

Suggestions on Sooner Enactment of Investor-friendly Futures Law

Professor Liu Junhai, Director of Commercial Law Research Institute of Renmin University of China

Currently the basic law governing the futures market of China is the Regulations on Administration of Futures Trading promulgated by the State Council on March 6, 2007 and amended on October 24, 2012 (“Regulations”). Since it is less than one year after the Regulations are amended, the relevant authorities have different opinions on whether the Futures Law shall be enacted by the Standing Committee of the National People’s Congress. The author holds that, with the purpose to facilitate the legal construction of Chinese futures market, create the upgraded version of Chinese futures market, and promote the sustainable and healthy development of Chinese futures market, an investor-friendly Futures Law must be enacted quickly.

I. Urgent need to enact an investor-friendly Futures Law

Firstly, the optimization of the civil law system in the field of futures market and protection of the rights of futures investors require the enactment of a Futures Law as soon as possible. The basic civil law system is the core of modern futures market law system. The futures market is a fund-intensive, risk-intensive and legal-rule-intensive market. Although the Regulations, an administrative regulation, may provide for the administrative legal norms, it is not authorized to provide for the basic civil law system with respect to the fundamental rights and interests of the participants of the futures market. This is an important reason that the Regulations is named as “Regulations on Administration”. However, not only vertical administrative regulation relation, but also horizontal civil law relation exists in the futures market. Pursuant to the provisions of Article 8 of the Legislative Law, the basic civil system may be governed by the law enacted by the legislative body. Therefore, only if the Regulations is upgraded to Futures Trading Law, it can be realized to regulate the civil relations between the futures exchanges, futures companies and investors and to establish and optimize civil law system group of futures market beyond the administrative regulation relation of the futures market.

Secondly, the facilitation of the progress of internationalization of Chinese futures market and strengthening of the international credibility and competitiveness of Chinese futures market require the enactment of the Futures Law as soon as possible. Internationalization and globalization are one of the reform orientation of Chinese futures market. Both the strategy of “bringing in” and the strategy of “going out” shall be implemented in Chinese futures market. Either the “bringing in” or “going out” requires a modern Futures Trading Law that meets the national conditions of China and is compatible with the international system. Although the administrative laws and regulations play important roles in the pyramid legal system of Chinese futures market, and the domestic regulators and participants of futures market pay highly attention to the authority of the Regulations, the majority of futures companies and investors from other market economy countries lay more focus on the stability,

predictability and authority of the law, while the administrative regulations and departmental rules and regulations and other official documents are changeable, which bring a lot of insecurity. To obtain the trust of international futures market and by reference to the successful futures legislation experience, Chinese legislative body shall also enact the Futures Trading Law as soon as possible.

Thirdly, the encouragement of innovation in the futures market and optimization of credit system in the futures market also require the enactment of Futures Law. Innovation is the source of vitality of futures market. However, nothing can be accomplished without norms or standards. The innovation can't happen without the protection of credit system. Without the base line of credit, the innovation activities surely will fall from grace. As there exists lessons on irregularities happened before in Chinese futures market, the current futures trading administration regulations lay particular stress on the regulation pattern of security orientation, and lay less stress on the regulation element of innovation orientation. To motivate the innovation in the futures market, and ensure the innovation activities in the futures market on the track of rule of law, credibility and rationality, it is urgently needed for the legislative body to enact the Futures Trading Law.

II. Fundamental philosophy of futures trading legislation

Firstly, the legislative body shall handle correctly the relation between the market and the government, establish the new thinking of attaching equal importance to the market innovation and governmental regulation so to further advance the market reform of Chinese futures market. The report at the 18th Party Congress points out that “efforts will be made to exert the fundamental role of market in the allocation of resources to a larger extent” and “to deepen the reform of economic system comprehensively”. To deepen the reform is the key to expedite the transformation of economic development mode. The core issue of reform of economic system is to handle the relation between the government and the market properly, which requires further adherence to market rules and reasonable exercise of the role of the government. Such opinion is a compass to understand the reform of capital market. The market may fail, and so does the government. Moreover, the failure of government may cause greater damage. Therefore, all efforts must be made to further increase the degree of marketization of sources of capital in China. Currently, although the socialist market economy system has been established in China, it has not yet been optimized. The market reform of Chinese futures market has not yet completed. Since Chinese futures market is also characterized as “emerging and transforming”, Chinese government actively applies the non-market administrative tools to establish the futures market and employs the non-market administrative tools to maintain and rectify the order of futures market for a long term. In addition, the futures market is a sub-system of Chinese uniform grant market, and the traditional mode of thinking of planned economy and the imperfect macroscopic market economy system, legal system and credit system still haunt, the market-oriented reform tasks of Chinese futures market have not yet completed. With the purpose to end the “emerging and transforming” characteristics of Chinese capital market as soon

as possible, and to transform Chinese government-dominated market to market-motivated market, it is suggested to advance the market reform of Chinese futures market comprehensively, further cut down the space of governmental control, reduce the administrative license sharply, regulate the maintained exceptional administrative licenses, and construct strongly a service-based securities regulatory commission compatible with the development rules of capital market. To cope with the risks of market failure, and maintain the interests of investors and the security of finance, the legislative body shall empower the securities regulatory commission to employ the administrative license, administrative guidance, administrative survey, administrative punishment and other administrative power granted by the law to maintain the order of futures market in a prudent and diligent manner. The supreme mission of the securities regulatory commission is to advance, activate and maintain the market mechanism, maintain the fair, open and equal trading and competition order of futures market, protect effectively the legitimate rights and interests of investors, and take the protection of market fairness as the start point to increase the efficiency of futures market greatly and create harmonious ecological environment prompting the co-win of participants of futures market and benign interaction of futures market and substantial economy.

Secondly, the legislative body shall handle the relation between fairness and efficiency correctly, attach more importance to the fairness of futures market and change the traditional thinking of “efficiency first, and equity balanced”. The traditional development views hold that the efficiency shall take the initiative and then the fairness shall be balanced. Efficiency is stressed in the primary distribution stage and fairness is stressed in the second distribution stage. Such traditional thought not only contaminates the mainstream value of fairness, justice and good faith, damages the equal and fair market order, but also hinders the realization of efficiency target. There exist not only difference and conflict, but also compatibility and intergrowth between the fairness and efficiency. The value of fairness and the value of efficiency are of same importance. The fairness will cultivate efficiency and the efficiency will stimulate the efficiency. The stake of the government is not the interests, but the justice. The fairer legislation and policy schemes will stimulate more strongly the internal drive of the people to create value and accumulate wealth, and the market will become more efficient. The spread of fair value not only takes the efficiency of the mighty party to the market negotiation into consideration, but also take the efficiency of the weak party to the market negotiation into consideration, therefore, it will promote the sustainability of the win-win and shared futures market mode. The smart legislators and regulators shall, through the democratic, scientific and transparent decision-making mechanism, select the schemes attaching same importance to the fairness and efficiency. If both the fairness and efficiency are hard to be realized, then the scheme of equal value shall be preferred. The emphasis on fairness and justice does not mean that the efficiency is not important. On the contrary, the value of efficiency is also very important. Merely, the value of efficiency can't confront the value of fairness. The harmonious futures market can't tolerate the efficiency with fairness sacrificed.

Thirdly, the legislative body shall handle correctly the relation between standardization and development, establish the new thinking of attaching same importance to standardization and development and change the traditional thinking of attaching highly importance to development and less importance to standardization. In the initial development stage of the futures market, it is a common situation to attach higher importance to development and less importance to regulation and exist the thinking set of “development first, regulation secondary” and “development precedes the regulation”. Such thinking set implies three important propositions: (1) at the beginning of the birth and start of a market, regulation is not a necessity, but is required after this market becomes mature. (2) a market emerging from immaturity to maturity always encounters a chaos period. In this chaos period, it is inevitable that the weak market participants such as investors will pay the price of the disorder of the market. (3) The problems existed in the process of development will be settled through development, but not through the means of regulation and rule of law. This kind of development view will inevitably results in the ceaseless accumulation of conflicts and contradiction during the development of the market. Once the contradiction and conflicts reach to a certain degree, they will hinder the prosperity and development of the market. The futures market can only be developed through regulation and regulated through development. The development and regulation are closely associated with each other and same importance shall be attached to the development and regulation. It is wrong to set the development against the regulation. Development is the target, regulation is the precondition, rule of law is the foundation and harmony is the key.

Fourthly, the legislative body shall handle correctly the relation between freedom of contract and justice of contract, establish the new thinking of attaching equal importance to the freedom of contract and justice of contract, and change the traditional thinking of pursuing freedom of contract partially and ignoring the justice of contract. One of the important achievements obtained in the reform of Chinese economy system is the overruling of the government-directed-plan-oriented planned economy system and the establishment of the freedom-of-contract-oriented market economy rules. While in developed market economy countries, they not only stick to the principle of sanctity of contract, but also attach importance to the justice of contract and pay attention to the substantial fairness between the rights and obligations of parties involved. However, in our country, we still remain the shallow level of confirmation of freedom of contract, particularly, the pro forma freedom of contract and misunderstand that “freedom of contract equals to the justice of contract”. We are likely to lay emphasis on the pro forma freedom of contract and ignore the substantial freedom of contract, not to mention the justice of contract. This is the severe imbalance between the freedom of contract and justice of contract. The author holds that the new spirits of contract required for our socialist economy market cover three elements which are differentiated with each other but also supplement each other, that is, freedom of contract, justice of contract, and strict observation of contract. These three elements play same role, without difference of importance. In practice, there exist lots of phenomena of ignorance of freedom of contract and abuse of

administrative control; the ignorance of justice of contract and existence of inequality contracts occur everywhere, and the ignorance of strict observation of contract and failure to keep faith also take place from time to time. Under the circumstance where the investors can't realize self protection through freedom of contract, if the legislative body fails to provide properly inclined legal protection for the investors through the compulsory norms, the rights and interests of investors are impossible to be respected, the justice of contract can't be achieved, and the true and substantial freedom of contract always falls into showing. Under the circumstance of imperfect market economy system and inadequate market competition, the thinking of one-sided emphasis on the freedom of contract tends to provide an institutional hotbed for the abundance of inequality contracts. We suggest that the legislative body should further uphold the spirit of justice of contract to realize the mechanic uniform of freedom of contract and justice of contract where both the pro forma and substantial freedom of contract are emphasized. The legislative body shall set out that the clauses of the standard terms provider that create interests for itself, exempt its own obligations, liabilities and risks, aggravate partially the obligations, liabilities and risks of investors, and deprive of the rights and interests of the investors. We should establish the administrative review and correction mechanism for the regulators against the standard contracts, introduce the public hearing program, exert actively the administrative guidance duties and urge the standard contract providers to provide the contracts on an equal basis.

Fifthly, the legislative body shall establish the thinking attaching same importance to self-disciplinary regulation and administrative regulation, change the traditional thinking of "administrative regulation dominated and self-disciplinary regulation supplemented", and innovate new governance system for the futures market. The regulation mode of the futures market in the opinions of the author is: adjustment through legislation + autonomous governance mechanism of market subjects + fair competition mechanism + industrial self-disciplinary mechanism + administrative regulation mechanism + judicial remedy mechanism where the adjustment through legislation is a precondition, the autonomous governance of market subjects is the foundation, fair competition is the central, industrial self-disciplinary regulation is the core, administrative regulation is the key, and the judicial remedy is the guarantee of such regulation mode. "The duck knows first when the river becomes warm in spring". The industrial self discipline equals to self-disciplinary regulation where the self-disciplinary regulation of the futures exchange and futures association shall take fundamental position in the regulation system of the futures market. Only when the self-disciplinary regulation fails can the administrative regulation gets involved. Of course, the self-disciplinary regulation organization shall also fully exert their self-disciplinary duties of self education, self management, self service and self constraint and is encouraged and guided to conduct self discipline prudently and follow the example of other subjects so to optimize ceaselessly the market environment of operation in good faith. If any market subject abuses of its power or breaches its obligations, the self-disciplinary organization shall impose self-disciplinary sanction. Of course, the securities regulatory commission

shall have the right to offer administrative guidance for the self-disciplinary organizations so to optimize ceaselessly the regulation on the autonomous governance of market subjects and regulation of self-disciplinary organizations.

Sixthly, the legislative body shall establish the new legislation method of “details precede over principles” and change the traditional legislation method of “principles precede over details” so to increase the operability and justiciability of legislation. The core of the text of law is to transmit the most legislation information by the least words. The justiciability and operability of legislation products are the touchstone to measure the quality of a law. The legislative body is suggested to change the thinking method of “principles preceded over details for legislation and establish the new thinking method of “details precede over principles for legislation” and to define the legal relation that can be confirmed and determined in the practice in a clear, rigorous, and comprehensive manner. A good law shall not only appear sound, but also operate effectively, easily, functionally, and availably. Law is a public instrument. The nature of law is a public product provided by the legislative body for the tax payers. To increase the justiciability of legislation, the legislative body shall not only hear carefully the opinions and voice of the subjects of the system through the conversion meeting, questionnaire survey and other means, but also take transpositional consideration and take the position initially of the participants of the futures market, diagnose correctly the crucial reasons and causation of the elements hindering the reform and development of the futures market, and increase the pertinence and practicability of the legal system responding to the actual situation appropriately.

III. It is suggested to focus on the protection of rights and interests of investors as the key of futures legislation and create effectively an investor-friendly legislation system

The protection of the rights and interests of the fund holders is always the bottle-neck challenge hindering the sustainable and healthy development of Chinese futures market. Without the protection of the rights of investors, there is no confidence of investment and the prosperity and great development of futures market. The respect and protection of the rights and interests of the investors are always the theme of futures legislation, the guiding light to optimize the internal governance of futures exchanges, futures companies and other intermediaries, the important entry points to advance the construction of rule of law in the futures market, the strategic measures to ensure the swift, sound, harmonious and permanent development of futures market, and the theme running through the development, reform, regulation and stability of Chinese futures market. Therefore, the legislative body is suggested to list the protection of the rights and interests of investors as the purpose of legislation of Futures Law at the very beginning.

The purpose of this law is to regulate the futures trading activities, protect the legislative rights and interests of investors and related parties, and promote the healthy development of futures market. The protection of rights and interests of investors shall, as the soul of law, run through the whole Futures Law. From the micro

perspective, the rights of investors are private and civil rights; from the macro perspective, the rights of tens of thousands of investors have become the public interests of the society. The private rights and public interests are not always diametrically opposed. They are differentiated but closely related. The accumulation of private interests becomes the public interests. The protection of the legitimate rights and interests of the investors is to safeguard the public interests of the society. The construction of harmonious investment environment is an important reflection of the people-first scientific development perspective in the field of futures market; therefore, it shall be included in the purpose of legislation.

The legislative body is suggested to, based on the concept of upholding the rights of investors and constructing comprehensively an investor-friendly society, set out the protection of rights and interests of futures investors in a specific chapter, detailing all legal systems to protect the rights and interests of investors. Such law shall expressly stipulate the right of information, option, fair trading, regret (right to terminate the contract unilaterally), privacy and trade secrets of investors and obligations of the futures exchanges, futures companies, other intermediaries and their practitioners.

To safeguard fully the rights of information and option of the investors, we must strengthen the information disclosure obligations of futures companies, optimize the investor appropriateness management, and guarantee that the futures companies will sell proper products to proper investors. The futures companies shall fully understand the nature, characteristics of relevant futures contracts, evaluate comprehensively the risks of such contracts and relevant proper investment subjects and classify such investors scientifically. The futures companies shall, based on the risk bearing capacity of the investors and risk level of the investment products, sell proper investment products to the investors, and sign appropriateness evaluation confirmation with the investors. If the futures companies can't judge the appropriateness of the investment products purchased by the investors, they shall not market such products to the investors. Of course, if the investors refuse the appropriateness matching opinions of the futures companies in writing and request expressly to purchase the investment products with risks higher than the risk bearing capacity of the investors, the futures companies shall respect the option of the investors, but shall keep the written confirmation letter of the investors undertaking to bear all consequences of the investment at its own costs.

Although "credit is valuable" and "credit is valueless" seem opposite, they are synonymous, and both of them imply the double meaning of credit: great value attributed to the credit and the great costs for loss of credit. From the positive point view, credit means capital and credit creates value. The credit brand will bring premium for the market subjects. The credit should become the permit of modern capital market. Comparing with those breaking their promise, those in good faith will enjoy lower transaction costs, more market opportunity, greater market shares, wider financing channels and sounder social image. Therefore, the premium of credit is proper, legal and operable. On the contrary, those breaking their promise will pay the costs finally. The legislative body shall not only lower the costs, and increase the

interests of investors to protect their rights, but also lower the interests and increase significantly the costs of futures companies and other intermediaries for breaking promise (“double increase and double lowering”). The investors should be encouraged to protect their rights while the government should strengthen the protection of the rights of the investors. It is suggested that the resolution of disputes relating to futures trading should be confirmed and the legal liabilities for violation of Futures Law should be stipulated, which should include but not limit to civil liabilities, administrative liabilities, criminal liabilities and reputation sanction.

Union is strength. Enlightened by the system of Chinese consumers’ association, the author strongly advocates that the Futures Law should permit the establishment of futures investors’ association. It is because that the futures companies and other intermediaries under power position in the futures trading activities may protect their interests through the futures association, while the investors under weak position therefore shall unite to form an organization to conduct social supervision on the futures market and to protect the legitimate rights and interests of investors. Considering the important practical significance of protection of rights of investors, if Chinese investors’ association may be established throughout the whole country, and if the investors are included in the protection of the investors’ association, it may be done.

The investors’ association shall be positioned as the “mother’s home” or “uncle” of investors. The investors’ association shall be of private but not official nature. However, the investors’ association is different with other social organizations registered at the authority of civil affairs. The investors’ association will not employ the ordinary membership system, nor charge member fees from the investors. To keep its credibility, and prevent the conflict of interests between the investors’ association and the futures companies and other intermediaries as the supervised, it is suggested the investors’ association must be funded by the treasury. It is suggested that the system of the investors’ association be surveyed, proposed and drafted pursuant to the basic principles of statutory society, statutory duties, statutory staff arrangement and statutory budget. To prevent the investors’ association deviating from its purpose to protect the rights and interests of investors, the legislation shall prohibit it to be involved in futures trading and profit-making service, or be involved in recommending futures companies or investment objectives to investors to seek profits.

Considering that relevant laws, regulations, policies, departmental rules and regulations, local regulations, other legislation documents, self-disciplinary rules of industrial association and mandatory standards formulated pertinent to the futures market exert great influence on the rights and interests of investors, it is suggested to stipulate that “the state shall, upon formulating the laws, regulations, policies, departmental rules and regulations, local regulations, other legislation documents, self-disciplinary rules of industrial association and mandatory standards relating to the rights and interests of futures investors, hear the opinions of investors’ association and investors. “The voice and opinions not only of the regulators and the futures

exchanges, futures companies but also of the futures investors shall be heard upon conducting the futures legislation. To reflect fully the philosophy of above mentioned “double increase and double lowering”, it is suggested that the investors’ association have the right to initiate public interest litigation with respect to the case of mass infringement of rights of investors pursuant to the provisions of Article 55 of Civil Procedure Law.

We have reasons to believe that the earlier promulgation of the Futures Law will lay solid legal foundation for improving the legal environment of Chinese futures market, promoting the sustainable and healthy development of futures market, and creating an investor-friendly society and will establish the corner stone of Chinese futures market.