Advances in Economics, Business and Management Research, volume 96

2019 3rd International Conference on Education, Management Science and Economics (ICEMSE 2019)

Watching Out for the Risk of "Entrusted Financial Management"

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***Abstract*—In recent years, as a lagging response to the deep adjustment of the stock market in China, a large number of entrusted financing cases have emerged. The main risk factors in entrusted financing are as follows: entrusted financing becomes "entrusted stock speculation". Most entrusted financing agreements adopt the method of guaranteed return rate, and the quality of entrusted companies is uneven, which easily leads to company losses and chain effects. This has done great harm to the whole stock market and the national economy. They should strengthen the management of such phenomena to prevent systemic risks. In dealing with such entrusted financial cases, attention should be paid to the principles of balancing rights and interests, stabilizing financial order, giving overall consideration and focusing on resolving contradictions. They should strengthen propaganda and raise investors' awareness of prevention, and report criminal acts as soon as they are found. When dealing with such contracts with fixed income and guaranteed terms, the court shall, in accordance with its substantive legal relationship, determine that the two parties have established a loan contract relationship. If a company without qualifications absorbs funds from the unspecified public in the name of entrusting financial management, and if the relevant circumstances are achieved, it may be investigated for criminal responsibility for the crime of illegally absorbing public deposits according to law. Subjectively, if it has the purpose of illegal possession, it may also be recognized as the crime of fund-raising fraud.**

Keywords—entrusted financial management; bottom guaranteed income; balancing of interests; principle of overall consideration; crime of illegally absorbing public deposits

I. INTRODUCTION

Entrusted financing refers to a business in which securities companies or investment companies accept client's entrustment and effectively manage and operate customer's assets through the securities market.[1] On the premise of strictly abiding by client's entrusted wishes, and on the basis of ensuring the safety of client's entrusted assets as far as possible, they realize the preservation and appreciation of assets.

In recent years, as the lagging reaction of the deep adjustment of the stock market in our country, a large number of entrusted financial cases have emerged. The main reasons are as follows: first, the securities business department violates the rules and regulations, misappropriates clients' entrusted financial funds or disguises them into large investors and bankers in the name of entrusted financial management; second, entrusted securities investment between individuals and companies in the name of entrusted financial management is increasing day by day. [2] In the case of the stock market plummeting, a lot of hidden problems emerge.

Foundation projects: This paper is supported by" the Cyan Project" of Jiangsu University in 2016.

II. MAIN RISK FACTORS IN ENTRUSTED FINANCIAL MANAGEMENT

A. Entrusting financial management to become "entrusted stock speculation"

Although the forms of entrusted financing are various, in practice, they are represented by such entrusted agreements as "treasury bond investment" and "fund investment", but most of these entrusted funds flow into the stock market. Because, short, flat and fast projects are not everywhere, and the return rate of entrusted financial management signed by entrusted units and entrusted financial companies is very high, usually 6% - 12%, and even some entrusted units promise a return rate of up to 20%. To achieve such high returns in the short term, the stock market has undoubtedly become the only choice. However, "the stock market is risky, please be careful when entering the market", has clearly told us that investment returns have much greater uncertainty or risk than industrial investment. On the one hand, the stock market itself has a high risk. On the other hand, the return rate is closely related to the qualifications and financial management level of the trustee company. Trustee funds entering the stock market are obviously facing huge market risks. What's more, if fraudulent activities are carried out with high return rate as bait, once successful, the losses of relevant units are even more serious.

B. Bottom-guaranteed rate of return is adopted by most trust financing agreements

However, this kind of agreement is essentially a loan contract, and it has become a disguised form adopted by enterprises to circumvent the prohibitive provisions of law on inter-enterprise lending.[3] This agreement, which covers up illegal purposes in legal form, has no legal effect. The interests of entrusted financial companies, especially interest income, will not be guaranteed by law because of their illegality.

C. The quality of the trustee companies is not uniform, and good or bad mixed up

At present, besides securities companies dealing with entrusted financial management business, investment companies, asset management companies, trust and investment companies of all sizes and sizes are also willing to participate in it. Even auction companies have to share in it.[4] The entrusted financial management business has even become one of the important sources of private equity funds. The degree of specialization of the entrusted company directly determines the safety factor and income of the entrusted fund. The low quality of the trustee company undoubtedly brings more risks to the trustee fund.

III. MAIN NEGATIVE EFFECTS OF ENTRUSTED FINANCING

A. Inappropriate sources of funds entrusted to financial management may easily lead to company losses and "serial losses"

The original intention of designing entrusted financial management system is to optimize the allocation of company funds, maximize the allocation of company resources and achieve the optimization of company benefits. That is to say, the company should entrust the financial management business with the stage idle funds which do not affect the normal production and operation of its own funds and the reasonable amount of funds raised. However, statistics show that the company is tempted by high returns, and most of the funds needed for the company's main business and a large number of bank loans are used for entrusted financial management. This undoubtedly puts the company on the edge of high risk. On the one hand, the large amount of funds used in entrusted financing directly leads to the "crowding-out effect", that is, to squeeze the investment needed by the company to develop the main business projects, which has a negative impact on the competitiveness and development potential of the main business of the company; on the other hand, once the entrusted unit loses in the stock market game, it will lead to the repayment crisis. Trustees may use their own funds to fill in, they may go to bank loans, or they may borrow from each other, or even mortgage in tandem. Once the entrusted unit has no money, the entrusted company will suffer huge losses, or make the company's liquidity tense, thereby weakening the expansion ability of the company, or its normal production and operation activities due to lack of funds can't be carried out or even closed down, or unable to repay bank loans, resulting in heavy losses to the bank. Once the capital chain between entrusted companies, trustees, banks or other affiliated units breaks, the consequences are unimaginable, and the impact on economic order and turbulence are also conceivable.

B. It will do great harm to the whole stock market and the national economy

In a healthy economic system, the real economy and the virtual economy should maintain a certain quantitative proportional relationship and internal organic relationship. Specifically, the development speed and scale of the two should be coordinated. The slow development of the virtual economy will inhibit the development of the real economy; while the virtual economy expands too fast, which will eventually damage the real economy because of the collapse of the bubble. A large amount of capital flows back to the stock market, which will aggravate the bubble of the economy and have a very serious negative impact on the macro-economy.

Faced with the huge risks in entrusted financing and the possible negative impact on the economy, supervision departments at all levels should strengthen the standardized management of entrusted financing and securities market, intensify the crackdown on irregularities, strengthen legal publicity, and ensure the rational and standardized operation of entrusted financing so as to maintain the healthy development of macro-economy.

IV. VALIDITY CONFIRMATION AND RISK PREVENTION OF ENTRUSTED FINANCIAL MANAGEMENT CONTRACT

A. Validity determination of entrusted financial management contract

Regarding the validity of the entrusted financial management contract, it mainly focuses on whether the entrusted financial management is the exclusive or franchised business of financial institutions, and whether the trustee must have qualifications to form a disagreement. There are three main opinions between academic circles and practical departments: negative theory, qualification theory and distinction theory.

1) Negative theory. This view holds that, since entrusted financial management business should be a financial business requiring administrative permission, it is necessary to appropriately limit the identity of the trustee and put forward certain access requirements for the trustee. Although there are a large number of entrusted financial activities of non-financial institutions in real life, it is inappropriate to legalize the entrusted financial activities of the above-mentioned subjects from the perspective of policy guidance, normative development and risk prevention.

2) Qualification theory. This view holds that it is lawful for securities companies to engage in asset management business, and basic rules and order have been established. In practice, some securities companies deviate frthe om customer asset management business, which is a normal phenomenon in the process of development. It does not affect the legitimacy of customer asset management business of securities companies, nor can it change the nature of entrusted financial management contracts. Asset management business is a franchised business. According to the relevant laws, administrative regulations and the regulation of the Securities Regulatory Commission, securities companies should acquire business qualification in entrusted financial management business, otherwise the contract should be considered invalid. According to the provisions of the CSRC on risk control and internal control, it is absolutely forbidden for branches (i.e. business departments) to engage in asset management business, so the entrusted financial management contract signed by branches under unauthorized circumstances should be considered invalid; otherwise, it may lead to the misleading that branches can engage in entrusted financial management business and

weaken the power of securities companies to manage branches ability to control force and risk.

3) Discrimination. According to this view, entrusted financial management should be divided into two categories according to the situation of the trustee: entrusted financial management by legal persons of financial institutions and entrusted financial management by legal persons (or natural persons) of non-financial institutions. In the case that the trustee is a legal person of a financial institution, because the securities law explicitly prohibits the securities company from fully entrusted financial management, and because the central bank and the Securities Regulatory Commission have qualification requirements for the entrusted financial management business of a legal person of a financial institution, the entrusted financial management business of a legal person of a securities company or other financial institution without qualification shall be deemed invalid. In the case that the trustee is a legal person (or natural person) of a non-financial institution, because the existing laws and administrative regulations do not prohibit the trustee from engaging in entrusted financial management activities, and in accordance with the spirit of relevant laws such as the Administrative Licensing Law, it is not sufficient to regard entrusted financial management as the basis for the exclusive or franchised operation of a financial institution. Therefore, natural persons, legal persons and other persons outside the financial institution are considered to be insufficient. The entrusted financial management business of other organizations should not be easily recognized as invalid.[5]

B. How to deal with the risks in entrusted financial management?

1) Relevant departments should intensify propaganda efforts, warn potential investors through various forms, entrust financial management with risks, and not be attracted by "guaranteed capital and guaranteed income".

Because entrusted financing is aimed at the financial market with high risk, the relevant principal does not bear the risk of capital loss, has the agreement of the guaranteed terms, violates the principle of fairness in civil law and the rules of responsibility in the entrusted relationship, also violates the basic economic rules and capital market rules, which should be invalid provisions. If the investor appeals to the court on the basis of the entrusted financial contract with the guaranty clause, the court will determine that the contract signed by the two parties is invalid and deal with it in accordance with the legal consequences of the invalidity of the contract.

2) Investors who discover that entrusted financial management is suspected of criminal offences should report the case in time.

If an investor finds that the project he invests is suspected of criminal offence, he shall report the case to the public security organ in time. According to the Provisions of the Supreme People's Court on Several Questions Concerning Suspicion of Economic Crime in Trial of Economic Dispute Cases, if the court finds that the disputes involved in investor prosecution have been filed and investigated by public security organs and other departments, and have not yet been dealt with, the court shall decide to dismiss the prosecution in respect of the civil case and the relevant case materials. Material is transferred to public security organs.

Investors should strengthen rational investment and financial management consciousness, not only pursue high returns, blindly believe the commitments made by the invested projects, but also fully realize that high returns often accompany high risks. Before investment and financial management, investors should fully understand the relevant knowledge, laws and regulations of this type of financial management. Once invested, we should strengthen the sense of participation and pay close attention to the status of financial assets. We should be aware of evidence, for example, in investing in the network platform, we should pay attention to retaining evidence such as electronic contracts, transaction details of financial products in the platform, details of capital exchanges, screenshots of websites related to investment projects, in order to avoid the risk of platform closure and incapacity of proof.

3) For a contract with guaranteed principal, interest and fixed return stipulated by both parties, it should be recognized as "entrusted financial management, in fact as a lending relationship". It should be recognized that both parties establish a loan contract relationship, determine the cause of the case by disputes over the loan contract, and apply the provisions of relevant laws, administrative regulations and judicial interpretations.

The study finds that when the trustee is a financial institution, the court has found that the guarantee clause is invalid, which is related to some laws and regulations stipulating that securities companies, trust companies and other companies can’t make a guarantee commitment. When the trustee is a non-financial institution, the validity of the guarantee clause is not uniform. The basis for determining the invalidity of the guaranty clause is mainly Article 52 (5) and Article 7 of the Contract Law. Most of the reasons are expressed as follows: entrusted financial activities are mainly oriented to financial markets such as securities and futures with high risks, and the agreement of the guaranteed terms that the principal does not bear investment risk violates the basic economic law and capital market rules, and also violates the rules of responsibility-bearing in the entrusted relationship, which is contrary to the fair principle of civil and commercial law, so it should be considered invalid.[6]

V. CONCLUSION

On the basis of the above analysis, I think the following conclusions can be drawn:

1) In dealing with such entrusted financial cases, attention should be paid to the principles of balancing rights and interests, stabilizing financial order, giving overall consideration and focusing on resolving contradictions. We should ensure procedural and substantive fairness, distribute the burden of proof fairly and reasonably, and avoid the negligence of civil liability. Starting from balancing the rights and interests of the parties concerned, we should solve disputes fairly and steadily in order to standardize financial markets, guard against financial risks, maintain financial stability and

promote the development of financial markets so as to avoid negative impacts on financial markets. We should fully consider the public policy nature of financial law, pay attention to the organic combination of law application and policy application, legal effect and social effect, and avoid the mechanical application of law. Attention should be paid to the pursuit of rights-based, equal protection and other concepts, while taking into account national economic policies, financial market regulation and social impact, so as to eventually balance and resolve social conflicts of interest.

2) If a company without qualifications absorbs funds from the unspecified public in the name of entrusting financial management, and it reaches the corresponding circumstances, it may be investigated for criminal responsibility for the crime of illegally absorbing public deposits according to law. If the company has subjectively possessed the purpose of illegal possession, it can also be considered as of fund-raisingnd-raising fraud.

Subjectively, if it has the purpose of illegal possession, it may also be recognized as the crime of fund-raising fraud. Essentially, unlicensed companies conduct so-called "entrusted financing" with "guaranteed capital and fixed annual income" which has the essence of illegal fund-raising. Principal financing should have the characteristics of "in the distribution of risks and benefits, the principal and the trustee sign the principal-agent contract in order to optimize the return of the principal assets, and its investment risk is assumed by the client itself". Similar to this principal-guaranteed and interest-paying type "principal financing" does not have the characteristics of principal financing at all. On the contrary, the commitment of guaranteeing principal and paying interest accords with the characteristics of "promising to repay principal and paying interest or paying return in monetary, physical and equity within a certain period" in the Interpretation of Illegal Fundraising of the Supreme Court for illegally absorbing public deposits or disguised absorbing public deposits.[7] Moreover, this way of "entrusted investment" is also in line with the behavior of "illegally absorbing funds by way of entrusted financing" stipulated in Article 2 of the Interpretation of Illegal Fund-raising. Actors are nominally entrusted with asset management, but such entrustment is still based on the premise of guaranteeing principal and interest and undertaking risks, excluding the management of specific investment behavior by fund providers, which in essence belongs to the act of absorbing deposits. If there is evidence that the perpetrator has the objective of illegal possession subjectively, it can be considered as the crime of fund-raising fraud. Non-bank financial institutions such as securities companies, insurance companies, trust and investment companies can operate asset management business according to the provisions of the Securities Law. However, according to the Notice of the Securities Regulatory Commission on Standardizing the Trusted Investment Management Business of Securities Companies, the legal relationship between securities companies and customers is a principal-agent relationship based on the asset management contract, and the securities companies must carry out asset management business by using the principal-agent relationship based on the asset management contract. In the name of the customer, it reflects the willingness of the customer, and its investment risk is assumed by the customer itself. In view of the above-mentioned characteristics of asset management business, the "Measures" of the Securities Regulatory Commission and the "Securities Law" clearly stipulate that securities companies shall not make commitments in any way to the earnings of customers' securities trading or to compensate for the losses of securities trading. It is against laws and regulations to entrust financial management by undertaking to guarantee the bottom and fixed rate of return. In addition, the main difference between asset management business and disguised public deposits is whether the funds are managed independently. If the securities companies arrange the use of funds in the name of asset management, the nature of their behavior has changed. Therefore, there are two boundaries between legitimate asset management and disguised deposit absorption: one is not to promise to insure capital and return, the other is to use it independently in the name of investors. When securities companies absorb funds for social non-specific objects, they not only promise to insure capital and income, but also regard assets management funds as their own funds, and make unified arrangements for the use of them, they belong to the act of disguised absorption of public deposits.

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