

An Empirical Analysis of the Judicial Judgment Path of Investor Suitability Obligation

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Abstract: *The investor suitability system effectively regulates the violation of the right to know by financial institutions in the financial market and the problems caused by the unequal status of financial Institutions and investors in the investment market. There are problems such as unclear identification. Through the empirical analysis of relevant cases in recent years, this paper believes that the court's judgment path for suitability duty cases is mainly based on formal review, supplemented by substantive review, combined with the 9th Conference Minutes and New Regulations for Asset Management. Relevant regulations are to be reviewed. Although the overall judgment idea is perfect, it is still necessary to further unify the principles of suitability obligations and improve the identification standards of product risk and investor level. Through the empirical analysis of relevant cases in recent years, this paper argues that nowadays the court's decision on the adjudication path of appropriateness obligation cases is mainly based on formality examination, supplemented by substantive examination, combined with the 9th Conference Minutes and New Asset Regulation. Although the thinking of adjudication is generally perfect, it is still necessary to further unify the principles of suitability obligations and improve the standards for the determination of product risk and investor level.*

Keywords: *Suitability Obligation; Financial institution; Referee path*

1. Introduction

For a long time, China has pursued the principle of financial market transactions that financial institutions should fulfill the obligation of suitability, in short, knowing your customers, knowing your products, and selling appropriately, which requires financial institutions to sell appropriate products to appropriate customers and to bear the obligation of reasonable recommendation and appropriate sales. And financial consumers should bear the risks and losses suffered from irrational investments for their own reasons. However, in practice, financial institutions often ignore consumers who are at an information disadvantage due to performance or self-interest considerations, thus causing damage to consumers' interests, and the investor suitability obligation is born. Since the introduction of the investor suitability obligation system in China, relevant regulations on investor suitability obligations have been preliminarily stipulated in various fields such as financial futures and private equity. However, local courts have different opinions on investor suitability. This article defines the concept of investor suitability obligations and outlines the current regulations on investor suitability obligations in China. And from the judicial judgment, it empirically analyzes the judgment ideas of Chinese courts for investors' suitability obligations, and puts forward suggestions for improvement.

2. The Legal Concept of Investor Suitability Obligation and Its Legal Norm

The concept of investor suitability obligation is not controversial in China^[1]. This article firstly sorts out the legal concept and specification of investor suitability obligation, so as to sort out the trial court though of investor suitability obligation in advance.

2.1 The Concept of Investor Suitability Obligations

The concept of investor suitability obligations is not a domestic concept in China, but an imported product from the Common Law System. Professor Zhang Fubiao and Li believe that the investor suitability obligation means that the products and services provided by financial institutions match the

investor's financial status, investment objectives, risk tolerance and other investors' capabilities and experience^[2]. The Summaries of the National Conference for Work of Courts on the Trial of Civil and Commercial Cases (hereinafter referred to as the 9th conference minutes) provides that the obligation of suitability refers to the obligation of financial institutions to sell appropriate products to appropriate customers when promoting and selling financial products. According to Ren Zili and Liu Jia, the investor suitability obligation refers to the requirement for financial institutions to recommend and sell the appropriate products to the appropriate customers^[3]. Professor Huang Hui believes that the investor suitability obligation means that financial institutions should ensure that the investment is appropriate for the client when providing advice on the purchase of specific financial products to the client^[3]. From this, it can be seen that scholars and Chinese judges have no different opinions on the meaning and definition of investor suitability obligations. As summarized in this article, investor suitability obligations refer to the fact that financial institutions should fully understand the investor's level, risk capability and other capacity factors when providing financial products and services to investors. Products or services sold after full and reasonable evaluation should be appropriate to investors.

2.2 The Normative System for Investor Suitability Obligations in China

China's regulations on investor suitability obligations are widely distributed, and there is no systematic set of regulations or measures. From the perspective of regulating the development in this area, the provisions on the suitability obligations of investors can be found in the *Interim Measures for the Administration of Commercial Banks' Personal Financial Management Services* in 2005, in which Article 37 stipulates that when commercial bank financial advisors recommend investment products to clients, they shall understand and evaluate clients' financial accounts and risk status, and reveal relevant risks. For the first time, this article stipulates that the main body of a commercial bank shall perform the obligation of suitability in the stage of investor introduction. In 2009, the China Securities Regulatory Commission promulgated the *Interim Regulations on the Suitability Management of Investors in the Growth Enterprise Market*. Articles 9 and 10 of the regulations stipulate that securities companies should implement suitability management and risk disclosure, and emphasize the strengthening of violations of suitability. Internal accountability mechanism for sexual obligations. Compared with the *Interim Measures for the Administration of Commercial Banks' Personal Financial Management Services* in 2005, the *Provisions on Suitability Management (Interim)* in 2009 extended to securities companies and strengthened the accountability mechanism for suitability obligations. In 2014, the State Council of China promulgated the *Regulations on the Supervision and Administration of Securities Companies*. Article 29(2) of the regulation stipulates that securities companies should recommend appropriate products or services. This regulation further clarifies the meaning of the suitability obligation and clarifies the obligation of appropriate recommendation. In 2018, Article 6 of the *Guiding Opinions on Regulating the Asset Management Business of Financial Institutions* jointly issued by the People's Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission and the State Administration of Foreign Exchange (hereinafter referred to as the "New Asset Management Regulations") stipulates that investors' suitability obligations should be including the obligation to understand the product and the obligation to understand the customer, and should pay attention to the suitability of the product and investors, as well as fully fulfill the obligation of risk disclosure. This is a detailed explanation of the application of investor suitability obligations. In the 9th conference minutes issued by the Supreme People's Court in 2019, Articles 72 to 78 of the Regulations clearly stipulate the obligation of investor suitability, and provide detailed explanation on the application of the law, the subject of responsibility, the allocation of the burden of proof and the amount of compensation in the trial process. It also provides detailed provisions on the application of the law, the subject of liability, the allocation of the burden of proof and the calculation of the amount of compensation, as well as the exclusion of liability in the trial process. At this point, China's investor suitability obligations have clear trial guidelines and a more established regulatory system^[4].

It can be seen that the Chinese investor suitability obligation specification system mainly includes three parts: First, the management of financial institutions' obligations to understand consumers and reveal products^[5]. The second is the management of suitability matching of financial institutions. The third is the scope of application of investor suitability obligations. The second paragraph of Article 6 of the *New Asset Management Regulations* clearly stipulates: Transfer to investors the concept of "financial institutions to sell appropriate products to appropriate customers and to bear the obligation of reasonable recommendation and appropriate sales^[6]. And financial consumers should bear the risks and losses suffered from irrational investments for their own reasons. "which is the primary principle of the investor's suitability obligation^[7]. As embodied in this paragraph, China's capital management industry has a long history of "rigid payment" chaos^[8]. How to implement the application of the investor

suitability obligation system, how the courts apply the law in such cases, and how effective the existing regulations are applied in practice. The following is an empirical analysis of the court's decision on investor suitability obligations from judicial documents. The following is an empirical analysis of the court's decision on investor suitability obligations from judicial decisions.

3. Analysis of the Adjudication Path of Investor Suitability Obligation Cases

By 16:00 on March 25, 2022, using "civil cases" as the search scope and "appropriateness obligation" as the search element, and selecting the years 2019, 2020 and 2021, a total of 743 judgments of various types were searched on the website of China Judicial Documents. A total of 743 judgments, including civil judgments and civil rulings, were searched on the China Judgment Documents website. After de-duplication, combined trial level and relevance screening, the final sample size was 246.

3.1 Elements to Examine in the Court Review Process

In these cases, there were four main elements examined by the courts: 237 references to the duty to warn of risks, 90 references to risk assessment and product suitability, 222 references to the financial institution's duty to know the consumer, and 189 references to the investor's level. The main meaning of the obligation of risk indication in the case is that financial institutions and their financial sales personnel must fulfill the obligation of indicating and fully revealing risks in the process of introducing and selling financial products to investors; the form of such written documents includes declaration, instruction, risk disclosure or inclusion in the contract; the content includes the direction of funds, risk prediction, transaction structure, leverage level and other content affecting the rights and interests.

3.2 The Court's Trial Methods during the Trial Process

From the case analysis, it can be concluded that there are differences in the trial thinking of the courts in various places, mainly reflected in the differences in the application of the principle of liability imputation. Some courts in the cases believed that the principle of fairness or the principle of negligence should be applied in terms of liability attribution. For example, in Yan Zhiyuan v. Ninghai Guangfa Sub-branch Financial Entrusted Financial Management Contract Dispute Case, the court held that Yan Zhiyuan had financial management experience and should be aware that the investment exceeded the own investment risk tolerance, so it is determined that each bears corresponding responsibilities. The rest of the courts believe that the principle of "seller's due diligence and buyer's responsibility" should be strictly applied. The premise and basis of "buyer is borne" is that if a financial institution fails to perform or does not fully perform its suitability obligations, the protection of the interests of investors shall be given priority, and the financial institution shall bear the responsibility for losses. This article believes that the second paragraph of Article 6 of my country's New Regulations for Asset Management stipulates the principle of "sellers are responsible and buyers are responsible", combined with the provisions of Article 78 of the 9th Conference Minutes on the reasons for the exemption of financial institutions, financial institutions can only invest only when the investor intentionally provides false information, or the level of the investor proves that it does not affect his free decision, can he be exempted from the corresponding liability for violating the suitability obligation. It can be seen from this that the seller's due diligence should be taken as a pre-consideration. Only when the seller is responsible can it be considered whether the buyer should be responsible. The non-applicability of this principle is an exception, and it can only be waived when it is effectively proved that the buyer's autonomy is fully preserved. From the sample analysis, it is known that the court's trial methods are divided into two levels, one level is the level of formal examination, and the other level is the level of substantive examination. The formal review stage mainly examines whether the financial institution fulfills the obligation of risk warning and the obligation of understanding of the financial institution. The content of this understanding has been discussed above and will not be repeated here. In the investigation of these two obligations in the case, the most important evidence is whether the financial institution conducts a procedural assessment and whether the investor signs the risk disclosure and assessment document. Taking "whether the investor signed the disclosure and evaluation document" as the classification factor, it is empirically concluded that among the 44 cases in which financial institutions lost lawsuits in 2019, 4 cases were signed by investors; among the 42 cases in which financial institutions lost lawsuits in 2020, There are 8 cases in front of investors; among the 60 cases of financial institutions losing cases in 2021, 15 were signed by investors. It can be seen that the court is generally gradually examining the determination of the substantive level, not just judging the outcome of the case at the level of formal examination. At the level

of substantive, the primary questions that need to be answered are those regarding the appropriateness of the risk assessment and the product risk. If applicable, the suitability obligation must be satisfied; an investigation must be carried out to establish whether or not it satisfies the criteria for exemption outlined in Article 78 of the 9th Conference Minutes. If it does, the exemption can be granted.

4. Proposals for Improving Investor Suitability Obligations

The overall methods of the trial is guided by the relevant provisions of the 9th Conference Minutes and New Regulations for Asset Management, but there are still many problems that need to be further improved.

First, the principle of "Seller is responsible, buyer is responsible" should be adopted as the rules of judge of. suitability obligations. The "seller's responsibility" is a prerequisite for the "buyer's responsibility", and it is clear from the relevant provisions of the 9th Conference Minutes that the buyer's responsibility is an exception in such cases. The court ruled in "Hu Shengli v. Zhongda Futures Co., Ltd. Yongkang Business Department, Zhongda Futures Co., Ltd. Property Damage Compensation Dispute Case" that financial institutions should prioritize the interests of investors. However, Zhongda Futures was found to have failed to meet its suitability obligations in the final verdict. Investors have thoughtless flaws as well, and the idea of compensating flaws applies. The notion of "the seller is accountable and the buyer is liable" has not been implemented in the trial, which is a misunderstanding. Investors have also committed the fault of imprudence, and the contributory negligence applies. This is a misunderstanding that the principle of "the seller is responsible and the buyer is responsible" has not been implemented in the trial. The court used Article 78 of 9th Conference Minutes in "Zeng Pingying v. Ping An Bank Contract Dispute Case." According to the paper, financial institutions are unable to demonstrate that investors can make independent decisions. As a result, the application of "seller's due diligence" is the foundation of buyer's responsibility, which more accurately embodies the connotation of suitability obligation. Please refer to Fig 1 for specifics regarding the reasoning behind the court's decisions in the aforementioned cases.

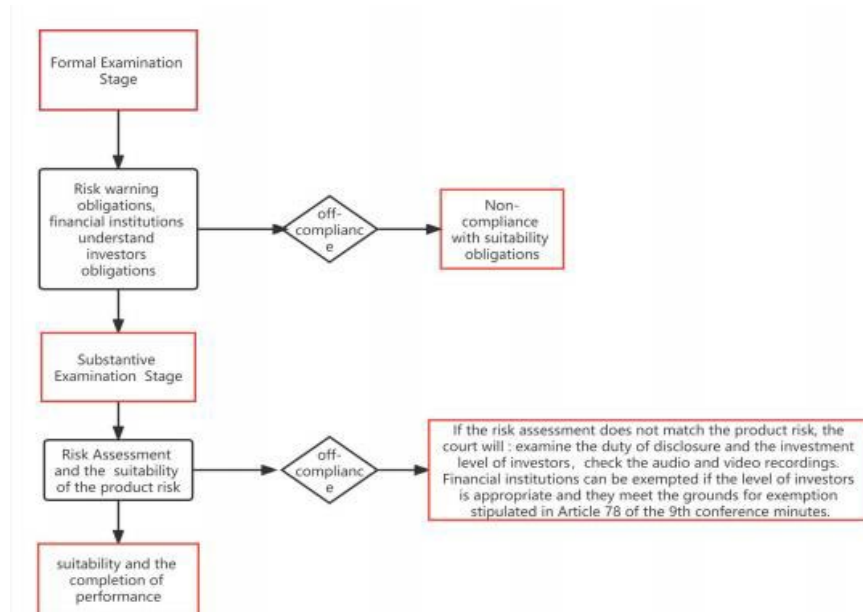


Figure 1: Trial train of thought

Second, raise the standards for identification criteria of investors and the grading system for financial products. The propriety of the product's risk assessment and the investors' tolerance will be the court's main concerns while hearing these cases during the substantive review stage. However, China's present financial rating system is still in its early stages. The essential norms of suitability obligations should be specified in terms of the division of responsibility for financial product rating. However, the court's decision of the number of investors is highly subject to discretion. In the case of Cheng Zhiyu v. China Merchants Bank Contract Dispute, for instance, the court determined that the plaintiff, a college student, possessed independent judgment because he had several years of financial expertise. For the definition of investor level, Article 8 of China's the *Eligibility Management Measure of Securities and Futures*

Investors divides investors into ordinary investors and professional investors, and simply distinguishes natural person investors by asset size and investment years. Obviously, this cannot fully serve the trial of investor suitability obligation cases, so it is necessary to improve the identification standard of investor level in the investor suitability obligation system.

Despite the fact that China introduced the suitability obligation rules of financial institutions in the *Interim Measures for the Administration of Personal Financial Services of Commercial Banks* in 2005^[3], the analysis of the adjudication path demonstrates that the suitability obligation rules in China are not yet perfect and the application of principles is not yet unified. The implementation of principles has not been consolidated, the standards on product risk and investor suitability are inadequate, and there is a lack of clarity regarding many fundamental norms. To better protect the interests of investors and maximize the guarantee of the investor suitability obligation system, more enhancements should be undertaken.

5. Conclusion

In conclusion, through the empirical analysis of the cases related to "investor suitability obligations", we can see that the courts in various places have not formed a unified opinion on the trial thinking, especially in the application of the principle of attribution of responsibility. This difference is caused by the inconsistency of content at the censorship level and the inconsistency of censorship logic. Through the comprehensive analysis of the samples, this paper draws the generality of the trial thinking and draws the following conclusions: when the court tries such cases, it mainly focuses on the formal review and supplements the substantive review. , the formal examination is given priority, and the formal evidence of the risk warning obligation and the financial institution's understanding obligation is screened. If the requirements are not met at this stage, it is judged that the financial institution has not fulfilled the investor suitability obligation. However, even if the form is compliant, it does not mean that the financial institution has fulfilled its investor suitability obligations, and will further proceed to the substantive review stage of the content. In this stage, priority will be given to whether the risk assessment of the product is appropriate. In practice, financial institutions tend to rate products as low-risk to get better sales. Therefore, in the case, the court prioritizes reviewing this item to determine whether the obligation of suitability is fulfilled, but even if this item fails, the court further examines the recording. Video recording and comprehensive assessment of whether investors have a certain level of risk-taking behavior under the condition of clear information disclosure. Therefore, the general thinking of the court appears to protect investors and increase the obligation of financial institutions to disclose accurately. Based on this, this article makes two suggestions. First, local courts should unify the principle of trial as soon as possible. Due to the differences in cases in various places, it is indeed difficult to unify the thinking of trial. However, the principle of accountability of "Seller is responsible, buyer is responsible" should be To unify as soon as possible, lest the attribution of responsibility will produce differences in various places, affect the overall fairness of the court and create judicial loopholes. Second, improve the rating system for financial products and the criteria for determining the level of investors. The court obviously lacks a mature rating system in such cases, making it difficult to reflect the accuracy of the trial in the substantive review stage.

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