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Development Considerations for a Chinese National Securities Market

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Abstract:

There are various reasons for attempting to create a capital markets union, and various avenues to do so. An important component is linking securities markets. This paper offers an analytical schema for understanding existing techniques for linking securities markets, a critique of the methods employed in the US National Market System (NMS) and EU Market in Financial Instruments Directive (MiFID) projects, and a comparative analysis of the models of linkage used in the Shanghai-Hong Kong Stock Connect and the ASEAN Trading Link, proposing eventual linking of the two systems, and concludes that it is the best model for linking securities exchanges. The primary critique I offer of the NMS and MiFID projects is that they fragment the market, disrupting both transparency and effective regulation, while offering their benefits primarily to the large broker-dealers in a position to profit from platform creation and exploitation. I explain that the alternative use of a concentrated matching model of linkage employed in China and ASEAN preserves market quality but places large broker-dealers under competition by introducing infrastructure that even small brokers can use. I find that the two Asian systems are interoperable, suggest that they be linked, and argue that such a direct linkage preserving liquidity and transparency offers regulators in Europe and the US a good example of what is possible, albeit probably not desirable for the large broker-dealers in their markets.