



Bank Financial Products Consumers Protection and Legal Suggestions

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Abstract

Along with the rapid development of bank financial products in our country, the situation where financial consumers' interests are encroached on is never new in the market. The major manifestation is that banks infringe upon consumers' property right, information right, privacy right and the right of fair trade when selling financial products. As to the defects in the protection for consumers of financial products provided by the existing laws and regulations in our country, the author suggests segmenting the information disclosure and implementing the suitability principle in sales to safeguard the legitimate interests of consumers of bank financial products.

Key words: Bank financial products; Financial consumers; Information disclosure; Suitability of investors

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1. REVIEW OF CONSUMER INTERESTS TORT EVENTS IN SELLING BANK FINANCIAL PRODUCTS

The amount of distribution of bank financial products in 2011 reached a historical high, which figure exceeded 17,000 till December 20, 2011, with an increase of 102% on year-to-year basis. As financial products develop continuously, the infringement upon consumers' interests emerge endlessly, which interests mainly include

property right, information right, privacy right and the right of fair trade. Firstly, infringement upon consumers' property right is manifested as: The bank transaction system automatically closes out positions for clients with insufficient margin deposits, no risk management measures are taken to control clients' transaction risk, or special restrictions on bank financial management deprive consumers of their opportunity for obtaining proceeds or cutting their loss. Secondly, infringement upon consumers' information right is manifested as follows: Banks choose to selectively disclose product information rather than fully disclose information of products, and insufficient information is disclosed in terms of the design structure, investment orientation, investment ratio, period, investment risk and proceeds of financial products. Thirdly, infringement upon consumers' privacy right is manifested as follows: Banks "transfer" or provide clients' identity information and account information to other bank departments without authorization for the purpose of recommending business to other potential clients. Fourthly, infringement upon consumers' right of fair trade is manifested as follows: When clients purchase financial products, banks often unreasonably sell insurance, force clients to open credit cards or ask clients to solicit potential clients for them.

2. DEFECTS OF OUR EXISTING LEGAL SYSTEM IN THE PROTECTION FOR CONSUMERS OF BANK FINANCIAL PRODUCTS

2.1 Defects of Civil Law in the Protection for Consumers of Bank Financial Products

2.1.1 Provisions of Standard Form Contracts Fail to Protect Consumers of Financial Products Effectively

In the financial management market for commercial

banks, financial management contract adopts the standard form contract that is formulated by commercial banks which have the information superiority. Although the transactional efficiency is increased by using standard form contracts, some problems arise. Firstly, during the financial transaction in which information is severely asymmetrical, banks do not explain the content of standard form contracts to clients in the right way, especially the content of exemption clauses and benefit distribution, failing to perform the obligation to explain as specified by law. Besides, the professional quality of financial sales staff of commercial banks is at different levels and most of sales staff sells financial products by inducing clients to purchase and even by concealing certain items from clients or cheating clients publicly. Secondly, some clauses stipulated in standard form contracts are obviously unfair. Article 39 of the *Contract Law* stipulates that, "The Party that provides standard clauses shall define the rights and obligations of parties concerned in the principle of fairness, remind the other Party to pay attention to liability exemption or restriction clauses in a reasonable manner and give explanation on those clauses as required by such other Party." What kind of distribution of rights and obligations between banks and clients can count as fair? What kind of reminder is "reasonable"? Legal rules on the principle of fairness can be applied to general civil acts on the basis of usual practice and ordinary standards, but bank financial management is a very professional field and adopting such a general practice is actually equal to leaving a legal gap. Thirdly, when performing the right of redemption in advance, banks generally announce the termination of financial management contracts on bank websites or outlets. In accordance with the provisions stipulated in Articles 39, 40, 93 and 96 of the *Contract Law*, the termination of contract is a significant matter for the other Party concerned because it is in close association with the interests thereof. Informing clients in the form of announcement and asking clients to take the initiative to check on bank website or outlets are obviously unfair.

2.1.2 Burden of Proof in Civil Lawsuits Is Not in Favor of the Protection for Consumers of Financial Products

Burden of proof refers to the responsibility of the party concerned to prove the authenticity of the claim such party initiates or the factum probandum on which the litigation defense is based with certain means. The principle adopted by the *Civil Procedure Law of China* is "the person initiating the claim normally assumes the burden of proof", and the *Law* also stipulates the exception rule of sharing the burden of proof, namely the inversion of burden of proof. The reason for such stipulation is that it is difficult for one party to conduct the investigation and collect evidence on its own due to the lack of professional knowledge or the disadvantageous position such party is in, or that the relevant evidence is mastered by

professional organs and the other party cannot obtain such evidence easily. Disputes arising from banks' personal finance business do not belong to the type of cases to which the inversion of burden of proof stipulated in the existing *Civil Procedure Law* is applicable. That is to say, banks are not supposed to assume the responsibility to prove the existence of misleading, delusive or fraudulent conduct that causes loss to investors. However, in the face of the contract and risk confirmation letter with signature, investors, also as the plaintiff, cannot provide more favorable evidence to prove the breach of contract or infringement act conducted by banks in the process of selling financial products or performing the contract. In reality, as it is difficult for investors to collect evidence on their own and banks do not have to assume the inverted burden of proof, investors may have no access to judicial remedies or are unwilling to resort to judicial remedies, which is very adverse to protecting the interests of investors.

2.2 Defects of Financial Laws and Regulations in the Protection for Consumers of Bank Financial Products

In order to normalize the development of personal finance business of commercial banks, China Banking Regulatory Commission (hereinafter referred to as the CBRC) promulgated the *Interim Measures for the Administration of Commercial Banks' Personal Finance Business* (hereinafter referred to as *Interim Measures*) and the *Guidelines for the Risk Management of Commercial Banks' Personal Finance Business* (hereinafter referred to as *Risk Guidelines*) successively in 2005. Nevertheless, the rapid development of bank financial management business in our country makes provisions stipulated in *Interim Measures* and *Risk Guidelines* increasingly fall behind the development of the times with obvious hysteresis phenomenon, which greatly confuses banks and consumers of financial products in dealing with relevant legal issues.

First of all, the legal nature of bank financial products is obscure. The *Interim Measures* does not define the nature of personal financial products, which results in vague legal relationship for such products. The trust theory and delegation theory are both backed up by corresponding legal provisions. As a result, the nature of financial capital cannot be accurately defined and the applicable law for subjects related to financial products is not clear, which sets a time bomb for bank operation.

Secondly, the CBRC rules concerning the regulation of financial products have low legal effect and poor binding force. The three rules that has been issued by the CBRC so far, namely the *Interim Measures for the Administration of Commercial Banks' Personal Finance Business*, the *Guidelines for the Risk Management of Commercial Banks' Personal Finance Business* and the *Interim Administrative Measures for Commercial Banks to Provide Overseas Financial Management*

Services, are only administrative rules and do not have the universal applicability and authority possessed by laws and regulations. Because of the low legal status of rules promulgated by the CBRC, some banks do not earnestly perform the relevant obligations prescribed therein and encroach on the legitimate rights and interests of consumers. Even worse, consumers cannot protect their legitimate rights and interests according to such rules.

At last, the content of the CBRC rules concerning the regulation of financial products is too general. The *Interim Measures* and *Risk Guidelines* both stipulate the operations of financial business, but such stipulations are excessively general, which are more the manifestation of inability to protect consumers of financial products in reality. For example, article 60 of the *Interim Measures* stipulates that, "The disclosure of statistical indicators, preparation of related statements, statistical method, statements and reports and relevant information of commercial banks' personal finance business shall be prescribed by the CBRC." However, the CBRC does not further define the information disclosure problem mentioned in the above stipulation.

3. SUGGESTIONS ON PERFECTING THE LEGAL SYSTEM FOR BANKS TO SELL FINANCIAL PRODUCTS

3.1 Segment the Information Disclosure System

In order to share the market of bank personal financial products, the publicity documents of bank financial products fail to truly, comprehensively and objectively reflect the characteristics of such products and even deliberately overstate proceeds and fuzzify risks in practice, which is very likely to mislead investors to make wrong decisions. Consumers should depend on full and sound information disclosure to make selections among numerous financial products. Louis D. Brandeis, an Associate Justice on the US Supreme Court, once said, "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman", which exactly indicates the importance of information disclosure principle to the financial products market.

3.1.1 Define the Content, Scope and Method of Information Disclosure

The supervision department should specify by legislation the information to be disclosed about financial products and enforce the information disclosure system. In reference to relevant provisions of the Basel Committee on Banking Supervision and in accordance with the characteristics of commercial banks' financial products market in our country, the information disclosure standards for our commercial banks' financial products are authenticity, accuracy, integrity, timeliness and

comparability, which can be stipulated by positive enumeration and general provisions. The positive enumeration is used to define the minimum information disclosure standards, including aptitudes and business performance of financial institutions, information about qualified employees, risk characteristics, legal characteristics and proceeds of financial products, expenses to be assumed by buyers of financial products, various risk hints for financial products, reminder for major issues in the course of implementing the contract, as well as full transaction record and relevant reports and statements concerning financial products after the contract is terminated. The general provisions are mainly used to cope with the constant change in the financial market and the continuous innovation of financial products. The power to determine the content and scope of information disclosure may be granted to both parties involved in the transaction of financial products, who are supposed to conduct negotiation on the basis of party autonomy and satisfying the minimum information disclosure standards and to write relevant content into the financial management agreement.

3.1.2 Establish Information Disclosure System Before Concluding, When Implementing and After Terminating the Contract

The obligation to disclose information before concluding the contract belongs to legal obligation, pre-contract obligation and collateral obligation in nature, for which banks are mainly obliged to describe products and reveal risks. First of all, the information about the nature of financial products is the most important factor that influences the decision made by consumers about whether or not purchasing such products. Therefore, the product information should be fully disclosed in the product description to accurately inform investors of the design features, investment orientation and the like of financial products. Secondly, commercial banks should take the initiative to assess the risk preference and bearing capability of investors and to recommend products to consumers on the basis of assessment results. During such recommendation process, bank sales staff should confirm that clients have had a correct understanding about the content of risks after full, clear and accurate description.

The obligation to disclose information when implementing the contract is generally divided into regular information disclosure and irregular disclosure (unconventional disclosure). The *Interim Measures* and *Risk Guidelines* stipulate no provisions concerning the unconventional information disclosure. When major issues that may influence the proceeds of consumers of financial products take place, stipulations should be made to require banks to accurately and timely notify consumers by disclosing information to cut the loss. At present, the period of financial products is getting shorter and shorter. As stipulated in the *Interim Measures*, the account bill

of asset evaluation shall be provided more than twice in total during the duration of financial management plan and such bill shall be provided at least once per month. Provisions that financial statements relating to financial instruments shall be prepared on a quarterly basis cannot fully guarantee the timeliness of information disclosure already, so the period for providing relevant materials should be flexibly and reasonably adjusted according to the duration of financial products. In addition, as to the aforementioned account bills and statements that are extremely professional and complicated, the supervision organ should explicitly stipulate that banks shall be obliged to make explanations and answer the questions asked by consumers when providing relevant materials.

The obligation to disclose information after the termination of financial management contract refers to the obligation to disclose the items that should be disclosed when the financial management contract is terminated or the income from financial management plan is distributed. Article 30 of the *Interim Measures* stipulates that, "In case of the closure of the financial management plan or the distribution of income from such plan, commercial banks shall provide clients with detailed report about the financial management plan and proceeds." However, this stipulation does not cover the specific content of such report. The author thinks that the changes in proceeds of clients' account, investment orientation and payment of expenses during the transaction period should be at least disclosed, and clients should also be informed of other information that is supposed to be disclosed. Besides, commercial banks should be required to provide the full transaction record of financial management services with mandatory provisions, so as to make sure financial management consumers can have a comprehensive understanding about the investment orientation and proceeds situation of the financial capital.

3.2 Implement the Suitability Principle in Sales to Investors

The legal basis of the policy that the investor himself takes charge of risk management is caveat emptor, a principle of British and American private law. Nonetheless, along with the economic development, the transaction means is undergoing earth-shaking changes, which makes the precondition of applying such principle unavailable. It is thus clear that when both parties of a transaction are obviously unbalanced in power and the transaction commodity cannot be tested in advance, the application of the "caveat emptor" principle should be limited. Fairer legal system such as strengthening the seller's duty of care and responsibilities should be adopted to recover the equal transaction status of both parties.

3.2.1 Establish Unified Segmentation Criteria for Financial Products

The hierarchy and risk assessment of consumers of financial products are based on the segmentation of

financial products, so a unified risk ranking system should be established for financial products. Such risk ranking should be conducted in accordance with the attributes and degree of risk of bank financial products. However, the stipulations as to risk ranking prescribed in the *Interim Measures*, *Risk Guidelines* and several notices on the administration of bank personal finance business issued by the CBRC are too general and thus not operable. In the practical implementation, some commercial banks carry out the risk ranking for the financial products they sell, but due to the lack of specific quantitative indexes, similar financial products have different risk rankings, which results in the fact that consumers with different risk tolerance can buy the same type of financial products. Therefore, a set of unified and segmented risk ranking standards should be established for financial products.

3.2.2 Establish a Scientific Classification System for Financial Consumers

The risk assessment for clients is the foundation work for selling financial products. Only by understanding the risk tolerance of clients can sales staff sell the suitable financial products for them. In the process of conducting the risk assessment for clients, it is inevitable to classify the clients. The purpose of establishing classification system for investors is to make financial institutions differentiate the legal responsibility and behavioral norms of investors, which can facilitate the recommendation of the same financial products to consumers of the same category more effectively, thus avoiding the enormous amount of work caused by the suitability principle.

Although the *Interim Measures* and *Risk Guidelines* promulgated by the CBRC stipulates that banks shall conduct the risk assessment for clients, rank the risk tolerance of clients on the basis of assessment results, and sell different financial products in accordance with different risk tolerance, no specific implementation procedures and unified standards is prescribed and the practical operations also differ from bank to bank. Furthermore, as the economic strength, risk perception ability, professional background and investment preference of consumers of personal finance are different, it is difficult to quantify the classification of consumers of financial products. In this aspect, our country can refer to the relevant provisions of Japan and the European Union to distinguish professional investors and ordinary investors and to establish classification system for investors in accordance with their knowledge background, experience and financial situation. For professional investors, some behavioral norms should not be applied and a flexible rules system should be constructed, thus realizing the classification protection for investors. For example, the Bank of Luxembourg divides its clients into five categories by age and risk preference and provides different financial services accordingly.

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