Research on the Path of Legal Regulation of Securities Violations

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Abstract. Currently, capital market violations are frequent, causing serious losses to national interests, social public interests and investors' legitimate rights and interests. In the face of violations, the limitations of "multi-headed governance" of regulators are obvious, and the phenomenon of "fragmentation" is serious, which cannot adapt to the requirements of the times of effective supervision of the capital market. In this regard, we should combine civil, administrative, criminal, public interest litigation and other legal regulation path weapons for securities violations to carry out coordinated management, fully open up joint securities enforcement channels and referral review mechanism, in order to achieve optimal governance effectiveness and effective and powerful supervision.

Keywords: Securities · Insider Trading · Market Manipulation · Misrepresentation

1 Introduction

1.1 Analysis of the Current Basic Situation of Capital Market Violations

In August 2013, when Everbright Securities was conducting ETF call arbitrage transactions, the strategic trading system it used bid for 180 ETF constituents with a huge volume of 23.4 billion yuan due to a procedural error, and the actual transaction was 7.27 billion yuan. When the public investors were not aware of the real reasons for the market fluctuations, Everbright Securities started reverse trading before the disclosure of insider information in accordance with the law, and the amount of trading was huge, which had a serious impact on the market. Finally, the CSRC confiscated the illegal income and fined Everbright Securities. In 2015, Wuyang Construction fraudulently reported materials to obtain permission from the CSRC for public issuance of corporate bonds without having the conditions for public issuance of corporate bonds, and publicly issued corporate bonds totaling 1.36 billion yuan to qualified investors, and then used the same false financial data to create a prospectus for non-public issuance of corporate bonds and disclosed it to qualified investors, and successively non-publicly issued bonds of 130 million yuan and 250 million yuan. Eventually, the CSRC imposed a fine of RMB 4 billion on Wuyang Construction. In March 2021, the CSRC imposed fines on Leshi

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for ten consecutive years of financial fraud from 2007 to 2016, resulting in false entries in the IPO filings filed and disclosed in 2010, annual reports from 2010 to 2016, failure to disclose connected transactions and external guarantees in accordance with the law, and the fraudulent issuance of Leshi's non-public offering in 2016.

From the above cases, we can find that the securities violations in China's capital market have become more and more serious, causing significant losses to investors and the state. Therefore, the regulation of the above-mentioned illegal acts appears to be urgent.

1.2 Shortcomings of Theoretical Results of Established Academic Research

Renowned scholars and professors from the securities administrative law enforcement and criminal justice interface should be supported by the priority of efficiency and adopt the principle of synchronization and coordination [1]; campaign-style securities enforcement is inconsistent with the rule of law concept that crimes should be punished [2]; the bond market should introduce a two-tier structure to strengthen market-making protection and back-office unification [3]. The classification of the types of responsible persons in misrepresentation can be considered on the basis of the duty of diligence in conjunction with the duties, positions, and roles played by the responsible persons [4]; in order to regulate the bond financing behavior of the issuing company, the registration exemption rules can be introduced on the basis of the bifurcation method to adapt to the complexity and variability of the bond market etc. [5]. The issue of the regulation of illegal acts in the capital market has been studied in depth and fruitful theoretical results have been obtained.

However, the above-mentioned research results are limited to the sectoral law, and the discussion is confined to the disciplinary field in which they are located, thus neglecting the coordinated management of a wide range of violations in the capital market and the unified regulation.

1.3 Practical Dilemmas in the Regulation of Securities Violations

At present, China's capital market supervision and management mechanism, although more regulatory departments and functional institutions, mainly including PBOC,CSRC and CBRC, but for the regulation of securities violations, often trapped in the dilemma of multiple management, the phenomenon of "government out of many doors" and drawbacks, "nine dragons ruling the water" dilemma continues to emerge. Specifically, the limitation of multi-headed governance is that some areas, such as the inspection of violations, are part of the intersection of various departments competing for "jurisdiction"; some areas, such as the handling of mass investor petitions, investor compensation, etc., are more prominent in passing the buck to each other. Therefore, it is urgent to integrate the supervision and remedy channels and promote the coordinated governance of the capital market.

2 The Basic Theory of Securities Violations Unfolded

2.1 Definition of Securities Violations

Illegal acts in the securities market refer to the acts of the subjects of securities legal relations that violate the law and intentionally or negligently harm the interests of investors and disrupt the order of the securities market in the issuance, trading, supervision and other related activities of securities.

2.2 Basic Characteristics of Securities Violations

According to the nature of securities violations, the main characteristics are as follows.

2.2.1 Concealment

The concealment is reflected in three aspects: First, with financial innovation as the protective color, the boundary between innovation and capital disorderly expansion is extremely blurred. (Hu Huaibang case) Second, the real economy and the financial industry cross each other. (Zhou Jiangyong case) Third, the moral hazard transaction structure itself is nested with each other and extremely complex. (Sun Deshun case).

2.2.2 Linkage

As the blood vessel and blood of the real economy, the capital market, with the securities market as the main component, undertakes the important function of serving and supporting the development of the real economy and providing "nutrients" for the real economy. Therefore, the serious consequences caused by illegal acts in the securities market will spread to all sectors of the real economy through the financial pipeline.

In 2001, the U.S. misrepresentations made for the accounting firm Arthur Andersen led to the bankruptcy of Enron, a major U.S. energy company and one of the world's largest electric, natural gas and telecommunications companies, ultimately triggering the financial crisis. In 2008, Lehman Brothers, the fourth largest investment bank in the U.S., announced that it had filed for bankruptcy protection after a failed takeover negotiation, triggering the global subprime mortgage crisis. Therefore, it can be seen from the two cases mentioned above that the violations in the financial capital market will endanger and affect not only the financial market itself, but will lead to systemic financial risks, affecting the real economy and causing serious impact to the national economic development.

2.2.3 Seriousness

The harm of securities violations is more serious, mainly in the following two aspects: Firstly, damage the order of the securities market. Securities market order is the basic conditions on which the securities market operates and functions, any violation of the securities law, the destruction of the securities market order, will more or less affect the function of the securities market. Illegal acts in securities issuance, securities trading, information disclosure and acquisition of listed companies have accordingly disrupted

the order of each link. Even serious ones can cause a big impact to the market, seriously endanger social stability and cause extremely bad influence at home and abroad. Secondly, damage to the interests of small and medium-sized investors. The majority of investors are the cornerstone of the securities market, without the active participation of the majority of investors, it is impossible for the securities market to survive and develop. Each listed company has tens of thousands or even hundreds of thousands of shareholders, and securities violations often harm the interests of many people.

2.3 The Main Types of Securities Violations

2.3.1 Insider Trading

According to Article 53(1) of the Securities Law of the People's Republic of China (2019) (Hereinafter referred to as the Securities Law), before the disclosure of insider information, the person who knows and obtains the insider information shall not disclose the information or use the information to engage in trading. Serious cases will commit the crime of insider trading, leaking insider information, and trading with undisclosed information as stipulated in Article 180 of the Criminal Law of the People's Republic of China (2020) (Hereinafter referred to as the Criminal Law). Insider trading violations mainly include: insider information lover using insider information to buy and sell securities, or suggest others to buy and sell securities based on insider information; insider information lover to disclose insider information to others so that others profit; non-insider information lover through improper means or other means to obtain insider information, and based on this trading securities or suggest others to buy and sell securities.

2.3.2 Market Manipulation

Market manipulation refers to the act of disrupting the order of the securities market by taking advantage of capital and information or abusing one's authority to influence the price of the securities market, create the illusion of the securities market, and induce investors to make decisions on securities investment without knowing the truth. Article 55 of the Securities Law provides for the main patterns of market manipulation. In serious cases, it will commit the crime of manipulating securities and futures markets as stipulated in Article 182 of the Criminal Law.

2.3.3 Misrepresentation

According to Article 56 of the Securities Law, misrepresentation refers to the act of making untrue, seriously misleading or materially omitting statements or inducing investors to make securities investment decisions without knowing the truth about the facts, nature and law of securities issuance, trading and related activities. Criminal Law also contains provisions on fraudulent issuance of securities, violation of disclosure and non-disclosure of material information, and fabrication and dissemination of false information on securities and futures transactions.

2.4 The Serious Dangers of Securities Violations

The serious dangers of securities violations are as follows: (1) Disrupting the order of the financial market. Securities illegal acts touch on all aspects of financial market operation, disturb the order of financial market and affect its function. (2) Harm investors especially the interests of small investors. There is a typical zero-sum game in financial markets. Under strict competition, the gains of one party must mean the losses of the other party, and the sum of the gains of all parties will always be "zero". The occurrence of securities illegal behavior causes the loss of the interests of many small and medium investors while the investment institutions gain huge improper benefits. (3) It affects social stability. Economic life is an important part of social life. The negative impact of securities illegal behavior on economic life will also extend to other aspects of social life, thus affecting social order.

3 Optimization of the Regulatory Path for Securities Violations

3.1 Civil Path: Securities Tort Damages Lawsuit

For securities violations, although China's laws have many provisions on administrative and criminal liability, they lack a civil liability regime. The establishment and improvement of the civil liability system for tort can timely and effectively remedy the damages suffered by investors and safeguard their legitimate interests. The optimization of the specific regulatory path mainly includes the improvement of the representative system for securities disputes, the promotion of financial courts, and the determination of the benchmark date for misrepresentation.

3.1.1 Improvement of the Representative System for Securities Disputes

Securities disputes are characterized by complex cases, many victims and great social influence, which has led to the emergence and gradual development of a representative system for securities disputes in China. Article 95(3) of the Securities Law introduces for the first time a special representative system for securities disputes, establishes the identity of the representative of the investor protection agency in litigation, and adopts the litigation participation mode of "implicitly joining and explicitly withdrawing". In order to ensure the uniform implementation of the system, The Regulations on Certain Issues Concerning Representative Proceedings in Securities Disputes(Hereinafter referred to as the Regulation) and the Notice on the Work Related to the Participation of Investor Protection Agencies in Special Representative Proceedings in Securities Disputes were issued respectively by the Supreme People's Court and CSRC, but some of the rules are not yet well designed. Firstly, there is a conflict between the pre-conditions for prosecution and the registration system. The Supreme People's Court stipulates that the parties in the prosecution must obtain the administrative penalty decision of the regulatory department on the infringer and other materials, this precondition causes the majority of investors' right to sue is not properly protected, the prosecution is difficult, it is difficult to remedy with the civil procedure, does not meet the requirements of the registration system to protect the rights of the parties to sue. In addition, according to

paragraph 2 of Article 5 of the Regulation, if the plaintiff cannot provide prima facie evidence of the fact of securities infringement, such as an administrative penalty decision, the court shall apply the non-representative proceedings for trial. However, there are no provisions and considerations on the specific procedures to be applied by the court to hear the relevant disputes afterwards and the costs incurred by the right holder in filing a separate court action. Secondly, the procedure of selecting the representative is too simple and crude. According to the Regulation, the content of the effective decision of the former litigation will be binding on the subsequent litigation, and at the same time, because there may be different interests between the right holders, so from the theoretical point of view, there may well be a securities group dispute in several representative litigation of securities disputes. When a securities dispute gives rise to both a common representative action and a special representative action, how does the litigation process move forward? How do courts dispose of several ordinary representative actions arising from the same securities dispute? The current judicial interpretation has not yet responded to these questions. In addition, the selection of representatives in the Regulation is determined by a majority of the number of representatives, rather than the share of rights each representative has in a securities dispute, and the scientific nature of the selection criteria needs to be considered. Thirdly, the investor protection agencies play a limited role. According to the existing legal provisions, the rules for the selection of cases by insurance agencies can be simply summarized as: the selection of cases must be typical, impactful and exemplary. The standard is too general, and the subjectivity and arbitrariness of the insurance agency in the specific application is large. In addition, at present, China's insurance institutions are small in number, limited in strength, and insufficient incentive to participate in representative litigation of securities disputes, and the support for the case is not strong [6].

3.1.2 Financial Court Promotion

In recent years, the development of Internet finance has stimulated a wave of financial innovation in China, while its chaos has also led to a significant increase in financial disputes in various regions, so there is an urgent need to promote financial courts nationwide, but there are challenges in the actual promotion process. First, the financial court's own institutional design is inadequate. The Shanghai Financial Court and the Beijing Financial Court have similar establishment procedures, with the Central Committee for Comprehensively Deepening Reform deliberating and adopting relevant plans, and then the Standing Committee of the National People's Congress fulfilling the corresponding legal procedures for establishment. This establishment model has positive significance in the initial stage of the exploration of financial professional trial institutions, but looking at the whole country, it is not possible to establish every specialized court through such a path, it should on the basis of the operation of the financial courts in Shanghai and Beijing, conduct a comprehensive study on the layout and establishment criteria of the financial courts according to the development of the national financial industry. Second, the scope of jurisdiction of the case is narrow. The current financial courts are mainly territorial jurisdiction, and domestic and foreign financial entities in the national market across provincial areas of operation of the financial rule of law protection needs do not quite match, to restrain local judicial protectionism "too long to reach". In addition, the

cases often involve financial criminal cases, resulting in a large number of criminal and civil crossover problems in the trial practice of financial cases. Therefore, in the future development of financial courts, the top-level design can be strengthened and the layout of reasonable division of labor; the jurisdiction of financial courts can be appropriately expanded [7].

3.1.3 Determination of the Base Date of Misrepresentation

According to the "Supreme People's Court on the securities market due to the several provisions of the civil compensation cases caused by false statement", the provisions of article 33 of the investment difference loss calculation of the base date, is refers to the false statements or corrected, as will compensate for the qualified investors should be within the scope of the loss caused by false statement, determine reasonable loss calculation during the specified deadline. In judicial practice, the common method for determining the base date is from the disclosure date to the date when the cumulative trading volume of securities affected by false statements reaches 100% of their marketable part.

3.2 Criminal Path: Criminal Law Control of Capital Market Crimes

The introduction of the amendments to the Criminal Law has driven the evolution of China's criminal legislation on financial crimes forward. One of the highlights of the latest Criminal Law Amendment (XI) is the substantial increase in criminal penalties for illegal and criminal activities that undermine the market economic order and harm the legitimate rights and interests of investors. This is mainly reflected in the following aspects:

First, increase the penalties for source violations. Amend Article 160 of the Criminal Law to include the issuance of depositary receipts in the scope of fraudulent issuance: abolish the maximum penalty of 5 years of imprisonment, the maximum penalty can be up to 15 years of imprisonment in the absence of several crimes; increase the fines for fraudulent issuance of individuals and units, respectively; the controlling shareholders, the actual controller of the organization, directing the crime into the punishment of regulation. Second, increase the penalty for non-compliance with disclosure requirements. Article 161 of the Criminal Law will be amended to remove the upper limit of 3 years of imprisonment for the crime of non-compliance with disclosure and non-disclosure of material information; at the same time, "and impose or impose a fine of not less than 20,000 yuan but not more than 200,000 yuan" will be amended to "and impose a fine"; In addition, increase the penalty provisions for unit crimes. Third, improve the regulation of new means of market manipulation. Amending Article 182 of the Criminal Law, for the crime of securities and futures market manipulation, three new market manipulation techniques emerged in the securities market, namely "fraudulent trading manipulation", "demagogic trading manipulation", "scalping manipulation" behavior. Fourth, expand the scope of punishment for intermediaries. The amendment to Article 229 of the Criminal Law, which implicates the crime of providing false certification documents, includes sponsors in the scope of regulation of this crime, while raising the maximum sentence of 5 years to 10 years. Sponsors who cause serious consequences due to the issuance of documents that are materially inaccurate will also need to be prosecuted for a maximum

of 3 years. The introduction of the Criminal Law Amendment (XI) has made up for the shortcomings of light criminal penalties and made the three-dimensional recourse system responsive to the development of the securities market [8].

3.3 Administrative Path: Administrative Sanctions for Securities Violations

Securities violations are characterized by high intelligence, high technology, complexity, materiality and difficulty in investigation and determination. The Securities Law, while regulating violations, also poses new challenges to the practice of securities administrative enforcement.

3.3.1 Administrative Supervision

First, the scope of application of the Securities Law has been expanded, and the field of administrative supervision has undergone significant changes. Article 2 of the Securities Law specifies depositary receipts as legal securities and brings them into the scope of administration; Article 37, Article 96(1) and Article 97 of the Securities Law further establish and improve the multi-level capital market system; Article 2 and Article 177 of the Securities Law clarify the extraterritorial application effect. It is evident that securities regulation has been greatly extended in terms of trading varieties, market levels and geographical scope. Administrative regulators should adapt to the changes in the law and expand their regulatory horizons so that the provisions of the law can be fully implemented. Second, the investor protection system has been effectively improved, and securities regulation should implement the concept of investor protection. The Securities Law continues to set up a special chapter (Chapter 6 "Investor Protection") to provide for the investor protection system, while the concept of investor protection is also fully reflected in the institutional arrangements for securities issuance, listing, trading and information disclosure. Therefore, in the process of administrative supervision, it is not only necessary to strictly supervise according to the law, but also to consider the issue of investor protection and make efforts to promote the implementation of systems such as ordering to repurchase, early compensation and representative litigation. Third, the administrative settlement system is formally introduced and should be promoted as soon as possible from pilot to regular. Article 171 of the Securities Law adjusts the administrative settlement system previously approved by the State Council on a pilot basis to an explicit provision of the law, enhancing the authority of the administrative settlement of securities. Therefore, securities administrative supervision should promote settlement pilots to turn conventional, make good use of administrative settlement and improve regulatory effectiveness from the objectives of intensive use of resources, efficient disposal of misconduct and compensation for investors' losses.

3.3.2 Administrative Penalties

The new Securities Law significantly increases administrative penalties for securities violations and aims to curb violations by increasing the cost of violations. Taking the new Securities Law as an example, the new Securities Law expands the boundaries of market manipulation: Article 55 of the Securities Law adds four types of market

manipulation: “frequent or large number of declarations and withdrawal of declarations without the purpose of closing the transaction”, “using false or uncertain material information to induce investors to trade in securities”, “making public evaluations, forecasts or investment recommendations on securities or issuers and conducting reverse securities trading” and “manipulating the securities market by using activities in other related markets”. In addition, the Securities Law has also significantly increased the upper limit of fines. Article 192 of the Securities Law provides that: (1) if the profit from market manipulation exceeds one million yuan, the illegal income shall be confiscated and a fine of not less than twice the illegal income shall be imposed (formerly 1–5 times); (2) if there is no illegal income or the illegal income is less than one million yuan, a fine of not less than one million yuan but not more than ten million yuan shall be imposed (formerly 300,000 yuan-3 million yuan); (3) if a unit manipulates the securities market, a fine of not less than 500,000 yuan but not more than 5 million yuan shall be imposed on the person directly responsible and other persons directly responsible (formerly 100–600,000 yuan). The expansion of the range and amount of fines has increased the discretion of securities regulators. How to use the full legal empowerment in the practice of securities administrative enforcement, to achieve the fairness and consistency of the scale of punishment, and to protect the fairness and consistency of law enforcement, all need to be refined and standardized [9].

3.4 Public Interest Litigation Path: Construction of Capital Market Public Interest Litigation

3.4.1 Civil Public Interest Litigation in the Field of Securities

According to Article 55 of Civil Procedure Law of the People’s Republic of China (2017), the relevant organs and social organizations specified in the law may file lawsuits in the courts against acts that harm the public interests of society, such as pollution of the environment and infringement of the legitimate rights and interests of many consumers. Civil tort litigation in the securities sector has similar characteristics. Securities bonds are essentially consumer products, and securities investors are financial consumers. The damage caused by securities violations has a large impact, a wide scope and a large number of people, and it is difficult to defend the rights of those whose interests have been damaged, and a large number of people who have been damaged by similar violations will take up a lot of judicial resources to sue separately. For example, Taiwan’s legislation provides that the Protection Center may sue or arbitrate in the name of the Protection Center with the authorization of 20 or more investors within the scope of its operations for the protection of public interest. China can authorize securities regulators or specialized agencies for investor protection to conduct public interest litigation, and seek waiver of litigation fees and exemption of security to reduce the cost of public interest litigation.

3.4.2 Administrative Public Interest Litigation in the Securities Field

In China’s economic field, the CSRC is responsible for regulating the national securities and futures market as the main body exercising administrative power in the capital market. With the development of the capital market, the violations or omissions of the SFC in conducting securities regulation have been gradually exposed, especially the lack of

protection of the rights and interests of small and medium-sized investors, thus affecting social justice. The legal supervision function of the procuratorial organs is currently developing toward safeguarding a wider range of public interests and guarding fairness and justice more actively. The development of administrative public interest litigation initiated by procuratorial organs is not only the current constitutional expectation of the function of legal supervision by procuratorial organs, but also can effectively guarantee the realization of relief public interest and state policy, and safeguard the legitimate interests of market subjects. In addition, based on the functions and litigation status of the procuratorial organs, securities administrative public interest litigation by the procuratorial organs can effectively reduce litigation costs, eliminate litigation obstacles, and improve litigation efficiency [10].

4 Conclusion

The governance of securities violations is a long-term project and systematic engineering. Because of the complexity of the objects involved in securities market violations, the diversity of behavior types and the concealment of behavior characteristics, the governance of securities violations should uphold the general policy of diversified governance and coordinated governance.

The theory of collaborative governance is an emerging cross-cutting theory based on two theoretical foundations: synergism as a natural science and governance theory as a social science. Collaborative governance, in short, is the process of finding effective governance structures in open systems. Collaborative governance theory is a research paradigm about the formation of effective governance structures in open systems. Put another way, collaborative governance theory is the re-examination of governance theory using the knowledge base and methodology of collaborative theory. Therefore, the formulation and improvement of collaborative governance theory is an important reference for improving the effectiveness of governance and achieving the goal of "good governance".

Society is essentially an open and evolving complex network system with coupling and adaptability, and social governance is a large and complex system project. The securities and futures market is also an important part of the above-mentioned complex system, and therefore the basic theory of collaborative governance should be applied. Due to the complexity and uncertainty of the environment and society, the traditional government-led linear management model cannot provide effective explanations and solutions to complex social problems. It is necessary to introduce a new management paradigm, namely the complex science management paradigm. Complex systems theory and social governance have an inherent fit, and can reveal the inner mechanism of social governance complexity and its laws. Complex systems theory shows that the more complex a system is, the higher the requirement for system coordination and the more significant the synergistic effect. The small world, scale-free, association structure, preference connection and topological paradigm of virtual and real "two-phase" nature of complex social network system have direct and profound impact on social governance. To strengthen and innovate social governance, it is necessary to analyze

the complex network structure and characteristics of social systems, establish collaborative innovation mechanisms and institutional arrangements for social governance, and develop collaborative governance in the capital market.

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