



A Study on the Relationship Between the Obligation of Appropriateness and the Obligation to Inform -- Based on the Tort Liability of Financial Institutions

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Abstract. Due to the similarity and overlap of concepts, the obligation of appropriateness and the obligation to inform are often vaguely defined, and the judgment is easy to be imprecise in judicial practice, which seriously affects the credibility of the judiciary and the protection of the rights and interests of financial consumers. Through the development and concept analysis of the obligation of appropriateness, as well as the analysis of the theoretical basis and concept of the obligation of disclosure, it is concluded that there is an inclusive relationship between the obligation of appropriateness and the obligation of disclosure, that is, the obligation of disclosure is one of the sub-obligations of the obligation of appropriateness. At the same time, the scope of use of the obligation of appropriateness and the obligation of disclosure in the judicial decisions of financial cases should be regulated, so as to protect the legitimate rights and interests of financial consumers, improve judicial credibility, and promote the steady development of the financial market.

Keywords: Obligation of appropriateness; The obligation to inform; Financial markets; Judicial regulation.

1 Introduction

1.1 Research Background

In today's financial field, with the rapid development of economic globalization and science and technology, financial innovation is spreading rapidly. Various types of financial derivatives and investment products with complex structures and diversified risks have sprung up, from cryptocurrency with high risk and high return to nested structured financial products, greatly enriching investment options, but also hiding hidden opportunities. On the one hand, the accumulation of mass wealth promotes the extensive involvement of ordinary people in the financial market, and their financial knowledge reserves are uneven, and their risk recognition and tolerance are different. On the other hand, institutional investors pursue refined asset allocation, and their

requirements for the depth and precision of financial services are rising. This complex change on both sides of supply and demand has spawned a lot of chaos, a large number of disputes caused by mis-selling financial institutions have flooded into the regulatory field of view, and investors have complained about product mismatching and unclear risk tips.

Judicial practice is faced with a thorny dilemma. Due to the similarity and overlap of the concepts of "obligation of propriety" in financial law and "obligation of informing and explaining" in civil law and contract law, and the lack of unified and scientific classification, in practice, judges often find it difficult to accurately decide cases involving the damage of investors' rights and interests due to the vague definition of "obligation of propriety" and "obligation of informing and explaining" in current laws and regulations, and the unclear relationship between them. This not only weakens judicial credibility, but also deadlocks investor protection and impedes the fair and orderly development of the financial market. In this context, in-depth exploration of the relationship between the two and clarification of the boundary and coordination mechanism have become the key issues to be overcome in the construction of financial rule of law.

1.2 Research Significance

1.2.1 Practical Significance.

First of all, for financial institutions, if they do not grasp the two obligations, it is easy to fall into the risk of violation in the product design and sales. After clarifying the relationship between the two obligations, it can help them accurately formulate internal processes and rationally allocate resources. Secondly, when investors suffer investment loss claims, a clear definition of the obligation relationship can enable the judicial system to accurately judge the responsibility of financial institutions and make a reasonable judgment. Investors can obtain reasonable compensation more efficiently, enhance their confidence in the financial market, attract more social capital inflows, and promote the healthy development of the market. Finally, regulatory authorities can refine regulatory rules, eliminate regulatory ambiguity zones, unify law enforcement standards, and focus regulatory forces on cracking down on serious violations.

1.2.2 Theoretical Significance.

Although there are some researches on these two obligations in the field of financial law, the systematic analysis of the deep relationship between them is still insufficient. Through in-depth exploration of the relationship between the two, it is helpful to fill the gaps in legal theories, integrate fragmented knowledge, build a complete theoretical framework, improve the pertinence and operability of regulations, provide theoretical support for the improvement of financial supervision and regulations, and make the theoretical foundation of investor protection in financial law more solid.

In addition, the research involves civil law, financial law, economic law and other multidisciplinary knowledge. Clarifying the relationship between the two can provide

a new perspective for the research on the integration and development of various laws, and then optimize the path of obligation fulfillment and promote the development of discipline theory.

2 Research Summary at Home and Abroad

2.1 Domestic Research Status

Domestic scholars have different views on the relationship between the obligation of appropriateness and the obligation to inform. The starting point of the study is basically based on the provisions of article 72 of the Proceedings of the Civil and Commercial Trials of the National Courts. There are three interpretations of it:

The first view is that the obligation to inform is an integral part of its obligation of propriety. For example, In his paper "The Tort Law Deconstruction of Investors' Appropriateness Obligation", scholar Xu Bin interpreted the Guiding Opinions on Regulating the Asset Management Business of Financial Institutions jointly issued by the four departments of 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 in April 2018 (hereinafter referred to as the "New Regulations on Asset Management"), pointing out that the obligation of appropriateness should include four sub-obligations: understanding customers, understanding products, appropriate matching, and informing.[1] The scholar Yang Libin pointed out that the obligation of appropriateness and the obligation of informing are the relationship between inclusion and inclusion, and the obligation of informing is included in the obligation of appropriateness, and is a necessary extension and supplement of the obligation of appropriateness. [2]And the Understanding and Application of the Minutes of the National Court Civil and Commercial Trial Work Conference, compiled by the Second Civil Trial Division of the Supreme People's Court, also points out that the obligation to inform is a prerequisite for the performance of appropriate obligations.

There are also views that the two do not exist a relationship of inclusion, but are completely different concepts. Wu Hong and Lu Zhiqiang pointed out in "Discrimination of Financial institutions' appropriateness Obligation -- Perspective of the New Securities Law and Summary" that the obligation to inform is an extension of the obligation to implement appropriateness.[3] Ge Xiang also pointed out that from the point of view of the contracting stage, the scope of responsibility of the two is different, and the obligation of notification belongs to the pre-contract obligation, and the obligation of appropriateness belongs to the generalized collateral obligation. [4]

In addition, for the interpretation of article 72 of the Minutes of the National Court's Civil and Commercial Trial Work Conference, some scholars simply believe that it is the obligation to tell or the obligation of appropriateness. It can also be seen that the difference between the two is not clear and easy to be confused.

2.2 Foreign Research Status

Compared with China, the research on the obligation of appropriateness in foreign countries started earlier and the theoretical system is relatively mature.

The "2111 Rule" issued by FINRA in 2012 stipulates that the obligation of propriety consists of three parts: reasonable basis propriety rule, specific customer propriety rule and quantitative propriety rule. Under the fiduciary duty system, the distinction between the obligation of propriety and the obligation to inform is not obvious, and the distinction is not significant.[4] The Markets in Financial Instruments Directive issued by the European Securities and Markets Authority (hereinafter referred to as "MiFID") stipulates the duty of disclosure and the duty of propriety respectively in Article 24 and Article 24, but in fact, it does not strictly distinguish.

In Japan, however, there was no obligation of propriety at the beginning, but there was an obligation of notification in civil law to protect consumers.[5] However, after the enactment of the Law on the Sale of Financial Products in 2000, Articles 3 and 4 stipulated the duty of disclosure, and Articles 8 and 9 introduced the duty of appropriateness, distinguishing the two.

It can be seen that, in foreign studies, there are different understandings of the relationship between the obligation of propriety and the obligation to inform under the influence of different legal systems. It is important to distinguish between the obligation of propriety and the obligation to inform.

3 Definition of Appropriateness Obligation and Disclosure Obligation

3.1 The Origin and Development of the Obligation of Propriety

The obligation of propriety originated in the securities industry of the United States. Because financial institutions often have expertise and information advantages, investors are in a relatively weak position. In order to deal with the problem of information asymmetry between financial institutions and investors in the securities market and to protect the interests of investors, the obligation of appropriateness has been gradually established. In the 1930s, after the Great Depression of the securities market in the United States, in order to strengthen the supervision of the securities market, Congress passed a series of securities laws and regulations, which laid a solid foundation for its development although they did not explicitly put forward the obligation of appropriateness, such as the Securities Act of 1933 and the Securities Exchange Act of 1934. In 1973, the National Association of Securities Dealers (NASD), the self-regulatory organization of the securities industry in the United States, formulated the Fair Trading Rules, which clearly stipulates the appropriateness obligation that securities brokers should bear when recommending securities products. Subsequently, by *Clark v. John Lamula Investors* *Follansbee v. Davis*, *Skaggs*, *Leone v. Advest* According to the practice of other cases, the obligation of appropriateness eventually became a legal norm that can constrain financial institutions. NASD further refined the obligation of appropriateness, requiring securities brokers to provide customers

with appropriate investment advice based on factors such as customers' investment objectives, risk tolerance and financial status when recommending securities products. In 2011, the Financial Industry Regulatory Authority (FINRA) consolidated the existing rules to create new FINRA Rule 2111, which defines the three main obligations of reasonable basis appropriateness, customer specific appropriateness, and quantitative appropriateness.

In the early days of the European Union, the framework for the obligation of appropriateness was established mainly through a series of financial directives. The Markets in Financial Instruments Directive (MiFID), for example, is designed to ensure that financial institutions act in the best interests of their customers by conducting a categorised assessment of their knowledge and experience, their financial position and their investment objectives before selling products. And in the product recommendation process, it is necessary to ensure that the recommended products are in line with the customer's risk tolerance. In Japan, regulators such as the Financial Services Agency construct a system of appropriateness rules based on the characteristics of the country's financial markets. It requires financial institutions to fully understand the client's asset status, investment purpose, investment experience, etc., before selling financial products. For example, when banks sell financial products to customers, they need to obtain such information through questionnaires and other means. Financial institutions are required to fully explain key information such as the nature and risks of financial products to customers, so as to safeguard the rights and interests of investors and ensure the fairness and efficiency of the financial market.

The obligation of appropriateness first appeared in China's financial market in 2005, which was put forward in the Interim Measures for the Management of Personal Finance Services of Commercial Banks promulgated by the CBRC. Subsequently, from 2009 to 2016, the concept of propriety obligation was gradually established, among which, the Interim Provisions on the propriety Management of GEM Investors issued in June 2009 required securities companies to understand investor-related information and fully disclose risks. The introduction of the New Regulations on Asset Management in 2018 has continuously improved the concept system of suitability obligation in China. The "Nine People's Records" adopted by the Supreme People's Court in 2019 completed the systematic summary of the theory. The amendment to the Securities Law in 2020 stipulates "investor protection" in the special section, introduces the adequacy obligation of securities companies in Article 88, paragraph 1, and stipulates the liability for violating the "adequacy management obligation of investors" in Article 198, directly elevating the adequacy obligation rule to the level of laws and regulations. [6]

3.2 The Concept of Bligations of Propriety

According to the Supreme People's Court, "Minutes of the National Court Civil and Commercial Trial Work Conference", Article 72: The obligation of appropriateness refers to the high risk financial products, such as bank financial products, insurance investment products, trust financial products, securities aggregate financial plans, leveraged fund shares, options and other OTC derivatives, which are promoted and

sold to financial consumers. In the process of providing services for financial consumers to participate in high-risk investment activities such as margin financing, New third Board, growth enterprise Board, science and technology board, futures, etc., it is necessary to fulfill the obligations of understanding customers, understanding products, selling (or providing) appropriate products (or services) to suitable financial consumers. [7]

The appropriateness principle is a kind of "buyer beware, seller responsible" principle arising in the context of the development of the financial market.[8] In the traditional contract law, it is often emphasized that "contract freedom, risk own". However, due to the particularity of the relationship between financial institutions and financial consumers, in order to prevent financial institutions from misleading or enticing financial consumers by using information differences, resulting in damage to the rights and interests of financial consumers, the obligation of appropriateness arises. In essence, financial institutions are restricted by the obligation of appropriateness, which changes from formal equality of contract laws and regulations to substantive equality.[9]

3.3 The Theoretical Basis of the Obligation to Inform

3.3.1 Principle of Good Faith.

Article 6 of the Civil Code of the People's Republic of China clearly stipulates: "Civil subjects engaged in civil activities shall follow the principle of fairness and reasonably determine the rights and obligations of each party." The principle of good faith is a very important principle in civil law, which is an open norm and belongs to a standard of conduct, that is, all civil subjects should not violate the principle of good faith when carrying out civil activities, otherwise it can be regarded as invalid. In judicial practice, when encountering new problems and new situations, the court can exercise fair discretion according to the principle of good faith.[10] The principle of honesty and credit contributes to the maintenance of social fairness and justice, the stable development of economic order and the protection of the rights and interests of vulnerable groups.[11]

3.3.2 Consumers' Right to Know.

Consumers' right to know is embodied in the Civil Code of the People's Republic of China, the Protection of Consumer Rights and Interests and the Insurance Law, and is an important part of consumers' rights and interests.

The right to know is the basis for consumers to make reasonable purchasing decisions. Only in the case of fully understanding the goods and services, consumers can compare the advantages and disadvantages of different products, assess whether it meets their needs and expectations, so as to avoid blind consumption. Moreover, it can effectively prevent merchants from fraud. When businesses have to disclose true information to consumers, it is difficult to mislead consumers to buy goods or services of poor quality or that do not meet consumer needs through concealment or false publicity.

In judicial practice, operators should clearly inform consumers of the scope of their voluntary disclosure obligations, otherwise it will be suspected of violating consumers' right to know. Generally speaking, the infringement of consumers' right to know belongs to the general infringement category, and the compensation follows the filling principle. However, if the operator deliberately conceals the truth and induces consumers to trade, it may be suspected of fraud, and in such cases the operator shall bear the liability for punitive damages.[12]

3.3.3 First Contractual Obligations.

Pre-contract obligations refer to the various obligations of informing, assisting and protecting which the contracting parties should undertake based on the principle of good faith in the process of concluding a contract and before the contract becomes effective. It starts with the offer becoming effective and ends with the contract becoming effective. For example, in the process of concluding a sale contract, the seller has a pre-contract obligation after receiving the offer from the buyer.

The pre-contract obligation is the practice of the principle of honesty and credit, which is the theoretical basis of the pre-contract obligation.[13] Pre-contractual obligations are significant. It can promote the smooth conclusion of contracts and reduce the obstacles in the process of contract conclusion through mutual cooperation and information sharing.

3.4 The Concept of the Obligation to Inform

The obligation of notification and explanation is a widely applicable obligation, which is reflected in the Civil Code, the Insurance Law, the Labor Contract Law and the Regulations on the Prevention and Handling of Medical Disputes. In short, the obligation to inform means that in a particular transaction or legal relationship, one party (usually the party with more information) has the obligation to truthfully, completely and clearly inform and explain important information related to the transaction or matter to the other party.

The obligation to inform and explain is based on the principles of good faith, contractual fairness, etc., to ensure investors' right to know and right to make independent decisions. Its specific categories include product key information, risk and income characteristics, contract terms, etc., with the characteristics of "adequacy" and "accuracy".

4 Relationship Between the Obligation of Appropriateness and the Obligation to Inform

4.1 Relationship Definition

The obligation of notification and explanation is reflected in both the Civil Code and the Contract Law. It is a widely applicable concept, which is applicable to labor contract, insurance contract and even medical dispute. The obligation of appropriateness

is stipulated between financial institutions and financial consumers, which is the obligation of financial institutions to be responsible for financial consumers. In the New Regulation on Asset Management, the obligation of appropriateness includes investors, classification product and service risk classification, suitability matching, risk warning, understanding investors, understanding products and strengthening internal management. As a widely used business obligation, the obligation of disclosure is naturally embodied in several contents of the obligation of appropriateness.

The obligation of appropriateness emphasizes that when financial institutions recommend products or services to customers, they should ensure that the products or services match the customers' financial conditions, investment objectives, risk tolerance, etc. The disclosure obligation plays a key role in this process. First, at the know-you stage, the propriety obligation requires financial institutions to collect customer information, such as age, income, investment experience, and so on. In conjunction with the disclosure obligation, financial institutions are required to explain to customers why the information is being collected and how it will be used to provide customers with appropriate product or service matching recommendations. Secondly, in the product or service recommendation stage, the obligation to inform is more important. Financial institutions must fully inform customers of key information about the product or service, including risk-return characteristics, product structure, etc. For example, when recommending a financial product, customers should be informed of the risk of principal loss, the expected rate of return and its fluctuations. This is consistent with the objective of the obligation of appropriateness, which is to enable the customer to make a well-informed judgment as to whether the product or service is suitable for them. Finally, from the perspective of protecting the rights and interests of customers, the ultimate purpose of the obligation of appropriateness is to prevent customers from suffering losses due to the purchase of inappropriate products or services. By clearly and accurately communicating various information about products or services to customers, customers can make reasonable decisions, so as to realize the value of the obligation of appropriateness. If the financial institution fails to fulfill the obligation of notification, it is difficult to ensure that the products or services it recommends meet the customer's suitability requirements, which may lead to the loss of the customer's rights and interests.

However, the obligation of appropriateness does not only exist in the task of informing and explaining, but also in other tasks such as investigating the background of users and products, matching, grasping supervision and management. Understanding the customer, understanding the product, appropriate matching, and informing should be the four sub-obligations of the obligation of appropriateness. The obligation to inform is an integral part of the obligation of propriety, it is included in the obligation of propriety, and it is a necessary extension of and necessary supplement to the obligation of propriety. The disclosure obligation and the other three sub-obligations complement each other, constitute and maintain the appropriateness obligation, and maintain the security of the financial system.

4.2 Judicial Regulation

In the judicial decision of financial cases, we should clearly distinguish between "obligation of appropriateness" and "obligation of informing and explaining", instead of applying the two confusingly. The author believes that in the judicial decision of financial cases, if the four obligations of financial institutions, namely, understanding the customer, understanding the product, appropriate matching, informing and explaining, have not fulfilled their duties, the judicial organ should be judged as "failing to fulfill the obligation of appropriateness"; If the financial institution does its best to understand the customer, understand the product, and properly match the three obligations, but ignores the obligation to inform the explanation, it should be judged by "not fully inform the explanation obligation", and indicate that the other three sub-obligations have been standardized, rather than "not fully fulfill the obligation of appropriateness".

However, in addition to financial cases, the obligation to inform can also be applied to other judicial decisions as a separate category. For example, in the website of China's Judgment Documents, with "failure to inform the obligation" as the search term, the "notification obligation" can be retrieved as an independent existence for the judgment of "medical malpractice", "insurance" and other civil cases.

5 Conclusion

The disclosure obligation is embedded in the propriety obligation system and is the key link of its implementation. The obligation of appropriateness focuses on the overall adaptation, from understanding customers, matching products to follow-up services, informing and explaining the whole process, providing information support for each step to ensure that customers understand the nature of the transaction. The ultimate goal of both is to protect the rights and interests of investors and maintain the stability of financial markets. The obligation to inform and explain helps customers make decisions through information transmission, and the obligation of appropriateness to accurately match and prevent investment risks, and jointly create a fair and orderly financial transaction environment.

In the future financial market development environment, we should pay attention to the collaborative optimization path of the two, and regulate the two categories in law. Focus on the improvement of the accuracy of obligation fulfillment under the empowerment of emerging technologies, and the unification of cross-market and cross-product obligation standards, laying a solid foundation for the steady development of the financial market.

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