



RED DRAGON MENACING

Chinese Communist Party(CCP) Exposed

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931. China Insiders Steal Billions From US Investors



Flags are seen outside the New York Stock Exchange (NYSE) in New York City, where markets roiled after Russia continues to attack Ukraine, in New York, on Feb. 24, 2022. (Caitlin Ochs/Reuters)

China Insiders Steal Billions From US Investors

The US government, beholden to big banks, fails to protect small American investors



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News Analysis

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China's corporate insiders are cheating small American investors of billions of dollars through advance information that enables lucrative trades just before the stock price falls.

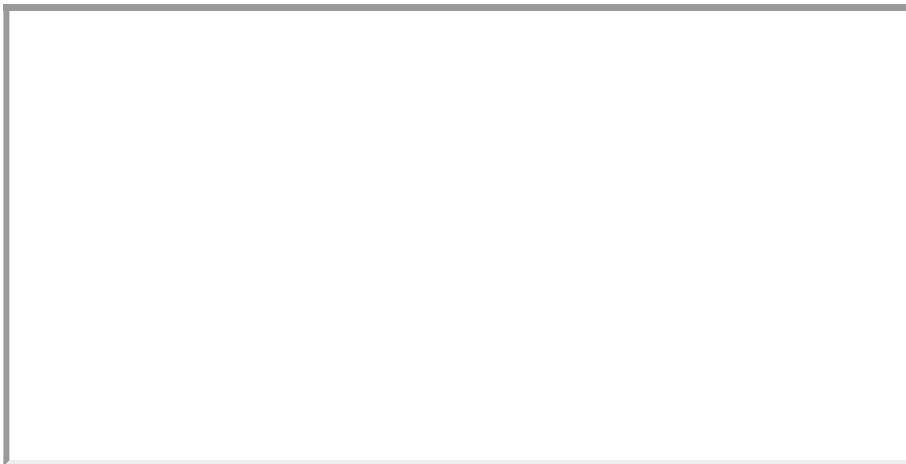
The total losses that insiders of Chinese companies listed on American exchanges have avoided by selling prior to price drops are at least \$10 billion between 2016 and the middle of 2021, according to a new study of their security filings.

Chinese company shares fell an average of 21 percent a year after the Chinese company insiders sold large quantities of stock, compared to a 2 percent rise after

insiders from American companies sold. Given inflation, that American number zeros out. Not so, China's 21 percent.

The Alibaba Case

The Wall Street Journal covered the study and used Alibaba Group Holding Ltd. as an example. In October 2020, “Alibaba’s payments affiliate, Ant Group Co., was preparing for its initial public offering, a move that would have likely increased the value of Alibaba’s one-third stake,” according to the Journal.



But Alibaba’s founder and CEO, Jack Ma, publicly criticized China’s financial regulators, who canceled the listing. Instead of rising, which the market predicted, Alibaba

shares fell 8 percent on the New York Stock Exchange (NYSE).

One day prior to Ma's announcement, Sky Scraper Enterprises Ltd. sold approximately \$150 million worth of Alibaba stock. An Alibaba insider controls Sky Scraper, but nobody knows his or her identity.

Whoever controls Sky Scraper, according to the Journal, which cited the Financial Times, "was one of the company's best-paid executives in recent years and had been granted huge swaths of stock as compensation."

This unknown Alibaba executive avoided losses totaling hundreds of millions of dollars through what appears to be insider trading. American and other investors who got caught on their back feet—because they couldn't know the inside information no matter how much research they did—apparently got cheated.

The SEC, Big Banks, and China Collude Against Small Investors

The researchers—Robert Jackson, Bradford Lynch, and Daniel Taylor—point out that U.S. securities law actually advantages and enables China’s insiders relative to those in the United States.

“Executives and other major shareholders at American companies have to disclose their trades within two days in a filing that is posted on the Securities and Exchange Commission’s website and freely available to investors,” according to the Journal.

That deters bad behavior because American insiders do not want to appear to have acted on inside information. They don’t want to signal other market participants to sell the stock and, thus, decrease its value.



Signage is seen at the U.S. Securities and Exchange Commission (SEC) headquarters in Washington on May 12, 2021. (Andrew Kelly/Reuters)

China's insiders don't have the same problem because U.S. Securities and Exchange Commission (SEC) regulators treat them with kid gloves. To encourage China's companies to list on NYSE and other U.S. exchanges in the early 1990s, regulators gave China's companies several key preferences relative to U.S. companies.

For example, unlike American insiders, China's insiders don't have to report their trades in a timely and highly public manner electronically but instead can mail paper

disclosures. The paper reporting may, by law, be thrown out after three months.

That preference gives China's insiders weeks before their trades are discovered and a window of just three months for investors with a lot of time on their hands to visit the SEC offices and discover the trades. Traders typically don't have that time, so China's insider trades are rarely discovered and seldom signal the market in the timely manner required to shield American investors from unfair losses.

As Western institutional investors increasingly invested in China stocks since the 1990s, however, they acquired an interest in lobbying U.S. regulators to continue providing China's companies with regulatory advantages, which kept up their Chinese stock prices.

That sordid party is ending, but addicted institutional investors are scheming an afterparty and trying to smuggle out their drugs, which are the tanking Chinese assets.

SEC Loopholes for Chinese Firms Should be Closed Immediately

The three researchers want the insider trading loophole closed, but, as usual, the SEC is dragging its feet and continues to give China's companies a major advantage that likely bilks small American investors of billions of dollars.

There are other SEC loopholes for China's publicly-listed companies as well. The SEC does not require the same auditing standards of Chinese companies listed on U.S. exchanges that are required of U.S. companies.

Some of these auditing loopholes are being closed through legislation rather than quick executive action, which should be the rule. The executive branch is more beholden to big bank lobbying on China than is Congress.

But even this legislation is taking years to effect. Audits are only extracted from China's companies through the too-

gradual threat of delisting, with a three-year warning. And new loopholes are being negotiated with China by the Biden administration at this very moment.

Due to the threat of delisting, the China Securities Regulatory Commission (CSRC) is proposing that it jointly investigate with U.S. and other authorities, which would give it influence on decisions and a patina of respectability that it does not deserve as a democratically unaccountable authority. It would also provide plenty of opportunities for Beijing officials to attempt to corrupt American SEC officials who are supposed to be laser-focused on integrity.



A sign of the China Securities Regulatory Commission (CSRC) is seen at its headquarters in Beijing, China, on Nov. 16, 2020. (VCG via Getty Images)

There is a more significant political reason for the proposal as well. “China doesn’t want to be seen as making concessions just to the U.S.,” a China financial analyst told the Wall Street Journal. Thus, China’s regulators are negotiating face-saving measures for Beijing and advantages for Chinese companies that they don’t deserve, given their lack of transparency.

The CSRC should be told in no uncertain terms to pound sand. U.S. authorities should investigate China’s companies listed on U.S. exchanges.

Yet the Biden administration is showing weakness. China’s companies could hire Western auditors that subcontract key work to Chinese auditors without checking the work closely. This auditing chain that relies on auditors in China—who are beholden to the Chinese Communist Party (CCP) and unreachable by American and other democratic authorities—will be unreliable and should be forbidden by the SEC.

As usual, the devil is in the details.

All of these loopholes and bargaining by the Biden administration give as much time and space as possible to U.S. banks to unravel their positions, even as their research departments publicly claim that China assets are underpriced. Small American investors, who do not have the time to do the research, have paid the price.

Last month, according to Institute of International Finance (IIF) data, \$11.2 billion flowed out of China bonds, and \$6.3 billion flowed out of China stocks. It is an “unprecedented dynamic that suggests a market rotation” away from China, according to the IIF.

Compare that to emerging markets ex-China, which saw \$10.8 billion flow into debt and an outflow of less than \$400 million from stocks, according to the IIF data. Emerging markets ex-China means emerging markets except for China.

Stronger US Government Action Needed

U.S. loopholes that give China's companies and insiders advantages are an obvious mistake of current and past administrations since the early 1990s—none of which fixed the problem, despite years of China's economic and military growth into an existential threat to both the United States and democracy more generally.

The political influence of the big banks, all of which are deeply invested in China, is mainly to blame. So the researchers are right—inside trading loopholes for China's companies should be closed immediately.

But much more is needed.

Even if the SEC closes all loopholes and preferences that favor China, China's insiders could continue to trade on inside information and escape legal consequences if they are far from American law enforcement. That China's

insiders are beyond American law—and the law of other democracies—needs to be corrected.

Anyone caught insider trading anywhere in the world, if outside the reach of law enforcement in democracies, should at minimum be subject to individualized economic and visa sanctions by democratic governments. This is absolutely necessary for democratic accountability, the rule of law, fair treatment of small investors, and the smooth functioning of international markets.

Anders Corr has a bachelor's/master's in political science from Yale University (2001) and a doctorate in government from Harvard University (2008). He is a principal at Corr Analytics Inc., publisher of the Journal of Political Risk, and has conducted extensive research in North America, Europe, and Asia. His latest books are "The Concentration of Power: Institutionalization, Hierarchy, and Hegemony" (2021) and "Great Powers, Grand Strategies: the New Game in the South China Sea" (2018).

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