

# The Practical Dilemma and Improvement of the Accountability System of the Capital Market--The Necessity of Accurately Defining the Subject of Responsibility

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## ABSTRACT

The effective implementation of investor protection and securities supervision is related to the stable operation of the capital market. How to identify and appraise the responsible parties for infringing on the rights and interests of small and medium investors in complex real-life cases is related to the effectiveness of the implementation of the new "Securities Law" and the development and improvement of China's capital market. Combined with the actual situation in China, the judgment dilemma of the responsible subject is mainly manifested in two aspects: theory and practice. In theory, there is a dispute over the attribution of the obligation after the principal-agent theory is updated, and the core of the accountability system is not clear in the legislation. In practice, there is a problem of different judgments in the same case in the determination of the responsibility of the intermediary agency of a specific subject, and a unified judgment standard has not been formed. In addition, advance compensation is not included in the compulsory obligation, and the compensation subject lacks the initiative to perform their duties. Based on this, when perfecting the accountability system and clarifying the core of accountability, it is necessary to clarify the enterprise's fiduciary duty in theory, clarify the identification of the actual controller, make up for the deficiencies in the legislation, and form a unified liability identification standard. In practice, it is necessary to improve the implementation efficiency of the securities regulatory mechanism, unify adjudication standards, and unite various entities to improve the level of investor protection.

**Keywords:** *securities infringement, subject of Responsibility, investor protection, precision accountability, regulatory system*

## 1. INTRODUCTION

Based on the fact that small and medium-sized investors account for the majority in China's capital market and their lack of awareness of rights protection and practical experience, the new "Securities Law" has highlighted the legal rights and interests of investors in terms of liability subjects and litigation procedures in the latest revision. The inclination protection of the government has significantly strengthened the binding force on the actual controller and the "key minorities" such as "directors, supervisors, and senior managers". The governance structure of Chinese companies is mostly based on the ownership concentration system. The traditional theory of controlling shareholder's fiduciary duty lacks a factual basis. The existing securities

regulatory roles incorrectly cited this theory, resulting in blurring of the responsibility boundary between the actual controller and the listed company.[1] In addition, China's existing laws and regulations have insufficient regulation of controlling shareholders and major shareholders, making it difficult to implement the concept of "accountability of the first responsible person" in securities supervision. There are also many controversies in the academic circles in promoting the duty of intermediary agencies and directors and supervisors to perform their duties. In practice, there are differences in the identification and division of subject responsibility boundaries. The resulting phenomenon of different judgments in the same case highlights the necessity of clarifying different subjects of responsibility. [2] The standardization and improvement of the capital

market cannot be achieved overnight. In the process of establishing and improving the “three-dimensional” accountability system of administrative punishment, civil compensation, and criminal punishment, the determination of responsibilities and boundary division of multi-party entities in the capital market have practical difficulties. How to accurately clarify the main responsibilities in judicial practice and administrative supervision to achieve consistency and effectiveness in the implementation of securities laws is the primary issue for creating a healthy market environment and promoting the sustainable development of the real economy. In view of this, this article will focus on the definition of each responsible entity in securities supervision, analyze its identification and determination standards, and make suggestions on how to promote the accurate implementation of the capital market accountability system and provide protection for the rights and interests of small and medium investors.

## **2. THE DEVELOPMENT PROCESS OF INVESTOR PROTECTION MECHANISM IN CHINA**

Investor protection research stems from the principal-agent problem.[2] From the perspective of traditional corporate governance, there is a potential conflict of interest between company owners and actual controllers, which leads managers to make decisions that deviate from the value maximization goal in the shareholder utility function under the condition of information asymmetry, resulting in opportunistic behaviours. In order to solve the problem of infringement of investors' rights and interests by company management and major shareholders due to information asymmetry in investment activities, investor protection came into being.[2]With the deepening of research on ownership structure and agency issues in recent years, a large amount of empirical data shows that the concentration of equity in modern enterprises is a common phenomenon.[3] The "separation of two powers" in agency theory lacks a factual basis. The research on investor protection should turn to regulating the behaviour of major shareholders or controlling shareholders to avoid sacrificing the interests of small and medium investors in the pursuit of their own goals.[5] Investor protection mechanism, that is, through laws and regulations supplemented by administrative supervision, improve the protection of small and medium investors, and solve the problem of information asymmetry in the transaction process.

The existing theoretical schools of investor protection can be divided into contractual schools, legal schools and incomplete legal schools according to the role of government in the process of investor protection. From the perspective of the new "Securities Law", this article focuses on the introduction of legal schools. Based on the empirical data of the LLSV portfolio [6], the legal school

proposes that the law plays a vital role in investor protection and is the most important factor in determining the difference in the level of investor protection. The proposal of this point of view breaks the previous oblique attention to managers in corporate governance, shifts people's attention to investor protection mechanisms, deepens people's knowledge and understanding of corporate governance, and expands the scope of research in this field.[7] LLSV pointed out that the deprivation of the rights of minority shareholders and creditors by controlling shareholders is widespread in the capital markets of many countries, and a large number of deprivation of rights is bound to damage the operating foundation of the financial system. Protecting external creditors through the legal system is the key to curbing this problem.[8] LLSV's research focuses on measures to protect investors at the national level. Although the model has been pointed out that there are many deficiencies in the selection of indicators and the statistical methods themselves, the attention and discussion it aroused in the field of investor protection are important to follow-up research.[9]

The implementation of the investor protection mechanism can be divided into the national system level and the company policy level. Capitalist countries are early in the practice of investor protection. Capitalist countries have been involved in the practice of investor protection earlier, and have gradually explored the establishment of a securities investor protection system aimed at protecting small and medium-sized investors since the end of the 1960s, through the establishment of a special investor protection fund or an investor compensation system to form the last line of defence for investor protection. The legislative models of securities investor protection funds in various countries are mainly divided into special legislation for securities investor protection funds, comprehensive securities regulatory legislation covering investor compensation systems, comprehensive legislation and relying on other laws, the most common of which is protection fund specializes in legislation, representing the United States, Germany, Australia, etc.[10] With the awakening of investors' rights awareness, their basic rights as ordinary consumers have been realized under the protection of the law, marking the further development and improvement of the financial market.

The Chinese capital market was founded in the 1980s and has experienced a development process from low to high, from simple to complex, and the securities legal system has also shown obvious characteristics of spiralling upward advancement. The promulgation of the "Securities Law" in 1998 became a milestone in the legal construction of China's securities market, which clearly stipulated information disclosure, insider trading, manipulation of securities prices, and fraudulent investors. The "Securities Law" has enriched the specific measures and methods for the protection of small and

medium-sized investors by integrating past experience and combining with emerging situations and problems. However, at this stage, China's investor protection mechanism is not mature, relevant regulations are scattered in various chapters of the legal text, and the investor protection system is fragmented.[11] Since then, the protection of investors in China's capital markets has continued to improve. For example, in 2005, China formally established a securities investor protection fund and established an investor suitability system. In 2018, the Shanghai Financial Court is established to provide a special venue for financial trials and improve the financial trial system. Regulatory departments, listed companies, and intermediary agencies have worked together to increase the supply of protection systems, improve the quality of listed companies, optimize regulatory models, and improve information disclosure guidelines, and gradually form a securities investor protection system with Chinese characteristics.[12] As a staged achievement of the development of China's securities market, the newly revised "Securities Law" in 2019 includes "investor protection" as a separate chapter, and improves the information disclosure system and restricts false statements by relevant media to reduce the influence of information asymmetry on investment. As important participants in financial activities, the majority of investors, whether their rights and interests can be protected is related to the sound development of the capital market. How to increase investor participation and protect the legitimate rights and interests of investors without interfering with the normal operation of the underlying market is an important issue in promoting the long-term stable development of China's capital market. Under the current legal system, the definition of the responsible subject remains controversial. Identifying and resolving this dilemma has a decisive impact on the accurate implementation of capital market accountability.

### **3. THE THEORETICAL MISUNDERSTANDING AND REALISTIC PROBLEMS OF THE SUBJECT OF RESPONSIBILITY**

Compared with general civil tort disputes, securities infringement disputes have a variety of infringements, a wide range of infringement subjects, and complex liability distribution and causal relationships.[13] Therefore, whether it can accurately point to the responsible entities in different cases at the theoretical and practical levels is related to the effectiveness of China's securities market construction and supervision, and is of great significance for stabilizing the information of small and medium-sized investors and maintaining the sound operation of the capital market. In the process of capital operation, small and medium investors are naturally at an information disadvantage, and their main channel for obtaining transaction information is the information disclosure of listed companies. However,

due to the long-standing objective existence of irregularities such as insider trading and false statements, it is difficult for small and medium investors to guarantee their right to know during the transaction process. The specific provisions of the new "Securities Law" in the "Information Disclosure" and "Investor Protection" chapters involve multiple responsible entities. However, the division and definition of responsible subjects, and the judgment standards for different responsible subjects corresponding to different responsibilities are still unclear. How to clarify the responsibilities of each entity in the entangled and complicated capital activities is an urgent problem to be solved in the further improvement and development of China's investor protection system.

At the theoretical level, the core responsibility of the accountability system is still controversial. In traditional theory, fiduciary responsibility means that under the condition of separation of the two powers, the operator accepts the shareholder's entrustment to manage the company and seeks to maximize the company's profit, that is, the operator has a fiduciary duty to the shareholder.[14] In the modern corporate governance structure, the rights of the company's manager and the board of directors are derived from the authorization of shareholders, and the directors and managers jointly assume the actual control of the company. Therefore, the operator refers to the company's directors and managers at the same time. However, under the equity concentration model, ownership and management rights are not completely separated, and managers are often shareholders, especially controlling shareholders. When constructing the accountability system, it is necessary to distinguish between directors and controlling shareholders who is the core.[14] In this context, the construction of the accountability system in securities supervision in Chinese academic circles is mainly divided into two schools. First, based on the current situation of high concentration of equity in China, combined with the core position and role of the controlling shareholder in corporate governance, it is believed that the actual controller and the controlling shareholder are unified, and the establishment of a governance structure and mechanism with the controlling shareholder as the core is proposed.[15] The second is that when the actual controller is deemed to damage the interests of the company by controlling the company, he assumes the role of a de facto director. Accountability of the beneficial owner is not achieved in a separate accountability system, but is incorporated into the accountability system by identifying the de facto directors.

At the practical level, there are two problems. One is that the standards for determining the responsibility of intermediaries are not yet clear, and the other is that under no n-compulsory conditions, the effectiveness of the implementation of the advance compensation system cannot be guaranteed.

According to the results of judicial judgments in existing securities civil compensation cases, there has not yet been a unified standard and position regarding the determination of the liability of intermediaries. The Wuyang Debt representative litigation [16] is the first case of civil compensation caused by misrepresentation in China's bond market, and the judgment of the Hangzhou Intermediate People's Court is also the first in the bond market to compensate for civil damages caused by misrepresentation. The "Wuyang Case" judgment requires Debon Securities and Daxin Accounting to bear joint and several liability for the principal and interest of all debts. In fact, it is a judgment that the securities service agency shall bear joint and several liability for the issuer's liability for breach of contract. The issuer lacks solvency, and securities service agencies need to redeem the principal and outstanding bond benefits on behalf of the issuer.[17] In the ST Zhongan false statement case[18], intermediary agencies such as China Merchants Securities and Ruihua Certified Public Accountants were judged to bear joint and several liability for the relevant compensation and payment obligations of Zhong Anke in the first instance. Since then, China Merchants Securities and Ruihua Certified Public Accountants filed an appeal to the Shanghai Higher People's Court on the above-mentioned judgment. Based on the facts of the case, the Shanghai Higher People's Court determined that China Merchants Securities and Ruihua Certified Public Accountants failed to provide evidence to prove their due diligence obligations. The second instance judged that China Merchants Securities should bear joint and several liabilities within 25% of the relevant payment obligations to Zhong Anke. The accounting firm shall bear joint liability within 15% of the relevant payment obligations of Zhong Anke. This is the first effective judgment on the application of proportional joint and several liability in disputes over misrepresentation in China's securities.[19]

The new "Securities Law" does not directly stipulate how the issuer, the controlling shareholder, the actual controller, and the intermediary agencies should bear civil liability for civil compensation.[20] As the information disclosure assistant appointed by the issuer, the core dispute of the responsibility of the intermediary institution is whether it directly participates in the false statement and is at fault. According to the judgments made by the judicial organs in the trials of different cases, they all support investors' requests for intermediaries to bear joint liability to varying degrees. However, in the current actual cases, the court's judicial judgments show serious post-mortem bias.[21] In order to pursue individual remedies, intermediaries are required to assume part of the joint liability for non-false statements' light negligence, and it is difficult to provide market entities with clear and definite behavioural guidance. The resulting excessive accountability problem can easily lead to improper incentives.[21]

According to Article 93 of the new "Securities Law"[22], the advance payment system of my country's securities market is formally determined from the legal level. Combined with existing cases, the system needs to be refined and improved in terms of law and practice. "Wanfu Shengke", "Hailianxun" and "Xintai Electric" and other advanced compensation cases have successfully opened up the advance compensation system under the Chinese Securities Law to solve the beneficial exploration of the problem of timely compensation for damaged eligible investors. However, the function of the advance payment system in the securities market is in its infancy, and advance compensation has not been written into the law as a mandatory obligation. In addition, the new "Securities Law" does not directly treat the issuer as the pre-payment subject, and at the same time lacks clear regulations on the specific responsibilities of the statutory pre-payment subject. As a result, the advance compensation entities lack the initiative to perform their duties. Only under the impetus of the China Securities Regulatory Commission and other hidden powers, will they first assume civil compensation, and cannot achieve timely and effective first payment of compensation to the injured eligible investors. Its practical effectiveness will be greatly reduced.[23]

#### **4.THE PERFECT PATH TO DETERMINE AND REFINE THE BOUNDARY OF THE RESPONSIBLE SUBJECT**

Through the research on the status quo of the determination of the accountability subject under the background of the new "Securities Law" of our country, we can find that how to identify and divide the responsibilities of the subject involved in the case has room for improvement both in theory and in practice. In the context of the economic shift to high-quality development, establishing a relatively complete investor protection system with Chinese characteristics and ensuring its effective implementation in light of China's actual conditions is an unavoidable issue for improving the efficiency of securities market management, and it is related to whether China can really and effectively construct a normative framework and thinking paradigm based on investor rights, and better transform the legislative system advantages into the system efficiency of investor protection.[24] Practicing the investor protection system and implementing the system requirements in administrative supervision and judicial adjudication are important ways for the system to be truly implemented.

In terms of legislation, the first is to improve the top-level institutional design of the investor protection mechanism, and establish an institutional environment that is more conducive to the protection of the rights of small and medium-sized investors through the establishment of special laws.[12] The separate chapter

of "Investor Protection" in the "Securities Law" has changed to a certain extent the scattered and fragmented legal texts of this part of the content, but compared to some western countries that specifically formulated the "Securities Investor Protection Law". For example, China's reform efforts are still slightly insufficient. The second is to carry out continuous and in-depth research on the development of corporate governance at this stage, to provide a solid theoretical and practical basis for the refinement of legal provisions. Under the background of China's public ownership structure, the phenomenon of "one share dominating" state-owned shares is common in Chinese joint-stock enterprises[14]. In this context, an in-depth study on the fiduciary duty of operators and the infringement and protection of investors' rights and interests is the first task to explore the experience with Chinese characteristics.

Combining with the above, we can see that under the securities supervision method of "accountability of the first responsible person", the difficulty and theoretical dispute in the construction of the accountability system lies in how to distinguish between directors and controlling shareholders as the core. Regulatory agencies, self-regulatory organizations, specialized investor protection agencies, market operation entities, and third-party advisory service agencies, etc., should perform their duties or obligations in investor protection, all of which need to be clearly divided into legal provisions on the basis of a clear theoretical system. The responsibilities of different entities in common infringement cases are classified to form a set of standards for accountability with clear boundaries and legal compliance.[12] Combining the background of China's public ownership and the current situation of high concentration of equity, the author believes that it is more feasible to construct an accountability system with controlling shareholders as the core. In addition, it is necessary to make more specific regulations on the establishment of mechanisms such as exercise of rights, dispute mediation, advance compensation, and class action, which are closely related to investor protection. Especially for the high incidence of damage to investors' rights and interests, the system design should be further improved to increase the cost and responsibility of violations of the rights and interests of investors, and build an institutional environment that is more conducive to the exercise of rights, rights protection and relief services for small and medium investors.[12]

The implementation of investor protection policies can be divided into two aspects: securities supervision and judicial adjudication. Regarding securities supervision, the efficiency of China's public implementation mechanism and private implementation mechanism need to be further improved.[26] The public enforcement mechanism refers to the former refers to government agents to expose and punish violators of the law. [27]The private implementation mechanism refers to

the implementation of securities laws by relying on market mechanisms, such as shareholder lawsuits, shareholder participation in voting, and capital transactions.[27] [28] For a long time, the main supervision method of China's securities market has been the public implementation mechanism-mainly the administrative supervision of the China Securities Regulatory Commission, and the first-line supervision of exchanges that has gradually emerged in 2013, while supplementing the private implementation mechanism that is still under development.[26] In addition, there is a special regulatory force between public and private that deserves attention. Among them, the establishment of the China Securities Small and Medium Investor Service Center (hereinafter referred to as the Investment Service Center) is China's first exploration and innovation on the path of investor protection. As a representative of the "semi-public-semi-private" innovative supervision with Chinese characteristics, the Investment Service Center has the essence of a public implementation mechanism, but in the form of a private implementation mechanism, [26]it serves as an investor protection public welfare organization to small and medium-sized Shareholders provide public welfare services, and at the same time have the color of flexible government supervision.[30] According to existing research, [26]the exercise of investment service centers can be more normalized and institutionalized, improving corporate governance from the source, protecting small and medium investors, and more embodying the role of "prior supervision".[26] At the same time, in order to solve the existing principal-agent problems, China must attach importance to the improvement of the evidence system.[25] Regarding civil claims for false statements by listed companies, the theory is basically mature and the practice is feasible. As for the civil claims for insider trading and market manipulation, due to the fact that relevant judicial interpretations have not been issued, practical operability is not strong, resulting in investor protection is not yet in place.[25]

In terms of judicial adjudication, it is necessary to clarify the connotation and standards of diligence as soon as possible, and clarify the responsibilities of intermediary agencies.[21] The punishment of intermediary agencies in China's false statement cases is mostly due to diligence and due diligence.[31] However, in the process of judicial adjudication, there is a phenomenon of confusion between process review and result review, behavior standards and responsibility standards, and the result-oriented excessively leads to the lack of rationality in the subsequent review of the responsibility of intermediaries.[21] The fault determination of an intermediary institution should be based on its objective responsibilities, based on its information acquisition, verification and verification capabilities, and comprehensively consider whether it uses reasonable prudence and diligence to control the

issuer's risk of false statements.[21] In addition, it is necessary to accelerate the unification of judicial rules based on the existing trial experience, improve the level of trial professionalization, and absorb the opinions of third-party experts when necessary to form a reasonable and fair judgment result.[31]

In addition to the improvement of legislation and the active performance of duties by administrative agencies and adjudication agencies, listed companies should also actively improve their own governance levels and improve their corporate governance structure. Improving the governance of listed companies is the source of investor protection. Public investors pay attention to the governance of listed companies because it is related to the investment value of listed companies and the investment risks they face. A sound investor protection mechanism also helps to enhance the value of listed companies, improve corporate governance structure and corporate financial decision-making.[32] In addition, by introducing institutional investors, alleviating the problem of "one share dominance" and improving the level of checks and balances in the equity structure, [33]will also help increase the professionalism and voice of investors, and strengthen the level of investor protection.

## 5.CONCLUSION

China's securities market is developing rapidly, and there are still many problems in achieving world-renowned achievements. Among them, the protection of small and medium investors is a typical example.[13] The serious asymmetry of information has caused small and medium investors to become a disadvantaged group in the securities market, and their legitimate rights and interests are vulnerable to infringement by other powerful entities in the market. The new "Securities Law" has made great efforts in investor protection, with a view to reducing the adverse effects on investors due to information asymmetry and other reasons. However, how to conduct liability screening from theory and practice is still a big dilemma hindering the development of investor protection system.

At the theoretical level, the principal-agent theory has been updated with the development of reality, and the ownership of the actual control of the enterprise is in dispute, which directly affects the judgment of the core responsibility in investor protection activities. At the practical level, according to existing cases, the responsibility determination of intermediary agencies has not yet unified standards, and it is difficult to form an effective reference. Although the advance compensation system has been clearly stipulated, it may not be compulsory. It is difficult to form a solid market atmosphere if it is only promoted by corporate ethics and hidden power.

To solve the above problems and promote the effective implementation of my country's investor protection system, it needs to be improved from two levels of legislation and practice. First of all, a unified system standard is formed in a legislative way to provide a code of conduct and reference for each market subject. Secondly, it is necessary to give play to the efficiency of various units in the public and private law enforcement fields to form a comprehensive securities regulatory system. In terms of judicial decisions, supplemented by relevant judicial interpretations, a clear reference model is formed for subsequent cases. In addition, the internal governance of the enterprise itself should also be taken seriously.

Accurate accountability plays an important role in boosting investors' sense of security and promoting the efficient operation of capital markets. To do a good job in investor protection, it is necessary not only to establish a complete and effective system, but also to ensure the efficient implementation of policies. Optimizing the investor protection ecology of the capital market requires the cooperation of multiple parties such as listed companies, intermediaries, and investors.[34] Improving the capital market governance system and protecting the legitimate rights and interests of investors are important issues that require long-term attention and exploration in the development of the securities market.

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