that a regulatory bureaucracy committed to rule-governed actions can mitigate uncertainty, enhance public trust and facilitate financial development. However, while rules apparently similar with the Western regulatory practices have become increasingly important in China's stock market governance, the ways these rules are formulated and implemented are deeply embedded in China's indigenous policy environment and underlying distributions of power. China's financial regulators possess pervasive discretionary authority and face only limited oversight apart from accountability to the upper-level party-state organs. Such pervasive bureaucratic power is a double-edged sword. On the one hand, it enables regulators to flexibly design, experiment and push forward reforms and policy initiatives, but on the other hand, it also generates administrative dilemmas that distort regulatory incentives, policy processes and market dynamics. Drawing on the Legal Theory of Finance (LTF), this article calls attention to how the pathological features of China's hybrid financial governance in terms of the regulatory elasticity and campaign-style enforcement dilemmas pose fundamental constraints on China's financial market stability and regulatory effectiveness.

While China's 2015-2016 stock market crisis manifests the inherent vulnerability and frictions of financial liberalization, the unusually volatile and costly financial market processes and policy actions also reflect the institutional weaknesses of China's bureaucracy and its existing hybrid financial regulatory regime. As China's financial markets become increasingly complex, open and interconnected, the governance dilemmas facing the regulatory bureaucracy can quickly transmit policy noises to the markets, which may actively speculate upon and even front-run policy actions. In reverse, market turbulence can also pressure the state bureaucracy directly and consume its political capital, creating a destabilizing feedback loop between market processes and the organizational dynamics inside the regulatory bureaucracy. Such interaction implies cautions on China's ongoing process of financial liberalization and capital market opening up. It also calls for more holistic institutional reforms to simplify the regulatory policy environment and constrain arbitrary bureaucratic mobilization that may distort incentives and exacerbate turbulence.

One possible strategy of reforms is to further differentiate the multiple organizational linkages, policy rationales and institutional logics facing the regulatory bureaucracy and major financial intermediaries in China's hybrid regime. This requires more structural separation, unbundling and realignment between CSRC, stock exchanges, financial market trade associations and major financial intermediaries, as well as among CSRC's multiple functions in regulation, market development, party politics, financial stability and state macroeconomic policies. The courts' authority and roles shall expand, creating stronger oversight on the financial regulatory bureaucracy. Such reforms should involve not only the *de jure* regulatory organizational designs, but more importantly also address the *de facto* allocation of authority and informal linkages across the hierarchical institutional network of financial market governance. Stronger 'distancing measures' are needed to create and maintain more rule-governed spheres of autonomy among the political leadership, regulatory bureaucracy and markets, at least in normal times. In crisis times, the regime may switch back to a temporary mode of integration, compressing the inter-agency distance to strengthen the regime's capacity for coordinated frontline responses. However, there is no optimal governance regime that can perfectly balance financial innovation and stability in an uncertain and changing environment. During the current stage of China's development, financial regulation and governance will continue to evolve through a trial and error process with the party-state control as the last resort in guarding the overall parameters of market development and the international practices as sources of references and learning.

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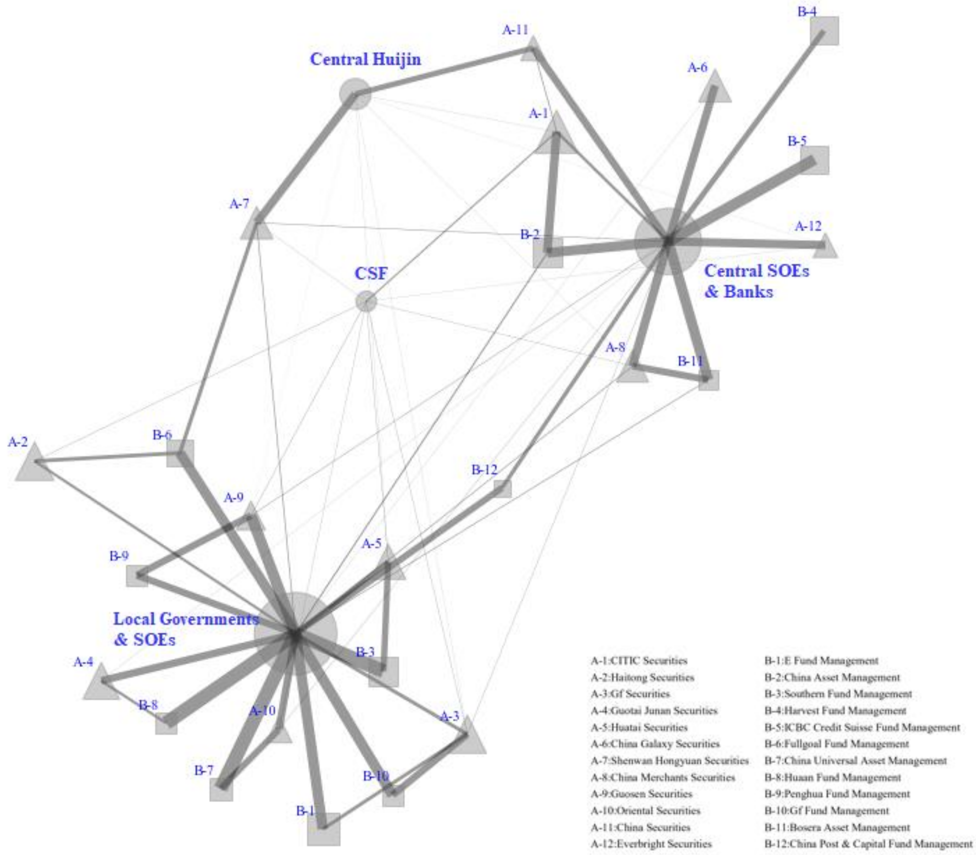
Figure 1. The state shareholding network of China's major securities firms and asset management companies in 2015



Note: Triangles (A1-A12) represent China's major securities firms with shape size difference based on their total assets. Squares (B1-B12) represent China's major asset management companies with shape size difference based on their total asset under management (excluding money market funds). Circles represent four main categories of state-linked shareholders of these securities firms and asset management companies, including local governments & SOEs, central SOEs & banks, Central Huijin and CSF, with shape size difference based on the estimated book value of their ownership stakes in these securities firms and asset management companies. CSF refers to China Securities Finance Corporation affiliated under CSRC. Its shareholding in China's major securities firms and asset management companies stems from the bailout purchase programs in 2015. Lines among the various shapes represent shareholding relations, with line width difference based on shareholding percentages.

Source: compiled from company annual reports and disclosure documents.

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[i] Lin and Milhaupt (2013) have proposed the notion of 'networked hierarchy' to characterize the governance of China's non-financial state-controlled business groups organized under the State-Owned Asset Supervision & Administration Commission (SASAC). As China's stock market governance regime is less vertically integrated and more dispersed in terms of the organizational forms and ownership pattern. We instead use the notion of 'hierarchical institutional network' to give more emphasis on the network aspects of this organizational field.

[ii] Interviews, 2016-07; 2018-01; 2019-03.

[iii] For example, administrative sanctions by CSRC is the precondition for the courts to hear investor lawsuits for misleading disclosure (Liebman & Milhaupt 2008; Miu 2017).

[iv] Interview, 2018-05.

[v] Margin trading refers to borrowing money from securities brokers to buy stocks, with the loan secured against the shares purchased; stock pledged lending refers to lending extended to key shareholders or managers of listed companies who pledge their shareholdings as collaterals.

[vi] Yang, YJ (2015) Stock Pledged Lending Repurchase Business: Current Situation, Risks and Recommendations, *China Securities (Zhongguo Zhengquan)* 2015(5), 41-45; Interviews, 2018-12; 2019-3.

[vii] Jiang F and Liu C (2015) The Bailout Struggles of A-share Market (A-Gu Jiushi Kuzhan), *Caixin Weekly (Caixin Zhoukan)*, 2015 (27). Available online at http://weekly.caixin.com/2015-07-10/100828060.html, accessed on July 20, 2018.

[viii] Interview, 2018-11.

[ix] CSRC Research Report on 'Circuit Breaker' mechanisms, available at http://www.csrc.gov.cn/pub/newsite/yjzx/yjbg/201603/P020160325403577653544.pdf, accessed on March 11, 2019.

[x] Interview, 2019-02.