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The Positioning and Reform of Insurance Institutions in Securities Group Litigation

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Abstract

The resolution of securities group disputes is a common problem faced by all securities markets in the world. Article 95 (3) of the new Securities Law provides a Chinese version of the solution to this problem. As a natural spokesperson for the interests of small and medium-sized investors, investor protection institutions are at the core of securities group litigation. In order to truly activate this system, we should do a good job in the top-level design of the rule system, clarify the substantive conditions and corresponding procedures for the initiation of litigation, accept cases with both group and public welfare, establish an efficient supervision mechanism for group members by establishing a representative committee of group members, and further reform the investor protection institutions, and open up the competition of investor protection institutions to better meet the actual needs.

Keywords: insurance institutions, investor protection, securities class action, group disputes

1. Introduction

The modern company law has established an internal governance system based on the principle of capital majority decision. In practice, rights are often abused, resulting in negative externalities. Therefore, it is necessary to intervene in external governance such as public law enforcement by regulatory agencies, civil litigation by private entities, and self-regulatory supervision by industry organizations. Securities market. The upper infringement damage has the characteristics of a small majority, and the traditional external governance cannot achieve the goal of deterring offenders and filling damaged investors. It is committed to exploring a fair and efficient system to resolve securities group disputes and maintain the order of the securities market. Article 95 (3) of the new Securities Law.

2. Proposing the Problem

Tort cases in the securities market have the characteristics of small majority and scattered investors, and there is a problem of 'collective action dilemma'. In the traditional civil litigation, the income of individual investors is far less than the cost of litigation, and the lack of effective incentives leads to the low cost of illegality in the securities market. However, the connivance of illegal behavior seriously affects the market order. In order to solve the problems of low efficiency, inconsistent judgment results and high litigation costs in civil litigation, and to achieve economies of scale in litigation, various countries (regions) have made useful explorations, such as the lawyer-led securities

group litigation system in the United States, the group litigation system led by the insurance center in Taiwan, and the group litigation system highly managed by the British courts. Article 95, paragraph 3, of the new "Securities Law" deals with the representative litigation system in the civil procedure law. (Wusheng Zhang, 2017)

At present, the urgent problem to be solved is how to implement the system and how to establish a reasonable and effective supporting system to maximize its effectiveness. In the domain.

2.1 How to Start Securities Class Action

The initiation of securities group litigation is the primary problem to be solved, which directly affects the number and quality of cases. The initiation of litigation involves both substantive conditions and specific litigation procedures. Determine the substantive conditions to clarify which types of cases can be included in the scope of group litigation, and the litigation procedure is related to whether the system can operate fairly and efficiently.

From the practice of extraterritorial related systems, the American-style securities class action system is often criticized for serious abuse of litigation, and the winning fee system greatly stimulates the enthusiasm of lawyers to start litigation. The phenomenon of 'the stock price falls, the lawsuit arrives' is very common, and it will be sued in a few days or even hours, which is related to the loose start-up conditions. The United States subsequently introduced a number of bills to try to solve the problem of abuse of litigation, but did not achieve good results. According to the data released by the National Economic Research Association's economic consulting company, only one year in 2020 Securities Group v. The number of litigation cases reached 326, down 22 % from 2019, and 320 cases were closed in 2020. In addition, some scholars have found that the defendant company in the US securities class action has nothing to do with the suspicion of fraud.

2.2 How Group Members Supervise Insurance Institutions

Securities group litigation has achieved a transformation from "many to one" to "one to one" in litigation, with representatives playing a core role in the litigation. Their actions involve the disposal of the litigation rights of numerous plaintiff members, possessing high litigation ability and professional advantages, which can better help investors maintain their rights. At the same time, it may also lead to behaviors such as inaction by insurance institutions, favoritism, and fraud that infringe on the interests of the plaintiff, an effective group member supervision mechanism needs to be established. (Chenglong Lv, 2017)

The serious drawbacks of the US securities group litigation system are the lack of strong supervision over group representatives or lawyers, the inability to compensate damaged investors, and the greatly reduced deterrent function. The issue of "collective action dilemma" has not been fundamentally resolved, and a large number of plaintiffs still adopt an indifferent attitude towards the lawsuit. On the one hand, the plaintiff's lawyer actively initiates a large number of group lawsuits, but on the other hand, after the lawsuit is confirmed by the court, they adopt a negative attitude. Most cases are settled through settlement, with a low proportion of compensation for the plaintiff and marginalized interests. Lawyers are the true beneficiaries.

Taiwan Insurance Center is a non-profit public welfare organization with strong official color, and the fairness of its behavior is guaranteed to a certain extent. Group litigation adopts the "joining system", and only parties who explicitly indicate their participation in the litigation will be bound by the litigation judgment. It can be foreseen that in the future, there will be a larger scale of plaintiffs in China's securities group litigation, and it is necessary to establish a group member supervision mechanism that takes into account fairness and efficiency.

2.3 How to Reform Insurance Institutions

The investor protection institutions currently established in China include the China Securities Small and Medium Investor Service Center (Investment Service Center) and the China Securities Investor Protection Fund Company (Insurance Fund). The insurance fund is mainly used as a risk management mechanism for securities companies, without any litigation and rights protection practices. In recent years, the Investment Service Center has undertaken the functions of equity exercise, dispute mediation, rights protection litigation, and investor education. Through its litigation practice in the

securities market, it has accumulated a lot of experience and become a natural subject for initiating securities group litigation. Although the law does not specify investor protection institutions, in current practice, there are no other entities that can undertake this function. The uniqueness of the subject will lead to drawbacks such as insufficient litigation capacity, insufficient incentive mechanisms, and monopolized litigation monopoly. Therefore, it is necessary to reform insurance institutions to meet practical needs.

3. Initiation of Securities Group Litigation: Physical Conditions and Program Design

3.1 Scope of Securities Group Litigation Cases

Article 95 of the Securities Law stipulates that a class action can be initiated against civil compensation lawsuits for securities such as false statements. In the preliminary exploration stage, this issue needs to be clarified on which cases can initiate a securities class action.

What is the relationship between group litigation and shareholder subrogation litigation ③ stipulated in Article 94 (3) of the Securities Law of the People's Republic of China, in the context of the investment service center generally holding one hand of the stocks of listed companies in the Shanghai and Shenzhen stock markets? This issue is also worth exploring. Taking false statements as an example, when a listed company's infringement behavior causes losses to investors, investors can file a civil lawsuit. In reality, illegal activities are often carried out by directors, supervisors, and senior executives, and listed companies themselves are also victims. As shareholders who file representative lawsuits and are not subject to shareholding ratios and time limits, the Investment Services Center can also file subrogation lawsuits to request compensation from the violators after fulfilling the pre litigation procedures to protect the interests of the company. So, should insurance institutions initiate securities group litigation, shareholder subrogation litigation, or both? Alternatively, after the listed company assumes compensation liability, it may seek compensation from the responsible directors, supervisors, and senior executives through subrogation litigation. If the two are parallel, what is the role positioning of the insurance institution in the two lawsuits?

The author believes that not all group financial civil and commercial disputes can initiate group litigation. From the perspective of the establishment of the system, it not only focuses on the protection of small and medium-sized investors, but also aims to punish and deter securities violations, achieve the maintenance of securities market order, and belong to the public goods provided by non-profit organizations. This is the basis for providing a series of preferential measures for them. Therefore, the scope of the case should take into account both group and public welfare. Group nature is reflected in the wide impact of the case and the involvement of multiple investors. Public welfare can be determined from whether it affects higher-level market management or trading order, and has an impact on potential investors, thus returning to the dilemma of insurance institutions in solving the litigation costs, legal expertise, and evidence ability of the majority of investors, thus creating its essence as an institution and medium for litigation. Insurance institutions should make judgments on individual cases, determine litigation roles, and select appropriate forms.

3.2 The Preservation and Abolition of Pre-Litigation Procedures

Pre-procedure refers to the plaintiff's need to provide an administrative penalty or criminal judgment for illegal behavior when filing a lawsuit. In 2015, the Supreme People's Court proposed to cancel the pre-procedure when filing a case. In the "Several Regulations", the scope of evidence has been expanded to include disciplinary actions or self regulatory measures taken by defendants' self admission materials, stock exchanges, and other national securities trading venues approved by the State Council. In order to promote the implementation of the system, Article 7 of the "Opinions on Strictly Cracking down on Securities Illegal Activities in accordance with the Law" clearly states that: "Revise the relevant judicial interpretation of civil compensation caused by false statements, and cancel the pre-procedure of civil compensation litigation". So how should we view the front-end program?

Group litigation should be regarded as a mechanism for protecting small and medium-sized investors that is independent of administrative supervision in detecting and punishing violations. Group litigation in insurance centers in Taiwan, China, has been criticized for its high reliance on criminal procedures. The author believes that the

front-end program still has value at this stage and should not be simple and one-size fits all. In the process of promoting the system, insurance institutions and courts should also improve their professional capabilities in identifying illegal behaviors, encourage investors to report illegal behaviors, establish a mechanism for discovering illegal behaviors, gradually eliminate the pre-litigation procedures, leverage the independent value of group litigation, and form a beneficial supplement to administrative law enforcement through private litigation. (Hao Tang & Lin Zhu, 2021)

3.3 Lawsuit Start-up Procedure

There are two understandings regarding the relationship between ordinary representative litigation and special representative litigation in the litigation initiation procedure. Firstly, there is a parallel structure, which means that ordinary representative litigation and insurance institutions filing special representative litigation can be parallel, and the two do not constitute a restrictive relationship; Secondly, progressive approach, which means that the insurance institution needs to be authorized by more than 50 investors to participate as representatives in the litigation after the investor files a representative lawsuit and is registered by the court. This means that the initiation of group litigation by the insurance institution is based on the premise of ordinary representative litigation, and the progressive approach is adopted in the Supreme Court's Several Regulations.

According to the progressive model, the participation of insurance institutions in group litigation relies on investors' choice of representative litigation form and does not have the right to directly initiate litigation. This provision may be aimed at preventing indiscriminate litigation caused by the lack of restrictions on insurance institutions. However, for a long time, Chinese courts have adopted a negative attitude towards group litigation, and the main problem that needs to be faced when introducing group litigation is the lack of litigation motivation, rather than litigation abuse. Therefore, insurance institutions should be allowed to actively solicit authorization from plaintiff investors to initiate group litigation, and the court should further review and confirm. Under current rules, insurance institutions can also convert into group litigation by first supporting investors in litigation.

3.4 The Case Selection System of Insurance Institutions

There is a viewpoint that the case selection system of insurance institutions believes that insurance institutions should not choose cases to initiate the process, as it will create fairness issues. If insurance institutions choose typical and significant cases, they cannot achieve integrated and fair protection for affected investors, which violates their positioning and responsibilities. Even if it is necessary to choose cases in the early stages of the system, the priority should be given to cases that are about to exceed the statute of limitations based on the time sequence of administrative penalties and criminal judgments. In fact, due to the constraints of human, material, and financial resources, insurance institutions are unable to initiate litigation in all cases, and case selection is inevitable. (Guoping Zhang, 2013)

Insurance institutions should follow the principle of cost-benefit in selecting cases, in order to obtain more deterrent effects with as little social resource investment as possible. Firstly, the public welfare nature of insurance institutions does not conflict with the consideration of litigation costs. If their funding comes from official institutions and disregards the principle of cost-benefit, it will result in overall low efficiency. In practice, if market entities have achieved certain results in safeguarding their rights, it is difficult to say the value of group litigation if insurance institutions file lawsuits against them. Secondly, due to the exclusive litigation implementation rights of the insurance institution, when choosing a case, under the premise of having a typical significant case and adverse social impact, real difficult cases should be selected, and their professional advantages in litigation ability should be utilized. Disputes that can be resolved by relying on the market's own strength are not given priority, and the public welfare positioning should be clearly defined. Finally, insurance institutions should prioritize cases with high success rates.

4. Litigation Supervision Mechanism of Group Members

4.1 The Exercise of the Right of Appeal

The exercise of the right of appeal is based on the theory of litigation contracts, where investors give special authorization to the representative and the insurance institution

carries out the litigation. The litigation results bind all plaintiffs, but there is a certain degree of separation between investors and representatives in the litigation. After the first instance judgment, when the defendant or insurance institution files an appeal, the case will enter the second instance procedure. Should some plaintiff members be granted the right to appeal when both the insurance institution and the defendant waive the appeal?

The "Several Provisions" clarify that plaintiff members have the right to appeal, stating that a first instance judgment is only effective for non-appellants, and that the rights and obligations of appellants should be determined based on the second instance judgment. This provision maximizes the protection of investors' litigation rights, but also creates procedural and substantive difficulties. (Weijian Tang, 2020)

The authorization of the parties to the insurance institution means that the results of the insurance institution's actions have a binding force on them. While investors are "free riding", based on the principle of equal rights and obligations, they should transfer their procedural rights and even substantive rights to a certain extent. Allowing some members of the plaintiff to appeal again would result in lengthy litigation proceedings. If some plaintiffs and investors appeal, in theory, there will be two effective judgments for the same case. When a parallel litigation ruling is filed on the same fact, there will also be a dilemma of whether to apply the first instance or second instance judgment, which affects the stability of the court's judgment. The superiority of the group litigation system lies in its efficiency value and the one-time resolution of group disputes. Therefore, the plaintiff's supervision over the insurance institution should be fully guaranteed, and a high degree of democracy should be achieved through full communication during the litigation process. After the insurance institution abandons the appeal, other plaintiff members should not be granted the right to appeal.

4.2 Strengthen Information Disclosure Mechanism

Due to the existence of information asymmetry, more information is actually held in the hands of the regulated rather than the regulator, leading to the failure of many systems in the operation process. The effective supervision of group members cannot be separated from the information disclosure of insurance institutions. The disclosure of information by insurance institutions should include regular quarterly and annual reports, as well as disclosure of relevant progress in specific cases. The Taiwan Insurance Center publishes its annual report on its official website, disclosing its organizational structure, personnel appointments, group litigation and other business reports, as well as its financial status, and is subject to public supervision. In order to strengthen the supervision effect of the public on the performance of insurance institutions and enhance their trust, the Investment Service Center should also establish a similar system. In specific cases, it should communicate with the representative members of the group in a timely manner, and disclose the progress stage of the case, evidence situation, settlement plan, etc.

5. Reform Direction of Insurance Institutions

5.1 Open Competition Among Insurance Institutions

The exclusive litigation implementation rights of insurance centers in Taiwan have been criticized due to the lack of incentives and litigation capabilities, and the limited energy and resources are unable to handle a large number of group litigation cases. At present, the human and material resources of the investment service center are not sufficient to cope with a large number of investor protection activities in the securities market. Its exclusive litigation implementation power can breed drawbacks such as low efficiency and selectivity. In the long run, the disadvantages outweigh the advantages. It is necessary to avoid designating a single institution as a monopoly organization leading collective litigation, and allow multiple qualified non-profit organizations to exist simultaneously, and carry out investigations on the government, market Private donations and competition for talent.

Explore the establishment of multiple investor protection institutions and introduce competition mechanisms. Firstly, the insured fund should be given the right to initiate litigation in a timely manner. Although the insured fund does not have the practice of safeguarding its rights in litigation, it is also a statutory investor protection institution, which can alleviate the work pressure of the investment service center to a certain extent and form effective competition; Secondly, explore the establishment of investor protection institutions or branches of investment service centers in

different regions by the local securities regulatory authorities and the security association, and realize the efficient operation of the system through the competitive incentives of multiple insurance institutions. Due to the fact that insurance institutions are public welfare institutions, in order to avoid shifting responsibilities between institutions, a method of linking the financial funds of insurance institutions with their work results can be adopted. In the future, allowing lawyers who meet certain conditions to initiate litigation is also a viable option.

5.2 Strengthen Independence and Neutrality

As a dedicated defender for small and medium-sized investors, the Investment Service Center is entrusted with multiple functions such as group litigation, supporting litigation, and mediation. In group litigation, as a representative of investors, I participate in the litigation and confront the listed company. However, when accepting the commission of the listed company to mediate disputes, I play a neutral and objective role. Under different roles, the behavior of the investment service center may inevitably conflict.

The internal structure of the investment service center needs to undergo certain reforms, such as the establishment of subsidiaries such as China Securities Capital Market Legal Service Center Co., Ltd., which can refine different specific functions into specific subsidiary models or be used for reference to avoid personnel crossing and excessive intervention. At the same time, it can also strengthen the strength of various professional departments and cultivate a specialized force engaged in securities group litigation. (Wenxu Guo, 2021)

5.3 Public Welfare Lawyers and Fee Compensation

At present, lawyers do not have the right to initiate group litigation, which can prevent the problem of lawyers abusing lawsuits and disregarding investors' interests in American group litigation. Chinese insurance institutions are public welfare institutions with official colors, which can to some extent avoid such drawbacks. However, securities civil disputes are complex, and lawyers have more professionalism in litigation, both in terms of professional knowledge and litigation skills. The investment service center lacks sufficient personnel and professional abilities. Abandoning lawyers' practical experience in the field of securities litigation will increase social costs, which is actually a practice of giving up due to choking. Therefore, insurance institutions should fully leverage the professionalism of lawyers in litigation, improve litigation efficiency, and the investment service center can hire external lawyers to participate in the litigation.

Regarding the issue of fees and compensation for lawyers participating in securities group lawsuits filed by the Investment Services Center, in the short term, public welfare lawyers have incentives to participate in lawsuits in addition to economic benefits. However, the workload and difficulty of group lawsuits have a significant impact on the effectiveness of lawsuits, and lawyer fees directly affect the enthusiasm and motivation of lawyers. Therefore, a market-oriented mechanism should be adopted. When the private interests of lawyers are aligned with public policy objectives, better institutional implementation results will be achieved. In China, lawyers assist in completing litigation activities in the investment service center and do not have the right to directly initiate litigation. The possibility of excessive litigation in China is very low. For the fees and remuneration of lawyers, due to significant differences in individual cases, the workload of lawyers also varies. Mechanized adoption of a fixed proportion will lead to the risk of lawyers choosing cases and conveying benefits. A model that can be preliminarily determined by the insurance institution based on the specific workload of the lawyer and approved by the court can be adopted to achieve matching of expenses with the actual workload.

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