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The Legal Application of Investment-linked Insurance

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Li You

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Abstract

This thesis discusses the legal application of investment-linked insurance (ILI). As a novel and hybrid financial product, ILI encounters a variety of legal challenges such as legal attributes, private law relationships, and regulations. The research methodologies this thesis has mainly adopted are law interpretation, comparative law, and empirical analysis on judicial cases, so that it is to be able to address these legal issues.

Different approaches to the application of ILI between China and the US can bring about different legal effects; this thesis favors the approach taken in the US. In China, ILI is regarded as a new type of life insurance. The nature of security in ILI is still not treated objectively because it is limited to the application of traditional insurance law. Specifically analyzing the regulations of the China Insurance Regulatory Commission (CIRC) it can be said that the CIRC insists on "appearance over reality" in terms of ILI, so there are incomplete, weak, and ineffective regulations for it. On the contrary, the US law has considered variable annuity and variable life insurance as securities, after the seminal cases of *SEC v. Variable Annuity Life Insurance Co.* (VALIC) and *SEC v. United Benefit Life Insurance Co.* (UBLIC). Such products in the US register as securities with the Securities and Exchange Commission (SEC), and receive the supervision of federally mandated disclosure rules, anti-fraud rules, etc. The US provides a more reasonable, favorable, and reliable way to privately enforce ILI as well as investors' protection.

Based on the experience of comparative law and the regulation means for modern financial products, the logical way for the legal interpretation and application of ILI is that the status of security is not to be overlooked, and is to be applied to securities law, trust law, and not just limited to insurance law.

It can be seen that ILI is a composite product that is predominated by the nature of its security from the perspective of "bearing investment risk," "investor protection," and its definitions on insurance and securities. As for the legal application to ILI, it is

necessary to take the approach of “substance over form” in the private law application and supervision required for ILI. The rights and obligations should be determined by the actual legal relationship stipulated in the contract, if the content stipulated is inconsistent with the name of the finance contract.

In terms of the private law application, the securities attribute of ILI focuses on the investment account, which is essentially a kind of securities investment fund. Under the viewpoint of “substance over form,” the rights and obligations between the policyholder and the insurer in the investment account shall be analogized to the legal relationship between the investor (the “trustor”) and the fund manager (the “trustee”) in the securities investment fund. Although it is difficult to directly apply to the *Securities Investment Fund Law* for the account due to the financial principle of “separate operation and classified supervision” in China, the private relationship can point out that the rights and obligations need to be rebalanced, and the obligations of the insurer are for investors protection.

With regard to the regulatory relationship, there are many contradictory rules in the relevant regulations to ILI because the CIRC takes the approach of “form over substance,” which in turn avoids the substantial status of ILI as securities. The CIRC’s standpoint relates to the current system of separated supervision, in that the traditional regulatory mechanism (institutional regulation) cannot satisfy the supervision of ILI as a hybrid product. Under the “substance over form” approach, the current “look-through” supervision is merely a regulatory means, and the functional regulation along with the conduct regulation should be considered as directed toward the improvement of ILI’s regulations.

For better protection of the financial consumer, the application of anti-fraud rules to ILI needs to be emphasized as follows. 1) For the insurer, the scope of explanation obligation as stipulated by the *Insurance Law* needs to be expanded, including the unit price, the operation, and any asset changes of the investment account. 2) The application of “suitability obligation” should be stressed to the insurer due to the complexity of ILI, and the performance of suitability obligations is the main content of “caveat venditor” and the premise and basis of “caveat emptor.” 3) Based on the securities attribute of the

ILI, its legal application should be followed by the securities law, and stress information disclosure. The disclosure should include, but not limit itself to, the requirements of comprehensiveness, understandability, and materiality. 4) As serving the roles of "asset manager" and "trustee," the insurer under the investment account should also assume the fiduciary duty, the best care and loyal execution, which is an obligation rather than a contractual duty for investment protection.

This thesis also explores the differences between US and Chinese law. Laws have natural regionalism, with corresponding rules reflecting the differences between the social conditions and backgrounds of various countries. For example, the incentives of financial regulators can be divided into internal incentives and external incentives. As for the internal incentives, financial regulators pay the role of "helping hand" in the financial market and the role of "grabbing hand" in reality. As for the external incentives of financial regulators, constituencies, interest groups, and elected politicians, etc., have a significant influence on policy formulation in the US. In China, financial regulators often consider the pressure of regulatory competition in the financial industry, vested interest groups, the possible reflections of public opinion, etc.

There are many reasons for differences between US and Chinese law, such as "different sources for rules and relief mechanisms", "different effects on 'separate operation and classified supervision' in applying laws in China and the US", "differences in horizontal regulation and the 'scope of securities'", and "different law systems".

Those differences are not merely restricted to the law itself, but respectively will also subject to the restrictions and influences from several aspects, including politics, economy, society, culture, etc. Due to the path-dependence, neither the US law nor the Chinese law is the most efficient state under their respective circumstances.

Key Words: Investment-linked Insurance; Hybrid Product; Substance over Form; Financial Consumer; Fiduciary Duty

Abbreviations

ILI	Investment-linked Insurance
CIRC	China Insurance Regulatory Commission
CSRC	China Securities Regulatory Commission
CBIRC	China Banking and Insurance Regulatory Commission
CBRC	China Banking Regulatory Commission
US	United States of America
SEC	U.S. Securities and Exchange Commission
VALIC	SEC v. Variable Annuity Life Insurance Co. of America
UBLIC	SEC v. United Ben. Life Insurance Co. of America
NAIC	(US) National Association of Insurance Commissioners
NASD	(US) National Association of Securities Dealers
FINRA	(US) Financial Industry Regulatory Authority
NYSE	(US) New York Stock Exchange

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Chapter One Introduction

1.1 Background

Around the 1950s, European and American countries launched "investment-type" insurance products, including variable annuity, variable life insurance, variable universal life insurance, etc. consecutively. China also introduced several new personal insurance products, including investment-linked insurance (hereinafter referred to as "ILI"), universal insurance, participating insurance, etc. at the turn of the 21st century.[1] These kinds of new personal insurance products have diversified investment and financial management functions, hence in China, they are also referred to as investment-based life insurances.[2] Among those investment-based life insurances, ILI is known as the "world's most advanced insurance,"[3] and also referred to as a "financial product that is most difficult to understand,"[4] or "the best possible investment,"[5] whose amount of payable insurance benefit is in direct relation to the investment performance of the investment account, differing from the fixed-insurance benefit that comes with the traditional life insurance. Hence, it is a composite financial product or a derivative product of traditional finance. The investment account of ILI refers to a capital account (in which the assets are managed separately) established by the insurance company for the ILI.[6] Undoubtedly, this is a complicated financial instrument, and it is not easy to define it accurately, at least, theoretically, so far, there is no useful definition for it, hence, what has been adopted is the official definition. In other words,

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[1] See Article 2 of *Interim Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (No. 6 [2001] of CIRC).

[2] In theory, there are some differences in whether "new life insurance product" is equal to "investment-featured insurance". Some scholars think that "new life insurance product" is actually "investment -featured insurance". See Yang Xiaoling, *Research on the Development of Investment-featured Life Insurance Products*, 10 Insurance Studies 23, 23 (2002). Some scholars also believe that the definition of investment-featured life insurance depends on whether the life insurance product has an independent investment account, such as variable life insurance, variable annuity, and universal life insurance. See Fu Ning & Yu Zhen, *The Development Status of Investment-featured Life Insurance Products and the Risk Analysis of Insurance Companies*, 5 Journal of Northeast Normal University (Philosophy and Social Sciences) 31, 31(2017).

[3] See Guo Li, *Investment-linked Insurance and Its Legal Issues*, 4 Financial Law Forum 71, 72(2001).

[4] "one of the most difficult-to-understand products". See Mary L. Schapiro, *The Consumer in the Financial Services Revolution*, available at < https://www.sec.gov/news/speech/2009/spch120309mls.htm >, latest visited on Nov. 15, 2019.

[5] "The policy can be described as the best possible investment: it purports to serve as a hedge against inflation, it offers participation in the growth of the economy, utilization of excellent investment advisory service, plus diversification of investment, and, to top it all, protection for the beneficiaries in the event of premature death." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1020 (1973).

[6] See Article 1 of *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance*, No. 32 [2015] of CIRC.

the former China Insurance Regulatory Commission (the "CIRC")[7] clearly defined the ILI in the *Interim Measures for the Management of Investment-linked Insurance* enacted by it in 2000—ILI refers to a personal insurance product that contains the insurance guarantee function and owns certain asset value in at least one investment account.[8]

As a foreign term, the corresponding English translations for ILI are mainly the following three kinds: "investment-linked life insurance," "variable life insurance," and "unit-linked insurance."[9] In foreign countries, ILI was mainly developed from the design concept of the variable annuity,[10] i.e., variable annuity in the US was researched and released by the Teachers Insurance and Annuity Association of America in 1951.[11] It was devised to minimize the inadequacies of a fixed-dollar annuity as a retirement device.[12] Inflation and an accelerating standard of living have left people receiving fixed-dollar annuities with only a fraction of the income required to meet their needs.[13] The economic background of this product is linked to the economic growth in America, which has long been considered as one of the most critical determinants for the development of life insurance. For example, the economic expansion in the 1840s well explains the sudden boom of life insurance at that time.[14] By the 1960s, the US witnessed a prolonged economic expansion period, starting from February 1961 and lasting until December 1969. This economic growth also brought a relatively high commodity price level, i.e., the inflation that commenced in 1963 had caused a

[7] "China Insurance Regulatory Commission" has been merged into the China Bank and Insurance Regulatory Commission. However, if the rules and regulations before the merger are involved in the expression of this dissertation, the expression of "CIRC" will be retained, or the expression of "former CIRC" will be used.

[8] See Article 2 of *Interim Measures for the Administration of Investment-based Insurance*, No. 26 [2000] of CIRC; Article 2 of *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance*, No. 32 [2015] of CIRC.

[9] There is no essential difference in these different expressions. "Investment-linked life insurance" is a literal expression of the investment function. "Variable life insurance" is a concept opposite to traditional fixed life insurance. "Unit-linked insurance" can reflect the calculation method, mainly adopted in the UK.

[10] "The variable annuity, as a life insurance company product, is in the earliest stages of development." See J. Edward Day, *Variable Annuity Is Not a Security*, 32 Notre Dame Law 642, 646 (1957).

[11] "The first variable annuity plan in this country, the College Retirement Equities Fund, was created in 1952 by the New York Legislature, acting upon the recommendation of a commission composed of educators and leading businessmen, for the purpose of providing educators, policyholders in the Teachers Insurance and Annuity Association of America, with an annuity which would respond more flexibly to changes in the economy and thus furnish constant purchasing power." See J. Edward Day, *Variable Annuity Is Not a Security*, 32 Notre Dame Law 642, 662 (1957).

[12] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 177 (1971).

[13] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 177 (1971).

[14] See Zelizer Viviana A., *Morals and Markets: The Development of Life Insurance in the United States*, (Shanghai: East China Normal University Press, Chinese translation edition, translated by Yao Zelin, 2019), p.22.

depreciation rate of nearly 700% within seven years after that.[15]

Unlike the US, the reason China introduced the ILI was mainly due to the evident fluctuation of the interest rate in the 1990s, since the insurance companies of that time lacked a timely realization of the impact to their business operations due to the declined interest rate, which caused them to shoulder a greater interest risk.[16] To step away from this challenging situation, China Ping An Insurance Company, took the lead by introducing China's first ILI in 1999—Ping An Century Financial Management Investment-linked insurance—which marked the beginning of the development of the ILI. Additionally, the improvement in the livelihood of Chinese residents and the continuous accumulation of wealth are also spurring a wide range of demands on financing and financial management. For example, the per capita disposable income for urban residents and the substantial increase in the balance amount of the bank savings deposits of urban and rural residents.[17] In addition, in terms of the product itself, the ILI has many advantages in financial management and can meet the demands of the middle class for financial management. For example, it can offset the depreciation caused by inflation,[18] and it can also lower the threshold for investment in trust.[19] Based on the abovementioned background and characteristics, since it came into existence around the year 2000, the ILI in China has been widely developed and sold,[20] and has accounted for a significant market share.

However, while it can make up for the shortcomings of traditional life insurance,

[15] See Jerry W. Markham, *A Financial History of the United States: From the Age of Derivatives into the New Millennium,1970-2001*, (Beijing: China Financial Publishing House, Chinese translation edition, translated by Li Tao, 2018), p.3.

[16] See Chang Ding & Hanxiong Li, *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), p.11.

[17] From 1998 to 2002, the income of urban residents and the savings deposits of urban and rural residents increased rapidly in China (as shown in the table below).

Index	Unit	1998	1999	2000	2001	2002
Per Capita Disposable Income of Urban Residents	Yuan	5425	5854	6280	6860	7703
The balance of savings deposits	Billion Yuan	53408	59622	64332	73762	86911

(Source: National Bureau of Statistics of China. Bulletin of statistics on National Economic and Soci al Development in 2002. Accessed October 15, 2018. http://www.stats.gov.cn/statsinfo/auto2074/201310/t20131031_450865.html).

[18] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 177 (1971).

[19] For example, the minimum amount of investment in a trust plan shall not be less than 1 million yuan. See Article 6 of *Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds*, Order No.1 [2009] of the China Banking Regulatory Commission.

[20] The same to the US. For example, Variable annuities and variable life insurance policies, which are other types of investment company securities, have also become very popular. Sales of variable annuities in 1994 have been estimated at $51 billion and are expected to exceed $90 billion in 1996. See Clifford E. Kirsch; Wendell M. Faria; W. Thomas Conner, *Mutual Fund and Variable Insurance Products Performance Advertising*, 50 Bus. Law 925, 926 (1995).

it also constitutes a challenge to the existing laws. For example, this kind of product may induce some issues, i.e., the legal supervision on it, whether it is necessary to have legislation on it, economic risk, and tax consideration.[21] In China, the legal risks of this financial product developed at an earlier stage, either in the earlier case of a collective policy surrender involving "Ping An," or the dispute over the voting rights relating to the universal life insurance issued by Qian Hai Life Insurance Company, as in the "dispute between Baoneng and Vanke," or even the doubts about the verdict of the "crime of fund-raising fraud" charged on Wu Xiaohui, the former Chairman of "Anbang Insurance Company," all of which have pointed to the same root problem. That is, while the ILI is considered as an innovative product in the financial market, the legal attributes of these products are not known. Specific to the ILI among the investment type life insurances, the issues concerning the legal application, including its economic essence and legal attributes remains unclear. As a result, it is unable to get adequate protection for its corresponding investment interests. Therefore, this dissertation adopts the ILI as its object of study, and attempts to analyze the issues, including how to review its legal attributes, supervise, apply existing laws to it, etc.

1.2 Literature Review

This dissertation mainly intends to carry out a literature review, as well as an evaluation and analysis from temporal and spatial dimensions. For the temporal dimension, it starts primarily from the legal discussions that have emerged since the variable annuity came into existence. The discussions for the spatial dimensions are limited mostly to America and the Chinese mainland, which also includes a brief analysis of relevant studies relating to it in Japan and Taiwan.

1.2.1 Research Features and Comments

1.2.2.1 Stage One: From the 1950s to 1960s

The discussion in the US on variable annuity and variable life insurance mainly started in some cases in the 1950s, e.g., *SEC* v. *Variable Annuity Life Insurance Company (VALIC)*. Those cases mainly focus on disputes over the determination of the legal nature of the variable products as insurance or securities.

[21] See Notes, *Variable Annuity: Security or Annuity*, 43 Va. L. Rev. 699, 699 (1957).

Prior to the ruling made by the US Federal Court on the "VALIC" case, the mainstream standpoint considered variable annuity as an insurance product.

For example, George E. Johnson opined in 1956 that an ideal retirement income should satisfy four factors (1) a life income, (2) an adequate income, (3) an income that will vary with the cost of living and, (4) an assured income, and the variable annuity satisfies those factors since it is a retirement income which is better and safer than a traditional annuity; therefore, the existence value of the variable annuity can be affirmed.[22] In 1957, J. Edward Day pointed out distinctively that variable annuity is not a security or investment plan, and cannot enter or exit the stock market as the mutual fund does.[23] In the same year, J. Edward Day and Meyer Melnikoff released an article claiming that the variable insurance adopts a number of actuarial characteristics, i.e., the Life Contingencies and the mortality tables, and that it is a life insurance design, which is nothing but the investment of the retirement fund under this product into the stock market.[24] Ralph E. Becker pointed out in 1958 that variable annuity is a very appropriate insurance product rather than a security.[25] In 1958, C. Lee Jr. Cook raised an objection to the SEC on its definition of the two key elements concerning the transferring and sharing of the insurance risk, as well as its definition of a variable annuity, believing that the risk transferring and risk sharing also exist in variable annuity and that the variable annuity should be defined as insurance rather than securities.[26]

However, during this period, many scholars have objected that the variable annuity should be deemed as a kind of security. For example, in 1956, Rowland H. Long held that the speculative character of variable annuity should not be hidden behind the word "annuity," especially for the independent account of a variable annuity, which derives its income from common stock securities investment portfolio; therefore, it should be deemed as a common stock investment scheme.[27] In 1956, Arthur H. Haussermann

[22] See George E. Johnson, *The Variable Annuity: What It Is and Why It Is Needed*, 1956 Ins. L.J. 357, 372 (1956).
[23] See J. Edward Day, *Variable Annuity Is Not a Security*, 32 Notre Dame Law 642, 669 (1957).
[24] See J. Edward Day & Meyer Melnikoff, *The Variable Annuity as a Life Insurance Company Product*, 24 Ins. Counsel J. 16, 16 (1957).
[25] See Ralph E. Becker, *Variable Annuity Contracts: Insurance or Securities*, 1958 Ins. L.J. 612, 613 (1958).
[26] See C. Lee Jr. Cook, *The Legal Barriers to the Variable Annuity*, 1958 U. Ill. L.F. 466, 471 (1958).
[27] See Rowland H. Long, *The Variable Annuity: A Common Stock Investment Scheme*, 1956 Ins. L.J. 393, 393, 397 (1956).

argued that when compared with insurance, a variable annuity is more "close" to investment securities.[28]

This distinctive dispute over the determination of its legal nature did not mitigate. It remained unchanged until 1959—the US Federal Court concluded that the variable annuity was a security in the "VALIC" case.[29] In particular, in SEC v. United Ben. Life Ins. Co. (UBLIC), the US Federal Court again identified the variable annuity as securities.[30] It was then that the mainstream viewpoint, which regarded variable annuity as insurance, changed to securities.

For example, in 1959, the article titled as "*Federal and State Regulation of the Variable Annuity*" gave a brief discussion on the issues relating to the application of the *Securities Act of 1933* and *Investment Company Act of 1940* to the variable annuity after the US Federal Court announced the verdict.[31] Richard Aughenbaugh further pointed out that the variable annuity contract should accept the supervision from the SEC.[32] George E. Johnson again pointed out in 1960 that the bearing of some risks by the variable annuity complies with the essential elements of insurance.

Meanwhile, it is quite similar to a mutual fund since it has a clear investment purpose. Thus the variable annuity has its composite nature.[33] In 1966, Joseph W. Bartlett contended that the dispute over the legal attribute of a variable annuity might not be solved ultimately as the interpretation of the Federal Court from the aspect of risk-bearing only provides a partial explanation of variable annuity.[34] In 1967, Clarence E. Galston discussed the variable annuity mainly from supervision perspectives, including efficiency and unified supervision, but has not given any specific answer to it, and held that it should be tested and solved over time.[35] In 1969, Boe W. Martin maintained that judging from the characteristics of the mode of operation for variable annuity and also because it was found to have many common attributes with a mutual

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28 See Arthur H. Haussermann, *The Security in Variable Annuities*, 1956 Ins. L.J. 382, 392 (1956).
29 See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 65 (1959).
30 See *SEC v. United Ben. Life Ins. Co*., 387 U.S. 202, 202 (1967).
31 See Notes, *Federal and State Regulation of the Variable Annuity*, 44 Minn. L. Rev. 289, 289-307 (1959).
32 See Richard Aughenbaugh, *Variable Annuity Contracts Subject to S.E.C. Regulation*, 20 Ohio St. L.J. 688, 688 (1959).
33 See George E. Johnson, *Variable Annuity –Insurance, Investment, or Both*, 48 Geo. L. J. 641, 682 (1960).
34 See Joseph W. Bartlett, *Va*riable Annuities: Evolution and Analysis, 19 Stan. L. Rev. 150, 151 (1966).
35 See Clarence E. Galston, *The Regulation of Variable Annuities*, 1967 A.B.A. Sec. Ins. Negl. & Comp. L. Proc. 348, 395 (1967).

fund, he was in favor of the determination of variable annuity as securities, but should have exemptions for its application of the *Federal Securities Act*.[36]

1.2.2.2 Stage Two: From the 1970s to 1990s

After the trials of the VALIC case and UBLIC case by the US Federal Court, the securities attributes of the variable annuity have been affirmed at the Federal level. Therefore, the studies in the US mainly shift to the specific law application for the variable products after they are determined by nature as securities. Meanwhile, in terms of the object and content of those studies, the focus was on the legal characters of the variable life insurance and its separate account (investment account), as well as the issues relating to the application of the *Investment Company Act of 1940*.

In 1971, Tamar Frankel published an article titled as "*Variable Annuities, Variable Insurance and Separate Accounts*", in which she made a quite detailed discussion on variable annuity and variable life insurance, i.e., the control of investment and the bearing of investment risk are indicated by her as the two key factors to form the investment protection; she concentrated her discussion on the specific issues relating to the application of the *Investment Company Act of 1940* to the separate account.[37] The article is a masterpiece in this regard as its discussion on legal issues relating to variable products is the most concentrated and most in-depth one in the US. In 1972, Kenneth Kubczak claimed that due to the complexity of the variable life insurance, full information disclosure obligation should be imposed on the insurance companies.[38]

In 1973, Tamar Frankel again discussed the application of the *Investment Company Act of 1940* to variable life insurance, and pointed out that the separated accounts are open-end investment companies, rather than periodic payment plan certificates.[39] In 1973, the article, *Variable Life Insurance and the Federal Securities Laws,* suggested that the Federal Laws should keep supervising products with material investment risks, such as variable life insurance, while the State Laws should keep supervising traditional insurance products.[40] In 1974, Robert P. Blank et al. discussed

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[36] See Boe W. Martin, *The Status of the Variable Annuity as a Security: A Lesson in Legal Line Drawing*, 30 Ohio St.L.J. 736, 772 (1969).

[37] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 177-401 (1971).

[38] "Full disclosure by the life insurance industry for VLI will be mandatory because, with such a complex product, the public must know what it is buying." See Kenneth Kubczak, *The Regulatory Problems of Variable Life Insurance in the United States*, 1972 Ins. L.J. 450, 470 (1972).

[39] See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1035 (1973).

[40] "The federal laws should continue to govern the marketing of products that contain a substantial investment risk,

the application of the Federal Securities Act to variable life insurance, and proposed the existence of many undefined points, such as the supervisory authority of the SEC.[41] In 1975, Joseph F. Krupsky held that the separated account is an entity without a legal person qualification and it is a kind of investment tool, which though is a product of the State Insurance Act, its business operation is carried out under an independent account—the securities investment—therefore, it should be regulated by the *Securities Act of 1933*, *Securities Exchange Act of 1934, Investment Company Act of 1940*, and *Investment Advisers Act of 1940*, all of which are laws at the Federal level.[42] In 1977, the District of Columbia Bar reviewed the supervision on variable life insurance over the last 15 years, believing that the insurance industry and SEC in the US had not tried to build a supervision structure for variable products.[43] In 1978, Milton P. Kroll and Gary O. Cohen noted that to find out the legal attribute of the variable annuity, the separated account should not be analyzed separately, but an overall approach should be taken by testing based on dominant factors and giving due consideration to the three judgment factors, including the contract characteristics, operation characteristic, and product appeal.[44]

In the early 1980s, the major objects of study were universal insurances. For example, Alan Lazarescu et al. discussed those issues, including the significance of the formation of universal insurance, its legal supervision, tax, etc.[45] Three aspects of the issues were mainly discussed in the seminar on a variable product as held by the North America Society of Actuaries in 1984, namely the State supervision, especially the "Model Regulation" enacted by the NAIC, the specific provisions of SEC and the tax issues relating to the variable products.[46]

In the 1990s, there was an apparent decline in the enthusiasm of the legal studies carried out on variable products in the US. There were mainly the reflections on the

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and the state laws should continue to govern traditional insurance products." See Notes, *Variable Life Insurance and the Federal Securities Laws*, 25 Me. L. Rev. 241, 294 (1973).

[41] See Robert P. Blank, Gordon L. Jr. Keen, Glen A. Payne, Stephen R. Miller, *Variable Life Insurance and the Federal Securities Laws*, 60 Va. L. Rev. 71, 112 (1974).

[42] "The purpose of such a separate unincorporated legal entity is to provide an investment vehicle for persons". See Joseph F. Krupsky, *Federal Securities Law and Variable Annuity Contracts*, 24 Drake L. Rev. 839, 839-840 (1975).

[43] "It may be useful to take a backward look over the last fifteen years to see bow the industry and the Commission, working together-or at least working at the same time-have tried to develop a regulatory structure for new products that were not contemplated." See A PANEL, *Fifteen Years of Federal Regulation of Variable Contracts - Evaluations*, 32 Bus. Law 685, 685 (1977).

[44] See Milton P. Kroll; Gary O. Cohen, *Insurance—Security Identity Crisis*, 46 Geo. Wash. L. Rev. 790, 805 (1978)

[45] See Alan Lazarescu & Harold Leff, Universal Life Insurance: Legal, Regulatory and Actuarial Aspects, 17 Forum 1000, 1000-1011 (1981-1982).

[46] See "Variable Universal Life", *Record of Society of Actuaries*, 1984 Vol. 10 No. 4B., p.2307.

innovations made on those products represented by the variable annuity. For example, in 1995, Clifford E. Kirsch et al. probed into the similarities between a mutual fund and variable annuity.[47] In 1998, Michael F. Lane et al. explored the advantages of variable annuities, e.g., the protection of its assets.[48]

At this stage, Japan also started its legal studies on variable insurance.

There were not too many legal barriers for Japan to promote variable life insurance in the 1980s, however the following two issues under discussion have complicated the formulation of legal framework (1) many differences on whether these kind of products should be supervised by a securities authority as investment products or by insurance authorities as life insurance products and, (2) the focus of the discussion was not on the form or management method of this product, rather on how to make the existing laws applicable to these kind of products.[49]

Nevertheless, the discussion on the legal nature of the variable products in Japan is less fierce than the initial analysis of the same in the US. From the late 1980s to the early 1990s, the economic bubble in Japan began to burst, the sales performance of the variable insurance was not excellent, for reasons, such as the complexity of the product and misleading sales, and consequently there were many lawsuits. Most of the theoretical research were focused on product introduction and the performance of the obligation by the insurer during the sales. For example, the variable insurance has the "investment element," so the suitability duty should be applied to it as it is for the securities transaction. The persuasion to invest in this product should be realized through the *Securities Exchange Act*, for example, by applying the suitability principle in the *Securities Exchange Act.*[50]

1.2.2.3 State Three: From 1999 to the present

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[47] See Clifford E. Kirsch, Wendell M. Faria, W. Thomas Conner, *Mutual Fund and Variable Insurance Products Performance Advertising*, 50 Bus. Law 925, 994 (1995).

[48] Five best use: (1) net after-tax value for long-term investors, (2) asset protection, (3) use of a variable annuity as a funding tool for a net income makeup charitable remainder unitrust, (4) guaranteed income for life, and (5) the Code Sec. 10351 exchange for lowering cost and improving expected returns of existing annuities. See Eleanor Blayney & Michael F. Lane, *Focus: The Pros and Cons of Variable Annuities*, 1 J. Retirement Plan. 34, 34-38 (1998).

[49] See Chang Ding & Hanxiong Li, *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), p.43.

[50] 参见[日]松井美知子：《変額保険の裁判例にみる融資者の責任》，《千葉大学社会文化科学研究（創刊号）》，第 146 页。

To begin with, in terms of the laws in the US and Japan, relevant studies are further improved and detailed.

In the US, the legal research on variable products over the recent years is not as intensive as it was for the US in the 1950s-1960s. The latest achievements of the US in its studies on legal issues relating to variable products are mainly represented by two volumes of collected works chiefly edited by Clifford E. Kirsch—*Variable Annuities and Variable Life Insurance Regulation* (New York: Practicing Law Institute, 2018). This anthology was mainly written by lawyers with its major research content focused on practical operations, including the application of a specific rule (possibly from multiple laws, such as the *Securities Act, Securities Exchange Act, Investment Company Act, and Tax Act*) to variable products in the US. This anthology sets special chapters for analysis and is an important literature that can be used to study variable products in the context of the US laws. Apart from this literature review, in 2010, Gary E. Jenkins discussed the exemptions in the application of the *Investment Company Act of 1940* to a variable insurance contract, for example, in the case where the separated account is registered as a unit investment trust, exceptional provisions on the election of directors and requirements are discussed.[51] In 2012, while targeting the existing problems for the disclosure of information on a variable annuity, Richard J. Wirth pointed out that a simple and plain disclosure promotes even wiser decision-making.[52]

Secondly, at this stage, Taiwan started its legal research on ILI.

Taiwan introduced the ILI in 2000 and started relevant studies. Nevertheless, the studies on the legal nature of the ILI was not as fierce as the debate over the same in the US, since, in 2002 Taiwan provided the nature of ILI as an insurance product in the "*Insurance Law*."

Despite this, in theory, a few supporters advocate that we cannot overlook the securities attributes of the ILI. For example, in 2007, Chen Yanjia stated that the ILI contract does not belong to an insurance contract or life insurance contract. Therefore the direct application of insurance law is not entirely appropriate. In the contents of the ILI simultaneous contract, for the section of the contract that applies to life insurance,

[51] See Gary E. Jenkins, *Exemptive Rules for Variable Insurance Contracts under the Investment Company Act of 1940: Part 2 of 2*, 17 The Investment Lawyer 3, 3-12(2010).
[52] "Plain English disclosures will surely help improve suitability and drive more informed decision-making." See Richard J. Wirth, *What's Puzzling You is the Nature of Variable Annuity Prospectuses*, 34 W. New Eng. L. Rev. 127, 157 (2012).

relevant provisions in the *Insurance Law* can be applied, however, for the section that applies to investment contract, especially the policy account value and the payment of the return on investment, which arise out of it, most of the application of the *Insurance Contract Law* require interpretations or special amendments to enable such applications.[53]

In 2009, Kuan Chucheng compared the operation and the characteristics of a separate account with that of a mutual fund that also refers to the US laws in its discussion, and then further asserted that the separated account should be positioned as an investment fund similar to a mutual fund.[54] In the same year, based on the ILI's similarity with the financial commodity, Li Yiyi focused the discussion on the similarity between the separated accounts of the ILI and the trust, and regarded this as the basis for the application of trust and trust relation, as well as the regulations on them.[55] In 2010, Du Yijing held that the ILI is, in fact, a fusion of the dual nature of both investment and insurance.[56] Nevertheless, there are viewpoints that raise doubts about the investment characteristics of the ILI, for example, in 2012, Chun-Hsiung Cho and Ming-His Tang argued that since the ILI has the functions of both the insurance and investment, it is often used as a pure investment or tax evasion tool, thus depriving the originally designed purpose of insurance guarantee from this commodity; therefore, the writer suggested that the relevant regulations on the ILI as in the existing laws and decrees should be amended as soon as possible and return to the spirit of stressing the essence of the insurance.[57]

The "*Financial Consumers Protection Act*" applied to the ILI after its enactment by Taiwan in 2011. Relevant studies in this field are thus further specified with a primary focus on the obligation of the insurer. In 2013, Chen Yicong held that based on the duty of loyalty bearable by the insurer against the applicant for the insurance, even before the establishment of the ILI contract, the insurer should choose a suitable

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[53] See Chen Yanjia, *A Study of the Issues Relating to the Application of Insurance Contract Law to the Investment-linked Insurance Contracts*, the master's thesis of Law Department of Taipei University in 2007.

[54] See Kuan Chucheng, *A Review on the Laws and Regulations Regarding Separate Account on Investment-linked Insurance Products in Taiwan: Observations from the Perspectives of Theoretical and Comparative Law*, 109 Chengchi Law Review 177, 177-241 (2009).

[55] See Li Yiyi, *The construction of the Obligation Bearable by the Insurer of the Investment-linked Insurance*, the master's thesis of Law Department of Taiwan University in 2009.

[56] See Du Yijing, *The Application of the Obligation to Explain and the Suitablity Principle to the Invest ment Insurance Commodity – Taipei District Court (96), Judgment No. 6 & Taipei District Court (97) Z. Y.Z. Judgment No. 1*, 27 Journal of civil and Commercial Law 130, 133(2010).

[57] See Chun-Hsiung Cho &Ming-His Tang, *The Reexamination of Investment Essence of Variable Insurance-Focused on U.S. Law Experience*, 1 Chaoyang Business and Management Review 53, 53-73 (2011).

"investment subject-matter appropriately" for the "possible" maximized benefits of the applicant for the insurance; after the establishment of the ILI contract, the insurer should also supervise the operation of the "investment subject-matter" by the issuing company of the "investment subject-matter" in an appropriate manner for the maximized benefits of the insurance applicant, in case there is any breach of the legal obligation, the insurer, for the maximized benefits of the insurance applicant, should feel much more deserved to claim damages against the issuing company of the "investment subject-matter" on behalf of the insurance applicant or perform other necessary relief measures.[58]

In 2018, some scholars studied the practical issues concerning investment-oriented insurance commodities in Taiwan over the recent years, which were mainly revealed by the weak position of the insurance applicant and the difficulties when it came to the burden of proof. Because once in dispute, the issuance applicant cannot produce evidence to prove that the salespeople have made any unauthentic and fraudulent explanation, then neither the court nor the financial ombudsman institution can make a judgment or resolution in favor of the insurance applicants.[59]

Third, the Chinese mainland's legal studies on ILI debuts at this stage.

The study of the ILI in the Chinese mainland started from the beginning of the 21st century. The studies performed during the startup stage are mainly the discussion of investment-linked life insurance from the perspective of economics and finance. The objects of studies include ILI, universal insurance, and participating insurance. Those studies are mainly intended to discuss the necessity and significance of investment-linked life insurance as a financial innovation product.

For example, in 2001, in *A Discussion of the Applicability and Limitations of the Investment-linked Life Insurance*, the investment-linked life insurance is introduced as being able to meet the consumers' increasing demand for investment and can bring the life insurance company with various aspects of benefits, including the operation and management, the prevention of interest rate risk, etc., and it is thus suggested that China should spare no effort in developing participating insurance and launch ILI and

[58] See Chen Yicong, *A Study of the Claim for Damages due to the Violation of Legal Obligation by the "Insurer" to the Investment-linked Insurance or Issuing Company of the Investment Subject-matter – Regarding the Exploration of Three-side Relation as the Core*, the master's thesis of Law Department of National Chengchi University in 2013.

[59] See Lin Guobin, *Research on the Development, Supervision and Dispute of Investment-linked Insurance in Recent Years (2)*, 11 Taiwan Law Review 76, 78(2018).

universal life insurance on a trial basis in areas with a relatively developed economy.[60] In 2002, *A Study on the Development of the Investment-linked Life Insurance* further affirmed the significance of the investment-linked life insurance, believing that the insurance industry had got involved in a wider financial field where it is developing toward diversified operations, thus their "living space is expanded."[61] In 2004, they aimed at the doubts many people had about the necessity to start developing new personal insurance products for China at the current stage. Some scholars think that we should rethink the new personal insurance products, because they represent important product and institutional innovations, and it is impossible that the innovation of life insurance products will be "smooth sailing."[62]

The abovementioned studies have provided reasonable theoretical support for the development of investment-linked life insurance as a financially innovative product. However, at the legal level, the clear divergence lies in how the law gives a "response" to this product, especially of the "legal nature issue." In 2001, in the article, "*Investment-linked Insurance and its Legal Issues,*" it was noted that four questions on the ILI, namely "whether the special management of account can be done to the fund under the ILI," "whether the rights of the investors can be practically and truly protected," "whether the supervision body can implement an effective restriction" and "whether protection ensures an abundant return."[63]

As for the specific discussion on the legal attributes of the ILI, in 2003, Luo Yu discussed the nature of the ILI from the perspective of comparative law; by making some introduction on the legal attributes of the variable annuity in the US, Luo Yu has analyzed the practice of regarding ILI as the securities, which is thus considered to be more beneficial to the investors and more convenient for legal application. However, this result is also not quite likely to be realized, because in China, the ILI is just an insurance product, rather than securities.[64] In 2005, Li asserted that the ILI, as a new personal insurance product, was different from traditional insurance, and it should be positioned as "insurance + trust" by its legal attributes.[65] In 2010, Ye Lin further

[60] See Jiang Xiaohu, Xu Ni & Sun Zhenzhen, *On the Applicability and Limitation of Investment-linked Life Insurance*, 12 Insurance Studies 11, 11(2001).
[61] See Yang Xiaoling, *Research on the Development of Investment-featured Life Insurance Products*, 10 Insurance Studies 23, 24 (2002).
[62] See Tuo Guozhu & Junsheng Zhu, *The Current Development of Insurance and Risk-Prevention*, 12 Insurance Studies 14, 20-22(2004).
[63] See Guo Li, *Investment-linked Insurance and Its Legal Issues*, 4 Financial Law Forum 71, 71-76(2001).
[64] See Luo Yu, *Investment-linked Insurance: A Securities?* 6 Financial Law Forum 85, 85-95(2003).
[65] See Li Li, *Investment-linked Insurance: Legal Attributes and Conflicts with Existing Insurance Law*, 4 Hebei Law

pointed out that this product almost had nothing different from the securities investment fund under the fund management company except that it does not adopt the fund unit and does not trade in the public market.[66]

Despite no "response" to the ILI from the basic laws, through theoretical discussion, we still have achieved certain common understandings about the investment attribute of this product. Theoretically, we start to attach importance to the advocation of the importance of the investment interest protection for this product, as well as some specific law application issues. For example, in 2010, Guan Renqing emphasized the study of the issues relating to the protection of the investment interests in ILI; this article held that the ILI is essentially a composite financial product that concurrently bears the attributes of insurance, trust, and securities, after the discussion of its attributes of insurance, trust, and securities. In addition, the article also put forward the idea of constructing the system for the protection of the investment interests in ILI from two aspects, namely the private right and public power, wherein the former includes three aspects, namely the right, obligation, and responsibility, while the latter attaches importance to the indirect protection of the investment interests by the administrative power.[67] In 2013, Zheng Qing held that the supervision and law application in relating to the ILI should be different from the legal protection offered to general insurance consumers, and hence put forward the suggestion that the regulation on ILI can be similar to securities.[68] In 2015, Li Pengxi contended that there were new changes in terms of the risk-sharing function if compared with the traditional insurance since ILI came into existence, and based on its original risk, the investment risk is added to it; therefore, we can appropriately readjust the risk-sharing and distribution system in China's existing basic insurance law system, and rebalance the rights and obligations between the insurer and the policyholder of the ILI in case there is an extension of the obligation to explain which is bearable by the insurer to a policy contract.[69]

1.2.2 Main Defects in the Studies Carried out in China

Science 100, 100-103(2005).

[66] See Ye Lin, *Investment-linked Insurance: a Guarantee or an Investment*, 27 Cross-Strait Law Review 142,148(2010).

[67] See Guan Renqing, *Study on the Protection of Investment Interests in the Investment-linked Life Insurance*, Doctoral Dissertation of law of Jilin University in 2010.

[68] See Zheng Qing, *The Protection of the Consumers of the Securities Investment Service by the Insurance Company*, Doctoral Dissertation of law of Tsinghua University in 2013.

[69] See Li Pengxi, *Legal Regulations on Sharing the Risk of Unit-linked Life Insurance*, 4 Seeker 114, 114-117 (2015).

First, theoretical studies on the ILI are mainly concentrated at the beginning of the 21st Century, which was the time ILI was introduced in China. Along with the uncertainties in the development of ILI in China, in theory, we have not followed up on it, and there is no corresponding theoretical analysis and explanation on it. As a matter of fact, some of the current studies are based on current events, which means they draw the attention from the public along with the occurrence of some "hot spots," nevertheless are again put on the shelf when those hot spots end. Consequently, this makes many studies limited to the basic introductions on products represented by the ILI, but in law, they lack discussions on their corresponding law applications. Of course, this research status is related to the studies on the macroscopic background of the insurance law, because insurance law is a subject that has long been ignored, many important research subjects in the context of insurance law have not received the due attention and sufficient discussions.[70]

Second, though many kinds of literature have regarded the participating insurance, universal insurance, and ILI as financial management insurance products, they fail to distinguish and discuss them based on their different legal structures and relations in product design. For example, though the participating insurance, universal insurance, ILI, and variable annuity have an investment feature, there is no separate investment account established for the participating insurance, its investment attribute is only indicated by the permission to share the operation dividend of the insurance company. By contrast, separately established accounts with the characteristic of trust are available for ILI and variable annuity. In other words, even though those products all have an investment element, those products present different characteristics in terms of product design and risk-bearing at the economy level, as well as the right-obligation relation at the law level. For this reason, the discussion of those products should be based on the study of a specific product, so that the analysis of right-obligation relation can be more accurate.

Third, from the perspective of the study, a theoretical study is mainly concentrated on the introduction of the characteristics of those investment products at the economic level. Literature from the perspective of law study is scarce in number. Since at the beginning of this century, ILI was regarded as a "new product," there were many studies

[70] See Zou Hailin, *New Development of Insurance Law*, (Beijing: China Social Sciences Press, 2015), pp.519-533.

that were intended to introduce the characteristics of those products, such as the advantages in financial management. However, there are many repeat studies in that literature. While, the study of ILI is mainly concentrated on its composite nature in terms of its function, not only does it have the insurance guarantee function it also has the financial management function, though no adequate analysis in the relation between the two functions have been made.

Meanwhile, for literature in which the analysis is carried out from the perspective of the science of law, most of them only analyze the legal nature of the ILI. No doubt the identification of the legal nature of the ILI is the precondition for its legal supervision and law application. However, if we only limit ourselves in the analysis of its legal nature and thus suggest the application of the securities law or the amendment of the insurance law, then the significance of this kind of study would not be manifested. The crucial issue lies in the fact that once the legal nature of ILI is identified, how should the supervision authority carry out adequate supervision and effectively apply existing laws?

Fourth, the lack of a thorough evaluation and analysis of existing regulations and judicial practice, the failure to probe into China's regulation on ILI and current situation in practice, or even if there is adequate evaluation and analysis in some studies it is not all-inclusive, and the emphasis is not on the ILI. Except for a few works of literature that cover a few issues pertaining to the judicial practice of ILI, e.g., the "*Investment-linked Insurance: A Guarantee or an Investment – Judgment (97) Z.Y.Z. No. 1 Made by Local Court of Taipei, Taiwan on Mercuries Life Insurance Case"*, many research literature on ILI are in the absence of discussion at the practice level.

Fifth, theoretically, the improvement regulation approach for financial management product is to advocate the application of the *Securities Law,* and a call for an extension of the definition of "securities." This includes the suggestion that incorporates insurance financial management products, e.g., the ILI, into the scope of adjustment for *Securities Law*. The studies in this dissertation are also in favor of this macro line of thought. Unfortunately, the discussions in the application of the *Securities Law* to these kind of products in the context of the existing theory remain too general.

The definition of "securities" should be extended to include these kind of products into the scope of adjustment for the *Securities Law*.[71]

However, it still lacks a discussion on a few questions, such as how to apply it? Does this mean the application of the whole *Securities Law*? In other words, theoretically, how to further apply the *Securities Law* remains undiscussed till this day. In fact, despite the fact that these kind of products retain their investment and financing characteristics and display explicit securities attributes, they are designed under the name of insurance and have many features which are different from traditional securities, for example, they are not allowed to trade in open markets, and their investment attributes are attached to insurance attributes. In theory, no solutions have been provided for "how to apply securities law," "what clauses can be applied," and "what clauses shall be exempted from application" to ILI.

1.3 Major Legal Issues and Viewpoints

1.3.1 Major Issues in Research

This thesis discusses the law application of the ILI from three aspects. First, how to clarify the legal attributes of this product? Second, how does this product return to the adjustment of existing law in the context of legal interpretation? Third, how to improve the law application of this product under the legislation interpretation? From the analysis of the abovementioned literature review, the focus of these studies, controversies, and advancement at each stage correspond to three significant issues in the law application of ILI. Therefore, the research in this thesis has been carried out from those aspects.

First, investment-linked insurance is a hybrid financial product that presents many legal attributes. Then how should the legal attributes of the product be duly responded under the existing legal system? This is an unavoidable confusion, which is the beginning and the end of the problem. and a question that has been continuously and carefully raised in the study of the whole law application process. The major and specific questions to be studied include the factor and standard in determining between

[71] E.g., see Ye Lin, Investment-linked Insurance: a Guarantee or an Investment, 27 Cross-Strait Law Review 142,148(2010).

insurance and securities, how to analyze the legal attributes of the ILI? Should the legal nature be determined predominantly by the insurance aspect part or its securities aspect? How do foreign countries define this kind of insurance, the line of thought, and the background behind such judgment? How should it effectively regulate ILI under the existing legal system? What kind of line of thought is a relatively appropriate one to be adopted for the legal regulation?

Second, the securities attributes of the ILI are indicated using the investment account as the "carrier," which is also the main characteristics of the ILI. Then, under the concept of, "substance over form," which is advocated in this thesis, how do we further explain the private law relation and its contents as found in the investment account? For the specific problems involved, for example, the entrusted financial management relation, as shown in the investment account, is not a nominated contract under the existing laws. How should this legal relation be explained? How should the nature of the ILI contract be interpreted? How should the rights, obligations, and responsibilities of the parties concerned be balanced? Especially under the idea of protecting financial consumers, how should the obligations of the insurer be identified and explained?

Third, under the line of thought, "substance over form," what are the inadequacies of the supervision on the ILI by the public power and how should it be improved? In particular, in 2018, after the job authorities of the China Banking Regulatory Commission (the "CBRC") and CIRC were combined to form the China Banking and Insurance Regulatory Commission (the "CBIRC"), the power for the supervision on financial institutions may also be adjusted or reallocated in this round of reform. Theoretically, it may have a certain impact on the legal supervision over financial composite products represented by the ILI. Then under this background, how do we analyze it by academic principle? What kind of supervision idea should be adopted for the ILI? In addition, over recent years, does the "look-through supervision" that appears in the financial regulation tally with the required regulation over ILI? In addition, in terms of the regulation, what aspects of the ILI should be mainly regulated by the regulators? That is, should it be product sales, solvency, information disclosure, anti-fraud, as well as the division of labor among regulators and emphases of the regulation.

Fourth, how are the existing financial laws that are to be applied to the ILI, an important and urgent issue. A simple classification of the ILI into traditional insurance or securities may not effectively solve the issues concerning its law application. The composite nature of this product determines that its law application involves many laws, mainly including *Insurance Law, Securities Law, Securities Investment Fund Law, Trust Law,* etc. However, those laws are not entirely applicable to ILI, and there are some contents or provisions to be emphasized or exempted. Therefore, after exploring the legal attributes of the ILI and the approach for its regulation, the private law relation in the investment account and the "ought to be" means of management by the public power are clarified. This thesis will regard the anti-fraud rules as its major analysis point and will further explore how to apply existing laws and will discuss how to improve it based on the legislation theory from the perspective of comparative law.

1.3.2 Major Viewpoints in Research

Investment-linked insurance, as a hybrid financial product, is not insurance in the traditional sense and it is not a representative of typical securities. If the ILI is positioned as securities, then its insurance attribute cannot be denied and vice versa.

In the legal interpretation, the definition of the ILI under the existing legal system is feasible either for insurance or securities. The key point lies in how to carry out an effective legal approach on it after the identification of its legal nature and how to apply existing laws so that it may be regulated accordingly in a reasonable and logical manner, and avoid the regulatory loopholes and the absence of the protection of investors. For this reason, this thesis contends that the line of thought or legal approach, "substance over form" should be adopted. The corresponding private law application and the regulation by public power should be enforced against the ILI, during which the application of many laws, including *Insurance Law, Securities Law, Securities Investment Fund Law, Trust Law*, etc. are involved. In the regulation of the ILI by the public power, the traditional and stringent principle of "classified operation and classified regulation" should be broken down. Instead, its regulation should be jointly conducted by both the CBIRC and CSRC, which are guided by the idea of functional and conduct regulation. In the future improvement of the financial law system, legislation should introduce the legal term for "financial investment instrument,"

whereas the composite financial management products, e.g., the ILI, should then be defined as “financial investment instrument.”

This thesis adopts the viewpoint that the legal attribute of ILI is a composite product and a financial investment instrument. In addition, unlike previous studies, this thesis adopts the practice of starting from typical cases in foreign countries and by analyzing the line of thought being followed in making the judgment. Thus to extract the factors which determine the differences between insurance or securities, an attribute assessment for ILI should be implemented, and then it should further project the line of thought, “substance over form” for the regulation. In other words, for this specific issue, the approach and method taken for the study in this thesis are innovative as it expounds and proves the composite nature of its legal attribute at the law level. Therefore, this thesis has made relatively evident advances in terms of the contents and methods of the study of ILI at present.

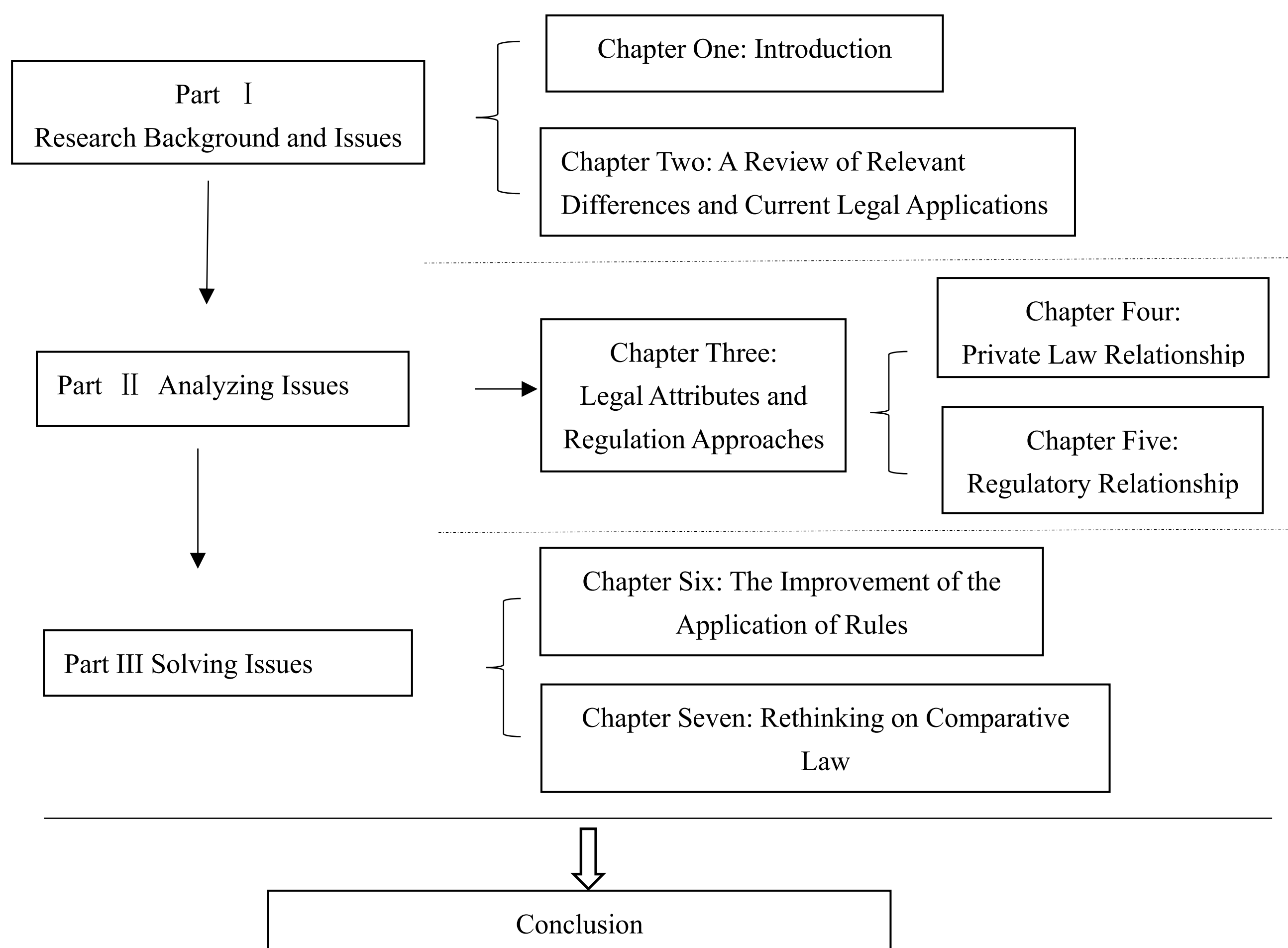
As for the differences between US and Chinese law, this thesis explores the incentives of financial regulators. As for the external incentives of financial regulators, constituencies, interest groups, and elected politicians, etc., have a significant influence on policy formulation in the US. In China, financial regulators often consider the pressure of regulatory competition in the financial industry, vested interest groups, the possible reflections of public opinion, etc.

There are many reasons for differences between US and Chinese law, such as “different financial regulators affect the application of the ILI”, “different sources for rules and relief mechanisms”, “different effects on ‘separate operation and classified supervision’ in applying laws in China and the US”, “differences in horizontal regulation and the ‘scope of securities’”, and “different law systems”. Additionally, these differences between the US and Chinese law are subject to the impact of multiple factors from the path-dependence perspective.

1.4 Structure, Methodology, and Significance

1.4.1 Logic Outline, Structure, and Methodology

The logic outline and structure of this thesis are presented in the figure below.



To adequately expound, prove, and unfold the viewpoints mentioned above, this thesis mainly adopts the following research methods.

The first method is the regulation analysis and law interpretation. The ILI involves many laws, including *Insurance Law, Securities Law, Trust Law*, *Securities Investment Fund Law*, and a series of departmental regulations enacted by the authorities. The current literature studies also lack adequate analysis and evaluation for those regulations. Therefore, the review of existing regulations in China is considered as the basis for the dissertation. Meanwhile, the ILI contract, as a non-typical contract, considers how to carry out the corresponding law application? It then requires the use of the law interpretation method. For example, to explain the contract as a mixed contract or simultaneous contract, and to further adopt either the “absorption theory” or the “analogical application theory” for the analysis on its legal application.

Next is the empirical analysis method, which is mainly based on the study on

judicial cases. This method can provide many beneficial materials and perspectives for this thesis. For example, some courts have provided an effective response that the interpretation of the insurer's obligation to explain should be extended under the ILI. Another example refers to how in some courts, only the insurance law applies to the ILI, but the investment account adopts the risk-bearing principle of "caveat the emptor." Thus, this thesis has analyzed many judicial cases on ILI and summarized the characteristics and inadequacies of current Court Judgments, to further promote the application on the ILI.

Finally, the comparative analysis. The comparative analysis is mainly carried out from the following two perspectives: First, by comparing ILI with similar financial products, this thesis explores the commonalities and differences between those financial management products at the economy and law levels to seek the best legal regulation mode for the ILI. For example, by comparing ILI with traditional life insurance, and investment account with a securities investment fund, it thus explores the economic characteristics and legal presentations of the ILI. Second, from the perspective of comparative law (comparative analysis of law), this thesis has mainly chosen laws from countries or territories, such as the US, Japan, and Taiwan, to make the comparison, so as to explore the experience and lessons of the regulations on ILI by those foreign laws. For example, variable annuity in the US, as a typical financial composite product, has caused many differences in some issues, such as the legal attributes of this product, the regulation of this product by the States or Federal Governments, etc., ever since it occurred in the US market. After long-term discussion and a series of judicial adjudication and evolution in its regulation, a relatively complete regulation system has been formed in the US. Therefore, this dissertation chooses the variable annuity in the US and regards the evolution of the regulation of such product in the US as the object of its study with an attempt to determine the logic of the regulation behind it and the cause for the formation of the system through the study of individual cases, in doing so, the reflection and enlightenment in the context of comparative law are obtained in this thesis.

1.4.2 Research Significance

The significance of the study in this thesis is mainly reflected in the following

aspects:

First, in terms of the legal attributes of the ILI, it has experienced many fluctuations ever since it was born. When the stock market rose, and the investment performance was excellent, ILI became a “star product” that was hotly pursued, whereas when the stock market plunged, and the investment performance was not good, ILI was deemed as a “problem product,” just like “a rat running across the street and everybody wanting to step on it.” The phenomenon behind this truly reflects that people do not have a clear legal understanding of the ILI. The study in this thesis can help to clarify this status of “looking flower in fog.”

Second, in terms of the private law application for the ILI, the approach taken to protect investment interests is analyzed mainly through the legal interpretation, thus realizing the target of private law relief. China has always attached great importance to the execution of public power, however it ignores private law relief. Though the investment interests of the ILI are protected at the departmental regulation level, it is still a blank at the financial private law level. Therefore, the study in this thesis has provided an applicable approach for the private law protection of the investment interests of ILI.

Third, in terms of the public regulation on the ILI, the financial regulation phenomenon “laissez-faire may bring chaos, however management and control may suppress its development” always exists in China. The development of ILI in China is a strong reflection of this impression. It is not correct to claim that the regulatory authorities have not realized the composite nature of the legal attribute of the ILI. However, they still follow the practice of “blocking instead of dredging.” This implies being stranded on the traditional regulation idea, with too much emphasis on the macro prudence, that ignores the conduct regulation. The study in this thesis also puts forward the reasonable mode of regulation by reflecting on the experience and inadequacies of the current regulation on ILI, which is beneficial to the improvement of the current regulation.

Finally, though this thesis is targeted at the study of a specific financial hybrid product, the significance of the research in this thesis is not merely limited to the law applicable for the ILI, which as a typical financial composite product, also bears the

reference significance for the law application of other composite financial products. This dissertation regards the "ILI" as its object of study, so some issues, i.e., the approach taken for its legal application, private law application, regulation by public power, etc., all have the significance for reference.

Meanwhile, these contents mentioned above can also provide a reference for the improvement of Japanese law.

Chapter Two A Review of Relevant Differences and Current Legal Applications to Investment-linked Insurance in China

The constant innovation of business transaction modes has become a feature of the most active field in the current market economy. Investment-linked insurance, as the representative of both a new transaction mode and an innovative financial product in China, is not only a maintenance of insurance guarantee, but also an expansion and innovation in terms of investment and financial management. The product was highly praised and appreciated as follows. It is the most advanced insurance,[72] and it is the development direction of the insurance industry,[73] etc. Although investment-linked insurance appears as a life insurance contract in legal form, it is different from traditional life insurance and other financial products, especially when it adds a strong investment attribute and involves important contract elements such as insurance and investment. More importantly, it occurs many dilemmas and in "conflict" with present norms (e.g., fundamental laws and administrative regulations).[74] Therefore, this chapter mainly discusses the following several aspects of content: a comparison between investment-linked insurance and other similar products, normative methods and differences for different financial products (insurance and securities), the status quo of the application of laws to investment-linked insurance in China.

2.1 Maintenance and Innovation in ILI – A Comparison with Other Relevant Products

China Insurance Regulatory Commission (the "CIRC") has clearly defined investment-linked insurance in the *Interim Measures for the Management of Investment-linked Insurance* (No. 26[2000] of CIRC) that it is a personal insurance product that includes the function of insurance guarantee and owns certain assets value

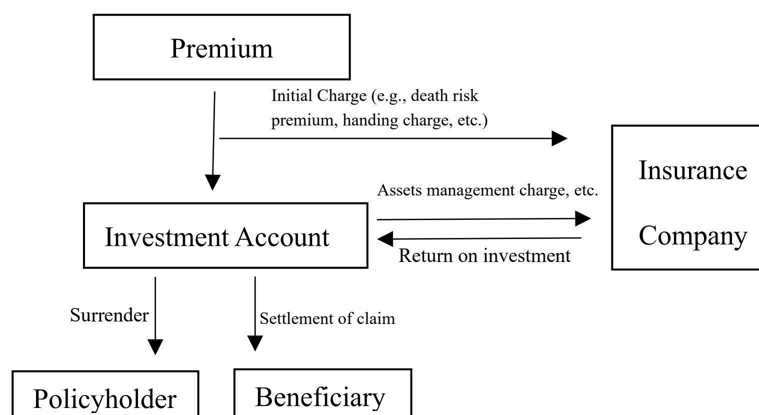
[72] See Guo Li, *Investment-linked Insurance and Its Legal Issues,* 4 Financial Law Forum 71, 71-76(2001).
[73] See Tuo Guozhu & Junsheng Zhu, *The Current Development of Insurance and Risk-Prevention*, 12 Insurance Studies 14, 20-23(2004).
[74] Investment-linked insurance can be treated as "variable life insurance" in the United States due to the same elements, operation, and purpose, etc. As a hybrid product, it has raised the same broad and vital questions as the US, such as "regulation, need for enabling legislation, danger of an insurance company dominated economy and varied tax considerations". See Notes, *Variable Annuity: Security or Annuity*, 43 Virginia Law Review 699, 699 (1957).

in at least an investment account. Thus, it can be seen that this definition at least includes three key elements, namely, the function of insurance guarantee, investment account, and personal insurance. However, this definition fails in revealing the unique nature of investment-linked insurance, because personal insurance, as an insurance product, the bearing of insurance guarantee function is the inherent meaning. Besides, the defect of this definition lies in that it has failed to describe the independence of the investment account and the features of risk-bearing by the policyholder. For instance, China's universal insurance also has an investment account, and is considered as a new personal insurance product, so the definition made by CIRC does not reveal the difference between investment-linked insurance and products, e.g., the universal insurance. This thesis holds that judging from the operation mode and product structure, the definition of investment-linked insurance should at least stress three key elements - "the provision of either mortality or pure endowment insurance guarantee," "the specially established independent investment account," and "the complete assumption of investment risk on the investment account by the policyholder."[75] In the following

[75] This can also be confirmed from the dispute over the definition of investment-linked insurance in Taiwan. Taiwan introduced investment-linked insurance in 2000, and the corresponding administrative authorities have issued some rules on investment-linked insurance to supervise the product. For example, Taiwan's "Ministry of Finance" promulgated the *Investment-linked Insurance Commodity Management Rules* in December 2001, in which Article 3 clarifies that the constituent elements of the insurance are "providing death or survival insurance protection, premium allocation by policyholder, investment account managed separately, investment risk-bearing by policyholder, evaluating the account assets regularly by the insurer, and prohibiting unsuitable use of investment account assets. In addition, Taiwan's "Executive Yuan" amended the *Implementation Rules for Insurance Law* in 2003, and clarified in Article 14 that investment-linked insurance means that the insurer will deduct the administrative fees paid by policyholder according to their agreed method, and policyholder decides the proportion of premium in the investment accounts, and the insured person shall bear the investment risk. However, the *Investment-linked Insurance Commodity Management Rules* was renamed *Investment-linked Insurance Management Rules* by the "Ministry of Finance "in 2004, and the definition of investment-linked insurance was deleted in this amendment. The reason behind it is that there has the definition of investment-linked insurance in the *Implementation Rules for Insurance Law*; thus it is unnecessary to define the product again. As for the revision, the original definition of investment-linked insurance should be retained but not retained because it reflects the most important features of the product and also provides an objective criterion for judging whether a product is an investment-linked insurance or not. See Kuan Chucheng, *A Review on the Laws and Regulations Regarding Separate Account on Investment-linked Insurance Products in Taiwan: Observations from the Perspectives of Theoretical and Comparative Law*, 109 Chengchi Law Review 177, 194 (2009). However, someone pointed out that the original definition of investment-linked insurance is inappropriate because some of the elements are the insurer's duty, not the features of the product. Therefore, if a product satisfies the two elements- "providing death or survival insurance protection" and "investment risk-bearing by policyholder", it would be the investment-linked insurance. See Ye Qizhou, *Insurance Premium Repayment upon Voidable Investment-linked Insurance and Culpa in Contrahendo*, 6 Global Law Review 45, 49 (2014). The above viewpoints only differ or emphasize the differences in the content of investment-linked insurance and insurer obligations. That is to say; the original definition makes it clearer that the insurer has standardized the operation of the special account, making its corresponding obligations more specific. However, regardless of the different definition of the product, in essence, it must be required to satisfy three elements, namely, "the insurer is required to set up an independent investment account," "policyholder fully assumes the investment risk of the investment account," and "net risk of death is the subject of coverage". See Li You, *Investment-linked Insurance in Taiwan: Its Nature and the Approach Taken to Protect Its Investment Interest*, 3 Taiwan Research Journal 52, 54 (2019).

paragraph, we will discuss those elements by comparing investment-linked insurance with relevant products.

Figure: Typical model of investment-linked insurance



2.1.1 Traditional Life Insurance and Investment-linked Insurance

The investment-linked insurance's capability to provide mortality or pure endowment insurance guarantee implies that this kind of insurance bears essential characteristics and functions – insurance guarantee or insurance protection. It is also the most critical feature that separates financial products from insurance products in general. The reason consists in that the investment-linked insurance developed from traditional life insurance, and issued under the name of traditional life insurance, so insurance guarantee is a prerequisite for it, meaning that the insurer must assume certain insured liability. Also, CIRC has restricted the scope of insured liability under investment-linked insurance to personal insurance (including health insurance, accident insurance, and life insurance), excluding property insurance. Besides that, in practice, life is mainly regarded as the subject-matter insured by investment-linked insurance. For example, an investment-linked insurance contract often provides that a policyholder may pay the premium either in a lump sum or by installment, in doing so, the insurer shall perform its obligation to pay the insurance benefit to the beneficiary in the event that the insured is dead or pay the same when the insured have reached an agreed age.[76] For this reason, investment-linked insurance bears the maintenance factor identified in traditional life insurance, which is the provision of either mortality

[76] A small part of investment-linked insurance also covers disability. For example, AIA Shuangying Life II Life Insurance (Investment-linked), No. AIA [2012] Life Insurance 021.

or pure endowment insurance guarantee. However, comparing with traditional life insurance, investment-linked insurance is different in some aspects, including the amount of payable insurance benefit and the mode for the operation of premium.

In theory, based on different subject-matters insured, personal insurance can be divided into health insurance, accident insurance, and life insurance, that can be divided into different categories. For example, life insurance can be divided into mortality life insurance, pure endowment life insurance, and endowment insurance.[77] Among those types of life insurances, based on whether or not the insurance benefit and cash surrender value are fixed, they can be divided into two types – variable and fixed life insurance. Fixed life insurance is a kind of traditional life insurance with an invariable amount of insurance benefit.[78] Whereas the variable insurance is in contrast to it, the insurance benefit and cash surrender value remain unfixed.[79] The reason why the traditional life insurance stresses as the "fixed insurance," significant reasons are that firstly, the amount of life insurance benefit is stable through a beforehand negotiation carried out based on the personhood of the subject-matter insured by personal insurance.[80] Based on such features, in general, personal and property insurances are distinguished at the legislation level, with different rules and requirements being applied to each one. For example, Article 12 of China's *Insurance Law* divides insurance into two categories, namely personal insurance and property insurance. Since property insurance intends to compensate for the actual loss of the subject-matter insured, the amount of insurance benefit shall not exceed the insured value of the said subject matter. In other words, the principle of indemnity only applies to property insurance, not to personal insurance. The jurisprudence behind this is that subject-matter insured by personal insurance, the life and human body, bears substantial personhood. Hence, they are priceless, and their value can not be calculated.[81]

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[77] See Liang Yuxian, *New Comments of Insurance Law*, (Beijing: China Renmin University Press, 2004), pp.229-231.

[78] Historically, "insurance" has provided against these risks by guaranteeing a substantial fixed-dollar benefit. See Milton P. Kroll, and Gary O. Cohen, *Insurance—Security Identity Crisis*, 46 George Washington Law Review 790, 794 (1978).

[79] In fact, as early as 1959, the US's supreme court held in the case of VALIC that "the issuer of a 'variable annuity' contract that has no element of fixed return does not assume any investment risk, which is inherent in the concepts of 'insurance' and 'annuity'". See *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65, 65 (1959).

[80] For example, personal insurance, also known as "fixed insurance", is based on the pricelessness of the body. The insurance contract parties can freely agree on the insurance amount, and it is directly paid for the compensation amount when the insurance accident occurs. See Jiang Chaoguo, *Basic theories of Insurance Law*, (Beijng: China University of Politic Science and Law Press, 2002), p.82.

[81] The personality and pricelessness of the personal insurance subject are not absolute, especially in some accidental medical insurances that compensate for the insured. The insurance benefit is dependent on the actual damage. Therefore, the type of life insurance and property insurance is not very rigorous and reasonable at present, so some

Secondly, traditional life insurance regards premium as the consideration of a contract; in this sense, policyholder acquires the promise of receiving an invariable amount of insurance benefit by paying the premium to meet their requirements for a stable life.[82] Therefore, no matter it is the mortality life insurance, pure endowment life insurance or endowment insurance, the premium paid by the policyholder is all flowed into the general account possessed by the insurer, the one who shall fully manage that premium. Meanwhile, the policyholder has no right to and is also unable to get involved in the operation of that premium.

What is different from the above description about traditional life insurance with fixed benefit is that investment-linked insurance is a kind of life insurance with variable insurance benefits.[83] Moreover, such characteristic of being variable shows in the variable amount of both insurance benefit and cash surrender value.

The premium of investment-linked insurance is different from the premium structure of traditional life insurance, as only a part of the premium is deemed as the consideration of risk guarantee. The fees included by the premium of investment-linked insurance are quite complicated. Major ones are following: (1) initial fees (costs, such as brokerage charges, marketing fees);[84] (2) bid-ask spread;[85] (3) pure premium;[86] (4) policy management fee;[87] (5) assets management fee;[88] (6) handling charge;[89] (7) surrender charges, etc.[90] The premium of investment-linked insurance will ultimately enter into the investment account after the deduction of some initial fees. Later on, the insurer will regularly deduct from the investment account the premium for mortality risk and some other fees (e.g., policy management fee). Therefore, unlike the premium of traditional life insurance, which is the consideration of risk guarantee, the premium

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counties abandoned this type (e.g., Japan), and adopt the new division of insurance: fix-sum insurance and indemnity-insurance.

[82] The premium of traditional life insurance can be divided into net risk premiums and additional fees (e.g., brokerage charges, contract cost, handling charge).

[83] "They vary according to the investment performance of a fund; hence the name 'variable' as distinguished from 'fixed' annuity." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 177 (1971).

[84] The initial fees are charged relatively high for the first 5 policy years, but will not be charged further after 5 years

[85] The premium is transferred into the investment account for the purchase of investment units, which in general, has a 5% bid-ask spread when it is sold for cash via redemption.

[86] It is deducted from the investment account the cost of insurance in correspondence to the insured liability.

[87] It is a service management fee charged in order to maintain the validity of the policy.

[88] The more complicated the assets under investment account is, the higher its management is. Generally, it is charged in a rate which is no more than 2% for each account throughout a year.

[89] It is a management fee charged when the capital transaction takes place in different investment accounts.

[90] See Tao Cunwen, *Theory and Practice of Life Insurance*, (Beijing:Higher Education Press, 2011), pp.55-56; Chang Ding & Hanxiong Li, *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), pp.23-24.

of investment-linked insurance is mostly used for investment, not for net risk guarantee, which results in variable insurance benefits.

As for the premium of investment-linked insurance, the proportion of it in different investment accounts with different risks is determined by the policyholder according to his or her risk-bearing capability. Furthermore, through professional financial management conducted by the insurer, the premium will be invested in the capital market (e.g., stocks, bonds). [91] The cash value in the investment account under investment-linked insurance will fluctuate with the investment performance, so the insurance benefit and cash surrender value vary with the cash value in the investment account.[92]

In practice, for the insurance benefit of investment-linked insurance (e.g., payments), there are two kinds of designs. One of them is the larger one among the amount insured and the value of the investment account (or a certain percentage of it). Under such a method, the amount of the death benefit remains unchanged at the early stage of the term of the policy but will fluctuate with the change of the value of the investment account after the point where the value of the investment account exceeds the death benefit. This practice makes it impossible for the death benefit turns out to be less than a predetermined amount, which is especially the case at the late stage, where the pure premium will be lowered down, eliminating the possibility of paying over the high-risk cost at an elderly age. The second is the sum of the amount insured and the value of the investment account. According to this method, the death benefit will fluctuate with the value of the investment account, however, at the late stage, risk cost may increase with the increased age of the insured, which is likely to cause the amount of the money in the investment account to be insufficient for the payment of the pure premium.[93]

[91] "The standard variable annuity contract provides that the contractholder has an option to cash in his accumulation units during the pay-in period." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 185 (1971).

[92] As the US's variable annuity, the contract holder is entirely dependent upon the management of the underlying fund (or separate account) portfolio. See Christopher S. Petito, *Status of Insurance Product under the Securities Act of 1933*, Variable Annuities and Variable Life Insurance Regulation. ed. by Clifford E. Kirsch, (New York: Practising Law Institute, 2018), pp.2-42. "Since the value of a consideration unit would change, in accordance with investment experience, it would be, necessary to make periodic determinations of value." See J. Edward Day, *Variable Annuity Is Not a Security*, 32 Notre Dame Law 642, 648 (1957).

[93] See Tao Cunwen, *Theory and Practice of Life Insurance*, (Beijing: Higher Education Press, 2011), pp.54-55; Chang Ding & Hanxiong Li, *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), p.3.

As mentioned above, investment-linked insurance belongs to a kind of variable insurance if it is compared with traditional life insurance. [94] Apart from this feature, many other differences between these two products are demonstrated in the table below. For example, in terms of the source of revenue on the part of the insurance company, source of profit for traditional life insurance is mainly on the basis of interest margin, mortality margin, and expense margin ("the tree margins"), whereas the profit of investment-linked insurance receives a relatively small impact from "the three margins." This is because a large portion of the premium of investment-linked insurance flows to the investment account, and the insurer has the assets- managing obligation for the capital in the investment account. For this reason, for investment-linked insurance, insurance companies rarely earn an underwriting profit. Instead, their source of revenue is the assets management fee rather than "the three margins."

Table: Comparation between traditional life insurance and investment-linked insurance

Comparative Terms	Traditional Life Insurance	Investment-linked Insurance
Products Function	Insurance Guarantee	Insurance Guarantee + Investment
Premium Composition	Pure premium and additional fees (e.g., brokerage charges, policy management fee)	Pure premium, assets management fee initial fee, and policy management fee.
Transparency of premium operation	Opaque	Transparent（information disclosure）
Payment method	Fixed date and payment	Flexible payment
Grace period（60 days）	If a policyholder does not pay during the grace period, the policy will be suspended.	Beyond the grace period, the policy will not be suspended.
Account	No investment account	Have independent investment account
Power of premium investment	Fully controlled by the insurer	The policyholder can determine the ratio of premiums into investment accounts.
Policy value	Determined by the predetermined interest rate	Determined by the performance of the investment account
Investment risk-bearing	The insurer	The policyholder bears the risk on the investment account
The primary source of the insurer	Underwriting profit, investment margin, etc.	Assets management fee, etc.
Common points: both bear the risk of death; both are a consensual contract, aleatory contract, and bilateral contract, etc.[95]		

2.1.2 Investment-linked Insurance, Participating Insurance, and Universal Insurance

[94] Just like the variable annuity. "The variable annuity is a variation of the conventional fixed-dollar annuity." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 182 (1971).

[95] According to Article 13 of China's Insurance Law, an insurance contract shall be formed after the policyholder applies for insurance and the insurer agrees to underwrite the insurance. Namely, it is not required for insurance contract to transfer a specific items or objectives from policyholder to the insurer, thus it belongs to the consensual contract; In addition, Article 14 of Insurance Law stipulates the insurance applicant shall pay an insurance premium as agreed upon, and the insurer shall start to assume the insurance liability from the time as agreed upon after an insurance contract is formed. In other words, there is a consideration between the policyholder and the insurer, which means the insurance contract is a type of the bilateral contract; Also, because the insurance liability assumed by the insurer is uncertain, it is a kind of aleatory contract.

If we merely judge whether or not insurance is life insurance with variable insurance benefits, variable insurance in China also includes those new personal insurances, such as the participating insurance and the universal insurance, except for investment-linked insurance. All those non-traditional life insurance products have the investment function, and the "unfixed" feature for the amount of insurance benefit exists in all three. Despite this, differences are still evident among them in those aspects, including product structure and the realization of investment function (see below table).

Significant differences between investment-linked insurance and participating insurance are as follows. First of all, in terms of product design, participating insurance is to share the operating dividend of the company. To be specific, the insurance company distributes surplus among policyholders by proportion when the actual operating results are better than pricing assumptions.[96] Participating insurance usually executes at a relatively low guaranteed interest rate, stresses the money-saving of the policy, and emphasizes the share of distributable surplus.[97] Investment-linked insurance, on the other hand, is to enable a policyholder's participation in the operation of the premium by establishing an independent investment account, thereby such policyholder is likely to further gain a return on investment depending on its investment performance. Secondly, in terms of the primary profit resource of product, participating insurance mainly relies on the investment-related interest difference to make a profit. By contrast, investment-linked insurance makes a profit by methods, e.g., the collection of an asset management fee. Thirdly, in terms of the premium operation, participating insurance is not transparent, whereas the investment-linked insurance is on the contrary because its initial fees, policy management fee, and assets management fee are all required to be disclosed to the policyholder. Fourthly, in terms of the payment of premium, the premium of participating insurance has to be paid in a fixed amount and at a fixed time, whereas the investment-linked insurance has a flexible way. Investment-linked insurance allows the premium to be paid irregularly without a fixed date. Even if it has exceeded the grace period of 60 days, the policy shall still be valid. Some investment-linked insurance even stipulates that the policyholder can pay a random amount (beyond the minimal amount restriction) of premium at any time.[98]

[96] See Article 2 of the *Interim Measures for the Management of Participating Insurance* (No. 26 [2000] of CIRC).
[97] See Tao Cunwen Theory and Practice of Life Insurance, (Beijing: Higher Education Press, 2011), p.52.
[98] See Tao Cunwen, Theory and Practice of Life Insurance, (Beijing: Higher Education Press, 2011), p.55.

As for universal insurance, there is no official definition in the regulations of CIRC. In general, universal insurance refers to a kind of life insurance that allows its premium to pay in a random amount, and the amount of death benefit to be variable.[99] Judging from the comparison between investment-linked insurance and universal insurance, both of them are financial products with evident investment function. Significant differences between then are summarized as follows. First of all, both of them have investment accounts. However, the investment account of investment-linked insurance is managed separately while the premium in the universal insurance's investment account works in collaboration with the premium of other insurances other than being managed separately. Secondly, in terms of the investment risk-bearing, universal insurance may offer the promise of minimal guaranteed benefit, the worst return on investment on the part of the policyholder is the minimal guarantee provided by the insurer. In contrast to this, the investment-linked insurance forbids the provision of minimum guaranteed return on investment. Thirdly, investment-linked insurance usually has multiple investment accounts bearing different types of risks, thus offering more investment choices to its policyholders compared with universal insurance. Fourthly, as for the calculation of the value of investment account, the value of an investment account is equal to the number of investment units multiplied by the price of each investment unit in the investment-linked insurance. By contrast, the value of the investment account under universal insurance is evaluated regularly according to the interest rate for settlement as disclosed by the insurer.[100]

Table: Comparation of non-traditional life insurance

Comparative Terms	Product structure	Earnings features	Profits source	Premium operation	Disadvantages
Participating insurance	No investment account	Relying on dividends	investment margin, etc.	Opaque	Fixed premium payment, poor flexibility, and opaque operation
Universal insurance	Have independent investment account	the performance of investment account with the promise of minimum guaranteed benefit		Transparent (information disclosure)	Poor liquidity, high cost of handling fee, and long-term financial management (more than 5 years)
Investment-linked insurance	One or more independent account	the performance of an investment account without the minimum guaranteed benefit	assets management fee, etc.		

[99] See Zhou Miaowei, Wang Ziwei, *Investigation and a Case Study of Universal Life Insurance: A New Model of Stock Market Margin Financing*, 10 Zhejiang Finance65, 65 (2016). "Universal life is designed to be whole life insurance." See Alan Lazarescu; Harold Leff, *Uiversal Life Insurance:Legal, Regulatory and Actuarial Aspects*, 17 Forum 1000, 1001 (1981-1982).

[100] As for the Universal life insurance, "In the product description just given, interest rates are declared at the insurer's discretion. Because of concern over possible adverse tax rulings, some insurers guarantee that their declarations will be based on an outside interest rate index, such as thirteen-week treasury bills or the prime rate." See Alan Lazarescu; Harold Leff, *Uiversal Life Insurance:Legal, Regulatory and Actuarial Aspects*, 17 Forum 1000, 1005 (1981-1982).

Comparative basis	China's *Insurance Law*, *Interim Measures for the Management of Participating Insurance* (No.26 [2000] of CIRC, *Measures for the Administration of Information Disclosure of Personal Insurance New Products* (No. 3 [2009] of CIRC), *Notice of the CIRC on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance* (No. 32 [2015] of CIRC), etc.

2.1.3 Investment Account, Securities Investment Funds, and Financial Management Plans

2.1.3.1 Comparation between the investment account and securities investment funds

Although the investment-linked insurance provides insurance guarantee, it is different from traditional life insurance in those aspects, including the characteristics it has shown and the mode of operation it has. The main reason that has caused the investment-linked insurance to have those differences lies in the design of the investment account. This account is characterized by features such as independence, risk self-bearing, and collective financial management, and these characteristics are compatible with securities investment funds.[101] The so-called securities investment fund is a fund collected from investors by issuing fund units, and the fund is managed and operated by fund management institutions that engage the fund in investment in the form of financial instruments, such as stocks and bonds.[102] In this sense, it features collective financial management, financial management by the expert, portfolio investment, share of interests and risk.[103] By comparing an investment account with a securities investment fund,[104] the features of an investment account can be more distinctive. The common ground that they share is as follows:：

First, both have the feature of being independent.[105] The independence of the investment account is manifested in three aspects. (1) The insurer needs to establish an investment account separately, to distinguish it from the premium of other insurances.

101 "Policyholders bear part of the investment risk; payments under the policies are automatically affected by the investment results of the account; cash values, like the redemption price, depend on the value of the underlying securities in the account; the investment performance of the account will, no doubt, serve as an important sales feature in competition with mutual funds." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1034 (1973)

102 The term "securities investment fund" refers to a profit- and risk-sharing collective securities investment method, namely, pooling funds from investors through issuing Fund units and entrusting to Fund trustees so as to be managed and operated by Fund managers to through investment in securities and bonds as well as other financial tools. See Article 2 of *Interim Measures on the Management of Securities Investment Funds* (No. 81 [1997] of Securities Commission of the State Council).

103 See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.7.

104 Funds can be divided into securities investment funds, equity investment funds, asset allocation investment funds, other private equity investment funds, and industrial investment funds according to different investment targets. Since there is apparent comparative significance between investment accounts and securities investment funds, this part selects securities investment funds to compare with the investment accounts.

105 "The variable contract account would be a separate account of the issuing insurance company, with the investments and liabilities clearly identifiable and distinguishable from the other investments and liabilities of the company." See J. Edward Day, *Variable Annuity Is Not a Security*, 32 Notre Dame Law 642, 647 (1957).

(2) The investment account is being managed and operated separately. Premium in the investment account cannot be mixed and invested together with premium from other insurance products. Also, the premium from different investment accounts of investment-linked insurance cannot be mixed in their use either.[106] (3) The insurer should adopt a separate business accounting for the investment account, without getting involved in the bankruptcy liquidation carried out in the insurance company.[107] There should be an investment management system and accounting system in place to meet the demand for separate management of investment account and independent accounting.[108]

Comparing with the investment account, the independence of the investment fund appears more apparent. (1) The securities investment fund is not only an independent accounting entity but even can be called an independent legal entity. For example, based on different organization forms, securities investment funds can be divided into corporate funds and contract funds. The former has a legal entity while the latter does not qualify. Nevertheless, the investment account of investment-linked insurance in China is merely an independent accounting entity, not a legal entity.[109] (2) The requirements for the establishment and management of investment funds is stricter and more normative than the establishment of an investment account. For example, each fund is being managed separately by a fund management institution.[110]Also, China's *Securities Investment Fund Law* has strict requirements on the qualifications for fund management institutions. For example, the registered paid-in monetary capital of a fund management company should not be less than 100 million RMB and they should have

[106] Assets in investment accounts shall be subject to separate management and accounting. Regarding the independence of an investment account, the following requirements shall be satisfied: (1) There are investment management systems and accounting systems meeting the separate management and accounting needs of the investment account；(2) There is no debtor-creditor relationship or joint and several liability between the investment account and any other asset managed by the insurance company and between the investment account and any other investment account；(3) There shall be no sale, transaction, property transfer, or tunneling between the investment account and any other asset or investment account of the insurance company；(4) The management personnel of the investment account shall not operate, either for themselves or others, business of the same category of the investment account, engage in any activities damaging the interests of the investment account, or conduct transactions with the investment account；(5) All assets in the investment account shall be entrusted for custody. The market access, eligibility requirements, and scope of service of asset custody agencies shall comply with the relevant regulatory provisions. See Article 7 of *Notice of the CIRC on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance* (No. 32 [2015] of CIRC).

[107] The CIRC also points out the three meanings of independent management of investment accounts. See CIRC's *Insurance Company Solvency Report Rule No. 7: Investment-Link Insurance* (Draft for Comment).

[108] Because of the independence of investment-linked investment accounts, it is called the "separate account" rather than "investment account" in other counties (e.g., the United States).

[109] In the United States, the case of *Prudential Insurance Company v. SEC* considered the separate account as an investment company under the Investment Company Act of 1940. See *Prudential Ins. Co. of America v. Securities and Exchange Commission*, 326 F.2d 383 (1964).

[110] See Article 50 and 89 of China's *Securities Investment Fund*.

excellent performance, good financial status, and social reputation, etc.[111] (3) From the assets independence of investment fund, the fund assets shall be independent of the assets of either a fund management institution or a fund custodian. No enforcement may be conducted against fund assets, except for the debts incurred by fund assets. [112]

Secondly, the policyholder shall fully bear the investment risk of the investment account. On the one hand, the policyholder shall determine on its own the specific proportion of premium to be allocated to each investment account. The policyholders share the income generated from the operation of the investment account by the insurer; on the other hand, the loss incurred when investing with the investment account does not fall into the scope of guarantee offered by the insurance company, meaning that the policyholder has to bear the loss on its own. The investment risk-bearing by the policyholder is described as "complete"; in other words, the policyholder and the insurer cannot assume risk as per a certain predetermined proportion, nor can they be given a promise of minimal guaranteed revenue as it is with the universal insurance. However, the investment account finally pools the premium fund from many policyholders. It has demonstrated the characteristic of spreading and sharing the risk, but this is somehow different from how the concept of 'loss appointment' is defined in traditional insurance. 'Loss apportionment' is a risk prevention system in which the loss caused by accidental risk is pooled through risk transferring and then have it assumed by an insurer, who further offers damage compensation or is responsible to the insured.[113] It resorts to mathematical or physical technologies, for example, the law of large numbers, to realize this purpose. However, for an investment account, what the phrase, "spreading and sharing the risk," intends to express, is to reduce investment risk via pooling capital and through portfolio investment. The reason is that more often, the premium invested by the individual policyholder is quite limited, with a limited scope of investment, which makes it more likely to be affected by the invested securities or assets performance. On the contrary, the investment account of investment-linked insurance can pool the premium from many policyholders. This pooled capital can reduce the risk faced by individuals investing in policyholders.

[111] See Article 13 of China's *Securities Investment Fund*.
[112] See Article 5, 6 & 7 of China's *Securities Investment Law.*
[113] See George E. Rejda & Michael J. McNamara, *Principles of Risk Management and Insurance*, (New York: Pearson Education, 2014), p.5.

The securities investment fund is also a “capital pool” formed by pooling capital from unspecified investors. Investors also share return on investment or bear loss according to the fund units in their possession. Through a scientific and diversified investment portfolio, securities investment funds can reduce investment risk and increase earnings.[114] Therefore, from the perspective of risk-bearing, there is no difference between policyholders and investors of securities investment funds as they all assume all the risks of their invested capital.

Additionally, investment account and securities investment fund have the same calculation of risk-bearing and earnings. There are many equal investment units in the investment account, and the number of investment units possessed by policyholders is the basis for the calculation of their gains and losses for each investment account. Securities investment fund also issues fund units, and such owned units are used to calculate return on investment or the assumption of loss.

Thirdly, an investment account is similar to a securities investment fund in terms of the mode of operation, legal structure, etc. For example, both of them are an indirect investment method by which they entrust professional institutions.[115] In terms of the legal structure, the securities investment fund is a form of trust, with the owner of fund units as the entrusted party, whereas the fund management institution and the fund custodian as the entrusted party.[116] Article 2 of China’s *Securities Investment Fund Law* has also confirmed the trust relationship found in an investment fund. Though the investment account is not in the name of the trust, essentially, it represents the legal structure of trust (see detailed analysis on this characteristic in the following paragraph). Moreover, in terms of the purchase purpose, policyholders and investors are all expecting to seek a value increase in their capital account, in other words, to acquire a return on investment with the help of professional skills from the professional institution.

However, there are some differences between the investment account and the securities investment fund. Apart from that investment account has no legal entity,[117]

[114] See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.9.
[115] Investment funds are formed in decentralized public funds. In other words, many public investors transfer their funds to professional financial companies to manage and operate the funds. See Shi Tiantao, *Rediscovery of Commercial Relations and Mission of Current Commercial Law*, 6 Tsinghua University Law Journal 136, 144 (2017).
[116] See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.64.
[117] As for the separate account of variable annuity in the US, the case of *Prudential Ins. Co. of America v. SEC* hold “company’s separate investment fund resulting from sale of contracts was a ‘fund’, within *Investment Company Act*.”

they vary from each other in the following aspects. [118]

Firstly, as for securities investment funds, the listing and trading of publicly offered fund shares (units) can be applied.[119] For the publicly offered fund shares, the fund management institution shall apply with a stock exchange for the listing and trading of them, and, if it is approved and agreed, a listing agreement shall be signed before actual listing and trading.[120] On the contrary, investment units in the investment account cannot apply for the listing and trading.

Secondly, there are differences between the rights of their members. For now, the investment units are merely regarded as the "units" used for the calculation of account value under the investment account. They are only representing the right to earnings (self-benefit right), and there is no provision of the right to vote (common-benefit right). By contrast, among securities investment funds, particularly in the publicly offered fund, the fund shareholders shall have such rights, including exercising their voting rights regarding matters deliberated at the fund shareholders' meeting.[121] Here is one more example. What is issued by the corporate fund are stocks whose relevant rights are not limited to the right to earnings, but rather, mainly working on stock equity, ranging from self-benefit right to common-benefit right (e.g., voting right).

Thirdly, despite the independence the investment account has, it is still somewhat in a subordinated position in the following aspects. (1) The motivation for the design of variable annuity and variable life insurance is to avoid the depreciation brought by inflation and to satisfy the demand for investment from investors.[122] The introduction of investment-linked insurance to China is mainly because of the enormous loss from the difference of interest rate brought to the insurance company by the highly-priced interest rate found in traditional life insurance in the 1990s.[123] Consequently, it urges

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See *Prudential Ins. Co. of America v. SEC*, 326 F.2d 383,383 (1964).

[118] As for this, Professor Tamar Frankel has been made a conclusion. "To sum up: in the pay-in period a variable annuity and a share in a mutual fund are virtually the same. They are investment arrangements, though variable annuities tend to emphasize long-term savings. The mortality guarantee in the variable annuity introduces an insurance element that constitutes the only significant difference between the two arrangements." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 182 (1971).

[119] Chapter 6 of China's *Securities Investment Fund Law* specially stipulates "Fund Share Trading, Subscription and Redemption of a Publicly Offered Fund".

[120] See Article 61 of *China's Securities Investment Law.*

[121] See Article 46 of China's *Securities Investment Fund Law.*

[122] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 177 (1971). As to variable life insurance of America, it was devised to be a hedge against inflation. See Tamar Frankel, *Regulation of variable life insurance*, 48 Notre Dame Law 1017, 1017-1091(1973).

[123] China's one-year deposit rate fell from 10.98% in 1993 to 5.67% in 1997, whereas the insurance industry did not realize this slump in time and still kept the previously high rate of return for endowment insurance products, resulting in hot-selling life insurance in 1996-1997. Subsequently, the industry-recognized this phenomenon and began to

insurance companies to develop investment-linked insurances that have a low-interest rate.[124] In this sense, from the generation background, either in America or in China, it has all been reflected that the investment function of investment-linked insurance serves the development of insurance. (2) The establishment, effectiveness, change, or termination of the investment account depends on the content of the insurance part under investment-linked insurance.[125] In other words, the investment part of the contract cannot remain entirely independent of the insurance part of the contract.[126] For example, if the insurer violates the duty of explanation to the exclusion clauses in a contract, it may be lead to the overall ineffectiveness of the contract. By contrast, if the insurer only violates the content of the investment part (e.g., the violation of information disclosure), it shall not constitute an essential breach of contract in general, and will not have any impact on the overall effectiveness of the contract under the investment-linked insurance.[127]

Finally, investment-linked insurance has its own advantage as a novel policy compared with a securities investment fund in China. For example, the reasons why some policyholders do not directly invest mutual funds but choose some funds through the investment accounts are that investors will be confused and do not have enough time and capacity to select valuable funds in the market by themselves. By contrast, insurance companies can provide certain quality funds based on their own research by investment accounts.[128] Additionally, ULI has more favorable tax treatment than investment funds because it would not be taxed currently in the name of life insurance pursuant to Article 4 (5) of China's *Individual Income Tax Law*, which stipulates

lower the interest rate in their products, but it lost consumers' attraction to endowment insurance products with a lower interest rate, and led to a decline in the total sales of life insurance. The industry tried their efforts to change the situation. For example, they would return the income of the interest rate spread to policyholders when the rate goes up, while the companies retained the risk of the rate if it goes down. The fact proved their efforts failed because the rate kept the downward trend in the 1990s, and the industry suffered from great operation pressure caused by the trend. Yongwei Ma, the first president of CIRC (Nov.1998-Oct. 2002), called for speeding up to develop new products to reduce the risk of the spread loss and meet the needs for the development of the insurance market. Accordingly, the industry began to exploit some new insurance products and the first investment-linked insurance product was taken leading in introducing by the Ping An Company to solve this economic dilemma.

[124] See Chang Ding, and Hanxiong Li. *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), p.11.

[125] For example, the policyholder makes an offer for insurance, whereas the insurer agrees to accept the offer, then the investment-linked insurance contract is formed.

[126] As for this aspect of content, we can refer to some product descriptions of investment-linked insurances. For example, "AIA Shuangying Life II Life Insurance (Investment-Linked)" clearly states the establishment of the investment part is dependent on establishment of insurance part.

[127] See *Huang V. China Ping An Life Insurance Co., Ltd.*, available at the official website of Shanghai Court, http://shfy.chinacourt.org/article/detail/2016/01/id/1783485.shtml, latest visited on May 16,2019.

[128] See Yan Tao, *Comparative Analysis of Unit-linked Insurance and Fund Information Disclosure*, 9 Insurance studies 88, 88-92(2010).

"insurance compensation" shall be exempted from individual income tax.

Table: Comparation between the investment account and the securities investment fund

Comparative items	Common features	Separate features
Investment account	Independence, risk-bearing, collective investment, portfolio investment, purchase purpose, etc.	Have a certain degree of dependence
Investment fund		A legal entity, apply for the listing and trading, and the rights of their members, etc.
Comparation basis	China's *Securities Law*, *Securities Investment Fund Law*, *Notice of the CIRC on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance*(No. 32 [2015] of CIRC), etc.	

To conclude, investment account and securities investment fund share many things in common, either in theory or in practice, because of which introduction of investment account shares similar description with that of the securities investment[129] Based on the common points, including economic characteristics and operation mode, etc., there is also a trend that legal regulation on investment-linked insurance becomes increasingly close to the regulation on the securities investment fund. For example, specific clauses enacted by the CIRC in the early years had not required the premium custody to be implemented for the investment account. However, Article 18 of the *Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (No. 3 [2009] of CIRC) stipulates that for investment-linked insurance for which a commercial bank is entrusted to implement premium custody, the name of that bank should also be disclosed. Thus, it can be seen that CIRC has started to pay attention to the custody requirement for capital in an investment account, but at the moment, this is not a rigid requirement. In Article 7 of the *Notice of the CIRC on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance* (No. 32 [2015] of CIRC), it explicitly stipulates that the custody should be mandatory to all assets under investment account, and the assets custody institutions should comply with relevant regulatory provisions (e.g., qualifications, service scope), which has become a rigid requirement. As for securities investment

[129] "In fact, it seems to me that so-called variable annuities are far more closely related to investment securities than to insurance." See Arthur H. Haussermann, *The Security in Variable Annuities,* 1956 Ins. L.J. 382, 382 (1956). The account, though attaches to the life insurance policy, differs from the insurance but resembles mutual fund in various aspects (e.g., the insured's risk retention, the net premiums deposited). See Kuan-Chun Chang, *Identifying the Character of the Separate Account of the Investment-linked Insurance Products in China from Theoretical and Comparative Law Perspectives - A Permanent Solution for Issues of Present Laws and Regulations Regarding the Administration of Such Products*, 11 US-China Law Review 514, 524 (2014). It is no doubt that a separate account is considered as an investment fund. See Kuan Chucheng, *A Review on the Laws and Regulations Regarding Separate Account on Investment-linked Insurance Products in Taiwan: Observations from the Perspectives of Theoretical and Comparative Law*, 109 Chengchi Law Review 177, 194 (2009). The investment-linked insurance is basically the same as a securities investment fund except that it is not in the form of a fund and is not transacted on the open market. See Lin Ye, *Investment-linked Insurance: Assure or Investment—A Review of Sanshang Meibang Case,* 27 Cross-Strait Law Review 142, 148(2010).

fund, regardless of a privately offered fund or publicly offered fund, China's *Securities Investment Fund Law* has all requested that funds custody must be followed.[130] Also, the law explicitly stipulates the rights, obligations, and responsibilities of the fund trustee.[131] Additionally, what makes the regulation of investment account similar to that of securities investment fund is also manifested across many legal regulations, e.g., the regulation on information disclosure (discussing in the following paragraph).

2.1.3.2 Comparation between Investment account and financial management plans

After the financial crisis in 2008, the financial industry in China reached a plateau in their development. Many financial companies develop some hybrid financial products to overcome the defect of the traditional separate operation and seek for new business growth; thus, those products have become the breakthrough points for the development of financial institutions in China. They mainly show in the investment-linked insurance issued by the insurance company, trust plans of assembled funds released by trust companies, the comprehensive financial management plan for commercial banks, management plans of collected funds released by securities companies. Those products develop continuously and rapidly and have accounted for a significant market share (see below table). Moreover, those products are consistent with each other in terms of the basic pattern of the transaction (see below figure) and legal features.

Table：the development of typical hybrid financial products, 2013-2018（Billion yuan）

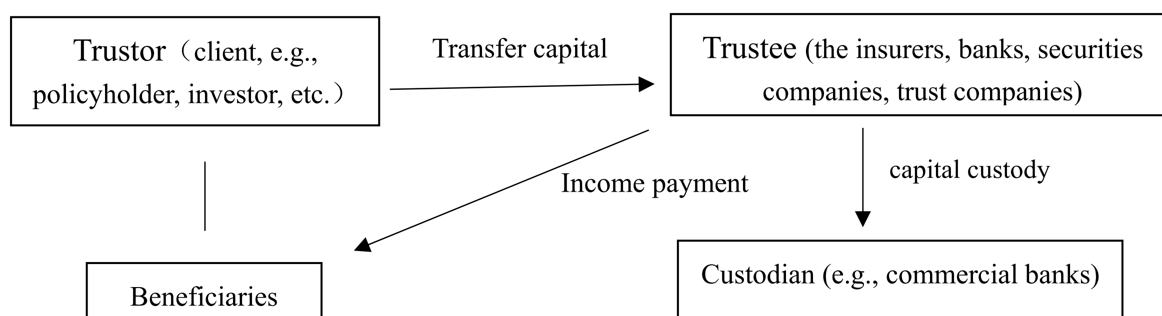
Products	2013	2014	2015	2016	2017	2018
Investment- linked insurance[132]	8.31751	28.94979	67.78833	93.89744	47.04176	33.2853
Trust plan of assembled funds[133]	2716.59	4003.28	5343.643	7335.332	9906.75	9110.0
Management plan of collective asset [134]	358.795	655.450	1557.409	2193.837	2112.499	1913.726
Banks' financial management product [135]	10240.0	15020.0	23500.0	29050.0	29540.0	22040.0

As discussed previously, the transaction model under the investment account is that the policyholder, as the entrusting party, invests premium into the investment

130 See Article 2 & 3 of China's *Securities Investment Fund Law.*
131 See Chapter III "Fund Custodians" of China's *Securities Investment Fund Law.*
132 The data comes from the official website of CIRC, available at <http://bxjg.circ.gov.cn/web/site0/tab5203/>, latest visited on May 11, 2019.
133 The data comes from the official website of the China Trust Association, available at <http://www.xtxh.net/xtxh/statistics/index.htm>, latest visited on May 11, 2019.
134 The data comes from the official website of Asset Management Association of China, available at <http://www.amac.org.cn/tjsj/xysj/zqqhjyjgzcglywtjsj/>, latest visited on May 11, 2019.
135 The data comes from the official website of China-wealth, available at <https://www.chinawealth.com.cn/zzlc/sjfx/hgsj/list.shtml>, latest visited on May 11, 2019.

account, whereas the insurer, as the entrusted party, manages the capital in the investment account, and has custody of those assets. The financial management plans mentioned earlier also adopt this transaction model. As for the trust plans of assembled funds, trust companies act as trustees and conduct centralized management, operation, or disposal of the funds trusted by two trustors or more, under the will of the trustors and for the interests of the beneficiaries.[136] When handling the collective asset management business for more than one customer, a securities company shall create a collective asset management plan, enter into a collective asset management contract with each customer, transfer customer assets to an asset custody institution qualified for the fund custody business for custody, and provide customers with asset management services through individual accounts.[137] Besides, concerning the comprehensive financial management plan for commercial banks, a commercial bank accepts an investor's entrustment to invest in and manage the entrusted investor's properties according to the investment strategies, risk assumption, and income distribution methods agreed upon with investors in advance.[138]

Figure: Transaction model of typical hybrid financial products



If further analyze the operation mode of the products mentioned above, those products are homogeneous.[139] Namely, all of them have adopted the legal structure of the trust. Trust refers to the act in which the trustor, based on confidence on the trustee,

[136] See Article 2 of the *Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds* (No. 3 [2007] of CBRC, issued on January 23, 2007).
[137] See Article 13 of the *Measures for the Administration of the Customer Asset Management Business of Securities Companies* (No. 93 [2013] of CSIC).
[138] See Article 3 of the *Measures for the Supervision and Administration of the Wealth Management Business of Commercial Banks* (No.6 [2018] of CBIC).
[139] Trust companies, securities companies, fund companies, insurance companies and commercial banks all provide financial planning services. Although the names of their products and the groups of their investors vary, the legal structures of their products are highly homogeneous. In China, some financial planning products deliberately avoid using the word "trust", but in essence they all fall within the scope of trust. See Ji Kuiming, *On Unified Application of Legal Norms on Financial Planning Products*, 6 Global Law Review 93, 106 (2016).

entrusts certain property rights it owns to the trustee and the trustee manages or disposes of the property rights in its name following the intentions of the trustor and for the benefit of the beneficiary or specific purposes.[140] The following paragraph will use the investment account as an example to analyze the trust structure of the typical hybrid financial products pursuant to Article 2 of China's *Trust Law*.

First, the expression, "the trustor, based on confidence on the trustee," points to the "essential trust element" of "trust." The policyholder's choice of an investment account for investment is mainly out of its trust on the insurer's capability for professional financial managing. Therefore, the policyholder expects to realize its purpose of gaining revenue through financial management conducted by experts. The core content of it is that one entrusts another one for financial management. This entrustment relies on confidence, and there is no confidence without it.[141]

Secondly, as for 'entrusts certain property rights it owns to the trustee,' the expression adopted by Article 2 is 'entrust' rather than 'transfer.'[142] Hence it has left a controversial issue on the ownership of the property right. However, there is no debate over the need to transfer the ownership of the property right with the popularization of the concept of trust in China. Because the essence of trust is that it is a "trade contract" on the management and distribution of trust property between trustor and trustee.[143] The separation of ownership from interest, as well as the separation of the subject of right from the subject of interest, is the fundamental feature that differentiates trust from any similar property management system.[144]For investment-linked insurance, the assets under investment account are the premium. If follow the rule that 'money possession means money ownership,' the premium is transferred from the policyholder to the insurer, and the insurer starts to possess the ownership and manage the assets under that account. The policyholder may enjoy the return on the investment account, but not the ownership of the assets under that account. This gesture has realized separation of the ownership of the assets under investment account from the beneficiary right of the same. Also, this characteristic further reflects the asset isolation or separating accounting system for the investment account. An investment account is independent

[140] See Article 2 of China's *Trust Law.*
[141] See "*the Legal Interpretation of China's Trust Law*", available at the official website of National People's Congress of PRC <http://www.npc.gov.cn/npc/flsyywd/jingji/2003-11/14/content_324178.htm >, latest visited on June 4, 2019.
[142] See Article 2 of China's *Trust Law*.
[143] See Zhou Xiaoming, *Research on Comparative Law of Trust*, (Beijing: Law Press, 1997), p.12.
[144] See Zhou Xiaoming, *Research on Comparative Law of Trust*, (Beijing: Law Press, 1997), p.12.

when it is established, managed, and accounted separately.

Thirdly, regarding 'the trustee manages or disposes of the property rights in its own name in accordance with the intentions of the trustor and for the benefit of the beneficiary or for specific purposes', the insurer makes use of the capital under the investment account in its own name, and makes a transaction with the subject company it has invested in. Moreover, the purpose of the insurer's management of capital under investment account is to acquire a value increase for that asset, in other words, the management of assets for the sake of the interests of the policyholder. For this reason, the insurer also accepts the supervision from the policyholder, provides relevant materials to the policyholder regularly, discloses investment-related information. This is to ensure the policyholder has adequate knowledge of the distribution of the premium it has paid and also is aware of the result. Therefore, the legal structure of the investment account is, in fact, a reflection of the characteristics of the trust.

By comparing investment-linked insurance with other relevant products and by analyzing them, it comes to a conclusion that investment-linked insurance is a financial product which not only covers maintenance of the traditional insurance guarantee, but also functions as an expansion and innovation in terms of the investment function.[145] Also, investment-linked insurance has adopted the legal structure of trust, thus making it a new financial product covering three critical fields, namely the insurance, securities, and trust.

2.2 Logic and Rules of Financial Products

Every country has different rules for different financial products, and the setting of different rules varies due to different financing patterns of the financial products.

2.2.1 Risk Allocations for Direct and Indirect Financings

2.2.2.1 The allocation of risk in financings and its rules

Finance is a process of capital raising. Its primary purpose is to provide financing service for an enterprise whose internal financing cannot meet its capital demand under various circumstances, e.g., the expansion of business operation or turnover of

[145] "Variable annuities are hybrids of insurance and investment." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 187 (1971).

capital.[146] External financing can be divided into direct or indirect financing pattern, depending on whether there is any financial intermediary involved.[147] The standard of the so-called 'whether there is any financial intermediary involved' is applied only when banks are the credit intermediaries, excluding those to do with direct financing that financial intermediary is absent.[148] Direct financing means that credit transactions take place between the capital supplier and the capital demander directly through the securities market, and there is no bank involved as a credit intermediary. In other words, enterprises will directly raise capital from the public to meet their financing needs, e.g., issuing of securities products by the listed companies. Under indirect financing, there is no direct transaction occurring between the capital supplier and the capital demander; instead, the bank, as a credit intermediary, serves the role of "capital turnover." Namely, it will raise decentralized capital from the public (the supplier of capital) and then provide those collected capitals to the demanders (e.g., enterprises). Typical cases for indirect financing are the deposits taking and loans made by commercial banks, as well as the insurance products issued by insurance companies.

Due to different operations of direct and indirect financings, there are many differences between them in terms of rules. For example, as for transaction costs, the direct transaction cost for a credit bank is the interest margins between deposit and loan, whereas the direct transaction cost in securities market includes the commission and handling charge incurred when issuing and trading securities, as well as the additional accounting cost spent for disclosing internal information of the enterprise to the public.[149] Nevertheless, the essential difference between the two is the allocation and sharing of risk.

Under the direct financing, when an enterprise issues stocks or other securities to the public, it will promise that it will pay individual earnings to the public according to its business performance and their investment amount. People can then decide on

[146] See Peng Bing, *Chinses Securities Regulation*, (Beijing: Higher Education Press, 2007), p.3.
[147] The proportion of direct financing in China is about 40%, while the developed countries such as Britain and the United States have reached the level of 80% - 90%, while Japan and Germany are about 60% - 70%. See Xiu Jun, *The Development Trend of Direct Financing and Capital Management Industry under the New Regulatory Framework*, 12 Tsinghua Financial Review 85, 86 (2017).
[148] Financial intermediaries can be divided into two categories: one is that institutions represented by traditional commercial banks play the role of "credit intermediaries" between investors and financiers; the other is that other financial intermediaries, such as investment banks, investment companies, credit rating agencies, provide service for investors and financiers, which enable them to establish some credit relationship directly. See Shao Dongya, *Division and Integration of Financial Industry: Global Evolution and China's Practice*, (Beijing: Peking University Press, 2003), pp.209-110.
[149] See Shao Dongya, *Division and Integration of Financial Industry: Global Evolution and China's Practice*, (Beijing: Peking University Press, 2003), pp.121.

whether or not to buy its financing products based on their understanding of the enterprise. For example, securities are the promise for payment or long term payment, so its value depends on the expected payment amount and the evaluation on the risk that the securities may be involved with, and this expectation depends on the judgment made by the investor using all accessible information.[150] However, if the public does not have sufficient information, e.g., the qualifications and the credit of this specific enterprise, then there exists a certain kind of investment risk. For example, it might be this case that the enterprise fails to achieve the expected business performance after the receipt of the corresponding financing, so it can not realize the promised return; hence it leads to a loss on the part of the public (the capital supplier).

For indirect financing, the capital supplier does not need to make a judgment on the risk of the final capital demander (enterprises or individuals). Commercial banks (or insurance companies) bear this risk relying on their professional capacity. Those institutions collect capitals by indebting themselves from the public and then distribute the capitals to enterprises or individuals whom they believe are reliable, obtaining the interest margins as well. Take insurance products as an example; an insurer may form a giant capital pool by charging a premium to the policyholders, then the insurer can make use of those capitals to achieve their purposes of financing. Thus we can say that under indirect financing, the capital suppliers only need to invest their money into commercial banks or the insurance companies. They can obtain a stable return that is relatively guaranteed, and they do not assume the risks of the final capital demander (e.g., enterprise).

The aforementioned different risk allocations for direct and indirect financings have also determined the different normative logic and rules for the two at the legal level. For direct financing, our legislation is mainly to ensure that the investors (capital suppliers) and the counterpart can equally and fairly trade. However, the capital demander knows about the real information carried by securities (e.g., the stocks or the bonds), while investors may know far less than the issuing party knows due to some factors, such as their knowledge and investment capacity, leading them in a disadvantaged position in the corresponding transaction. Modern laws implement a normative concept - the “philosophy of disclosure” and establish a system of rules that regards information disclosure as its core to realize an open and transparent market so

[150] See Wu Zhipan, *An Introduction to Financial Law*, (Beijing: Peking University Press, 2011), p.17.

that the investors can have adequate information for making independent decisions. A typical example is that after the 1929 crisis in the US, the former President Roosevelt declared that the securities act should consider information disclosure as the legislation philosophy for securities.[151] "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 policemen."[152] In light of this, the US constantly enacted many laws, e.g., the *Securities Act 1933*, the *Securities Exchange Act of 1934*, the *Investment Company Act of 1940*, etc., and thus has established and taken information disclosure as the core of rules system for the modern securities laws.

In terms of indirect financing, since both the commercial banks and insurance companies adopt the form of indebting to raise funds, a form with inherent leverage effect and usually has a long-time limit, they are easy to have business risk. Therefore, the legislation raises many strict restrictions and requirements for banks and insurance companies to ensure them to realize their promise made to capital suppliers, such as the solvency, safe use of the capital, and capital adequacy ratio. Additionally, the legislation takes supervision on solvency as its core to the insurance industry. The policyholder or the insured pays the premium to obtain insurance benefits paid by the insurer at a time when the insurance accident takes place. There is quite a long time from "the premium was paid" to " the insurance benefit is received." The insurer may have many risks during the period, e.g., the operational risk. To ensure that the promise made by the insurer regarding the payment of insurance benefits can be realized, the precondition would be that the insurer can make that payment. In this sense, the solvency is the core of the supervision under the insurance rules. Although the solvency may have various patterns, e.g., the EU pattern – Solvency II, the "risk-based capital requirement" as put forward by NAIC in the US, etc., all of them serve the solvency and cover the management of overall risk involved in the operation of the insurance industry.[153] For another example, the supervision on a bank adopts the form of an asset-liability ratio, in which it requires the bank to allocate sufficient capital or take other guarantee measures for its risky business to prevent the adverse impact of the bank operating loss

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[151] See Franklin D. Roosevelt: *"Statement on Signing the Securities Bill"*, May 27, 1933. http://www.presidency.ucsb.edu/ws/index.php?pid=14654, latest visited on September 10, 2018.
[152] Louis D. Brandeis, *Other People's Money and How the Bankers Use It*, (New York: Frederick A. Stokes Company Publishers, 1914), p. 92.
[153] See Jiang Xianxue & Wu Lan, *Research on Supervision of the Insurers' Solvency*, (Shanghai: Shanghai Jiaotong University Press, 2013), pp.32-33.

on the depositors.[154] The Basel II adopted by the bank industry is a typical case for this as an adequate capital ratio, which is used to evaluate the business risk of a bank.

2.2.2.2 An Analysis of the Rules on Insurance and Securities in the US, Japan, and China

Among the direct financing patterns, the US's *Securities Act of 1933* regards the "public disclosure of information" as the philosophy idea to its legislation on securities, which has a far-reaching impact on other countries, such as Japan and China. For example, Japan's *Financial Instruments and Exchange Act* (FIEA) is intended to realize an open and transparent market through information disclosure by enterprises,[155] and it has used the chapter two to formulate provisions on "information disclosure by enterprises." China regards "open, fair, and impartial" as the primary principle of the *Securities Law*.[156] There are differences among those countries in terms of the review of the disclosed information. For example, the US does not examine and approve the authenticity of the securities-related information disclosed by enterprises, and investors need to decide whether the securities are worth buying or not. China adopts the examination and approval system for the issuance of securities. In other words, the government examines and approves the authenticity of the securities-related information disclosed by enterprises.

As the insurance supervision, both the US and China regard the solvency of the insurer as their core of supervision, but there are some differences in specific testing standards. Each state requires that the preconditions for those companies to obtain their licenses include the critical element of having adequate solvency when issuing those licenses for the operation of the insurance business in the US. For the supervision over the solvency of the insurer, each state generally requires a review every 3 to 5 years; in particular, they often carry out a test on financial data submitted annually by the insurer using the Insurance Regulation Information System of NAIC, e.g., "premium/surplus" ratio is a test on the quota of capital available at the time; when the insurer fulfills its obligation to compensate, the higher this ratio, the larger the risk.[157] In China, the solvency is tested by the ratio between actual capital and lowest capital. If this ratio is

[154] See Wu Zhipan, *An Introduction to Financial Law*, (Beijing: Peking University Press, 2011), p.56.
[155] See Article 1 of *Financial Instruments and Exchange Act*.
[156] See Article 3 of China's *Securities Law.*
[157] See Kenneth S. Abraham, *Insurance Law and Regulation: Cases and Materials*, (Beijing: China University of Political Science and Law Press, Chinese translation edition, translated by Han Changyin, 2012), p.107.

less than 100%, the company in question falls into the category of insufficient companies; if it is somewhere between 100% and 150%, it is a company under sufficient category I; if higher than 150%, it belongs to sufficient category II. For those insufficient companies, CIRC will adopt multiple supervision measures, e.g., an order to increase capital.[158]

Although there are common characteristics among the US, Japan, and China in their concepts for regulations on direct and indirect financings, many differences still exist when it comes to the formulation of specific provisions in the following paragraph.

First of all, in terms of the legislative background, Japan and China are countries that have established on the centralized and unified legislation power and implement nation-wide unified supervision on financial industries, including insurance and securities. In the US, the securities supervision power is in the hand of the federal government, while the insurance supervision power belongs to each state. Thus, the US has a different legislative pattern, the States are supervising insurance, and the federal government is supervising securities. From the perspective of historical evolution, the supervision on the insurance industry by the government started from legislation in various states of America in the mid-19th century when each state established its independent insurance supervision institutions within its territorial boundary.[159] At that time, the acts, including the establishment of insurance companies and the sales of insurance policies, must abide by the Insurance Act of each corresponding state.

However, with the development of the insurance industry, the separate regulations adopted by each state created an obstacle for the insurance companies' business expansion in other states, and disputes arose as a result of this obstacle. Among them, the case of *Paul v. Virginia* is the most influential.

In this case, Paul was a citizen of the State of Virginia, also the agent for several fire insurance companies in the State of New York. According to Virginia's *Insurance Act of 1866*, anyone who runs an insurance business in the state must obtain an insurance business license of the state first; otherwise, he shall not be allowed to carry out any similar business. In order to carry out insurance business in the said state, Paul

[158] See Article 3, 37, and 38 of *Provisions on the Administration of the Solvency of Insurance Companies* (No. 1[2008] of CIRC).

[159] See Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 Florida State University Law Review 625, 630(1999).

submitted corresponding materials following the provisions in the Insurance Act of that state. However, he failed to obtain a business license due to the lack of materials on the guarantee deposit. Despite this, Paul still kept selling insurance in the State of Virginia; eventually, he was prosecuted and fined 50 dollars. Thus, Paul filed a lawsuit against the State of Virginia, believing that it had violated "the citizens of each State shall be entitled to all the privileges and immunities of citizens in the several States" in the US Constitution, as well as "Congress shall have the power to regulate commerce with foreign nations and among the several States."[160] In the end, the Supreme Court of the United States held that "the term citizens as there used applies only to natural persons, members of the body politic, owing allegiance to the State, not to artificial persons created by the legislature, and possessing only the attributes which the legislature has prescribed."[161]

In other words, each state had set forth different rights that can be enjoyed by the companies; if the companies were deemed as citizens, it would contradict the same privileges and immunities invested to the US citizens in each state by the US Constitution in the first place. As to the second claim raised by Paul, the Court held that the Insurance Act of the State of Virginia was established based on the federal constitution; thus, it is valid. Though the Congress enjoys the right to conduct supervision over commercial activities, "issuing a policy of insurance is not a transaction of commerce," for it is not an object to be traded in a market and can not be circulated across various states together with any other commodities. Those policies can not be valid unless they are permitted and sold by the State.[162] Being guided by the Judgment made by the Supreme Court of the United States, insurance is considered as a public interest, and the power to supervise insurance is directly exercised by each state.

After that, under the principle of case law, which is to stand by things decided, this case was followed and further confirmed by subsequent cases. E.g., in *New York Life*

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[160] See *Paul v. Virginia,* 75 U.S. (8 Wall.) 168, 168-170(1868).
[161] See *Paul v. Virginia,* 75 U.S. (8 Wall.) 168, 169 (1868).
[162] "There is, therefore, nothing in the fact that the insurance companies of New York are corporations to impair the force of the argument of counsel. The defect of the argument lies in the character of their business. Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independent of the parties to them. They are not commodities to be shipped or forwarded from one State to another, and then put up for sale." See *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 183(1868).

Ins. Co. v. Deer Lodge County, the Court held that insurance contracts are not commerce at all.[163] Therefore, a pattern where each state supervises insurance on its own was formed in the realm of financial supervision in the US and later was further specified in *the McCarran Ferguson Act of 1945* that the insurance must be supervised under the law of each state.[164] Also, the supervision on insurance by each state has long been effective, unlike the invalid *Blue Sky Act* adopted by each state during the early days.[165] Additionally, the US has formed the nation-wide legislation and supervision on securities after in the 1933 crisis. Thus we say that even to this day, the US has been maintaining a general pattern that the state supervises insurance while the federal government supervises the securities.

Secondly, at the transaction level, differences are found among obligations vested to financial institutions through legislation. Both the US and Japan have specified the fiduciary duty and the suitability principle;[166] however, none of those obligations are established in the fundamental laws of China.[167] The law in the US has established a standard of conduct with a focus on fiduciary duty. For example, in *Kurth v. Van Horn,* based on this, it can be argued that the fiduciary relationship exists between the bank and the customer and the bank, in this case, bears the fiduciary duty.[168] The US

[163] See *New York Life Ins. Co. v. Deer Lodge County*, 231 U.S. 495, 510 (1913).
[164] See 15 U.S.C. § § 1012(a) (1988). Although there is no uniform national insurance law in the US, the National Association of Insurance Commissioners (NAIC) has a significant influence. NAIC is an unofficial organization composed of Insurance Supervisors in American states. In most cases, NAIC plays a significant role in the insurance regulatory system of the US. In particular, some model laws promulgated by NAIC play an important reference role in the insurance laws of American states. If each state adopts it, it can be directly cited as the law of the state. “The history of the NAIC, from its beginning in 1871 to the present, illuminates the tension between state-level regulation and an acknowledged need for uniformity. The NAIC’s central role in the United States system of insurance regulation demonstrates that, for the most part, the states' regulatory apparatus has been unable to function appropriately as individual units because of the complex national and international nature of the insurance industry.” See Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 Florida State University Law Review625, 630 (1999).
[165] The main reasons for the invalidity of the early Blue Sky Act in the United States are as follows: Firstly, government officials lacked some professional staff to check securities information in the early period; Secondly, the state government can not provide sufficient funds to support securities investigation and remedial measures; Thirdly, many states have loosened supervision and attracted some companies in other states to enter his state. Fourthly, most state laws provide that securities on the NYSE are exempted from state regulation because the listing requirements are stricter than state laws, and the state government tried to give securities exemptions on other exchanges. See Howell E. Jackson & Edward L. Symons, Jr., *Regulation of Financial Institutions*, (Beijing: China University of Political Science and Law Press, Chinese translation edition, translated by Wu Zhipan, 2003), pp.634-635.
[166] Although there is a coincidence between the fiduciary duty and the principle of suitability in content, the principle of suitability mainly emphasizes the full disclosure of financial commodity investment risk, and promotes "suitable products" to "qualified customers"; and the fiduciary obligation is not limited to this. The content of the fiduciary duty is open and can not be listed in detail, but it requires the best interests of the beneficiaries to engage in the entrusted matters, including the duty of loyalty and the duty of care. See Robert Cooter, Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 New York University Law Review 1045, 1047 (1991).
[167] Except for the *Trust Law* and *Securities Fund Law*.
[168] The court held that as long as trust existed in the other party and dominated and influenced others, a trusted relationship would arise. See *Kurth v. Van Horn*, 380 N.W.2d 693 (1986).

traditionally distinguishes status between an investment adviser and securities dealer and the adjustment of the relation with customers.[169]

However, the *Dodd-Frank Act* extends the duty of fiduciary into financial institutions, fiduciary duty for brokers and dealers.[170] Namely, all securities dealers or brokers own the fiduciary duty to their customers. Japan's *Financial Instruments and Exchange Act of 2006* has also provided the fiduciary duty of the financial institutions, e.g., the duty of good faith to customers (Article 36), regulation of advertising (Article 37), and best execution policy (Article 40-2). Besides, both the US law and Japan law requires that the seller of financial instruments also has to follow the suitability principle and fully reveals the risks involved. This principle requires the consideration of risk threshold for customers when recommending or selling securities to them and let them decide by themselves whether it is suitable to buy.[171] Article 40 of Japan's *Financial Instruments and Exchange Act of 2006* has stipulated that the traders of financial instruments need to consider those factors about customers, such as indexes, experiences, and property of them, thereby the principle of suitability is established.

Thirdly, at the level of supervision, except for the difference in the distribution of the power to supervise, there are apparent differences among the US, Japan, and China in terms of the principles and concepts of supervision. China currently still adheres to the principle of "separate operation and divided supervision," whereas countries, such as the US and Japan used to adopt this principle as well, but rescinded it in the subsequent amendment. Robert C. Merton, a Nobel Economics Prize winner, proposed the "functional supervision" as a legal response against a backdrop of mixed financial operation, that is, under the mixed operation, the supervision on the financial product should be function-oriented.[172] In *Dodd-Frank Act of 2010*, through implementing a series of measures, such as the establishment of a supervisory committee for financial stability, the formulation of Volcker rule, reform on the supervision over financial derivatives, etc., the US has thus formed a supervision pattern - "dual-layer with multiple authorities," in which not only both the federal government and each state has

[169] Article 206 of the Investment Advisers Act of 1940 stipulates that the legal relationship between an investment advisor and a client is a trusted relationship in the US, while Article 202 (a) (11) (c) of the Act maintains the traditional principal-agent relationship between a securities dealer and a client.

[170] Article 913 (g) of *Dodd-Frank Act.*

[171] See Robert H. Mundheim, *Professional Responsibilities of Broker-Dealers: The Suitability Doctrine*, 1965 Duke Law Journal 445, 449(1965).

[172] See Robert C. Merton, *A Functional Perspective of Financial Intermediation*, 24 Financial Management 23, 23-41(2009).

the supervisory power, but also multiple regulatory agencies are responsible for supervision.

Japan enacted its *Securities Trading Act* in 1948. Article 65 of this law, it stipulates that commercial banks and securities companies shall operate separately, which lays the legal basis for separate operation among the bank and securities industries. In June 1997, the Japanese Ministry of Economy (大蔵省) announced its "financial reform plan" in which it intended to cancel the limit of separate operation required for the financial industry. Also, the early financial supervision system in Japan was centered on the Ministry of Economy (大蔵省) and carried out supervision over all financial institutions. Afterward, in 1998, the country established its Financial Supervision Agency (金融監督庁), which separated the function of supervising non-governmental financial institutions from the Ministry of Economy (大蔵省). In 2000, a number of other steps, such as the authority to file a finance administration case, were removed from the Ministry of Economy (大蔵省), and the Financial Supervision Agency was renamed as the Financial Services Agency (金融庁), thereby a new financial supervision pattern that regards the Financial Service Agency as its core was established.

Fourthly, at the level of private relief, the civil liabilities about insurance in the US, Japan, and China are mainly shown by contractual liabilities. However, for law in the US, if the insurer breaches the contract maliciously, it can also constitute a tort action and will be asked for punitive damages.[173] For the remedy available to civil liabilities about securities, the chief difference between the US and China is the difference between "class action" and "representative action" before 2020. China's *Securities Law* did not introduce the "class action" before 2020 which is found in the US law, but to rely on the "representative action" which is found in its traditional civil procedure law, meaning that a joint litigation in which one party has numerous litigants may be brought by the representatives elected by the litigants of the party.[174] The US attaches importance to private enforcement and relies on "class action" for the civil remedy in the securities. China emphasizes public enforcement, and private relief is obstructed. Thus, there are some differences between the class action and the representative action, and the class action is more conducive to protecting investors.[175]

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[173] See I*ngalls v. Paul Revere Life Insurance Group*, 1997 N.D. 43, 561 N. W. 2d 273 (1997).
[174] See Article 54 of China's *Civil Procedure Law.*
[175] First, the different ways to initiate and participate a lawsuit; "class action" takes the way of "express quit and tacit consent", whereas the "representative action" takes the way of "express participation and tacit objection",

Table. Comparations on financial rules among the US, Japan, and China

<table>
<tr><th colspan="2" rowspan="2"></th><th colspan="3">Insurance rules (Indirect financing)</th><th colspan="3">Securities rules (Direct financing)</th></tr>
<tr><th>US</th><th>Japan</th><th>China</th><th>US</th><th>Japan</th><th>China</th></tr>
<tr><td rowspan="7">General features</td><td rowspan="2">Legislative features</td><td rowspan="2">Lacking a nation-wide unified insurance law, the legislative and regulatory powers of insurance are mainly in the states, but the model law of NAIC has a significant impact on the states.</td><td colspan="2">Japan adopts the “Separation of Civil & Commercial”, while China adopts the “Integration of Civil & Commercial”.</td><td rowspan="2">Before 1933, securities laws are the Blue Sky Laws of each state; after 1933, the US was born the nationwide unified the Securities Law of 1933, the Securities Transaction Law of 1934, etc.</td><td rowspan="2">The rules for financial products with strong-investment in the FIEC is a horizontal and unified law for investor protection. The same kind of financial product applies to the same law. It is an essential reform of the traditional securities law and has a far-reaching significance.</td><td rowspan="2">Securities Law for traditional securities products</td></tr>
<tr><td>Chapter 10 of the Commercial Code of 1890 is the Insurance Contract Law; the Insurance Business Law separately enacted in 1939; the Insurance Law issued in 2008, which separated from the Commercial Code.</td><td>The General Provisions of Civil Law are the General Provisions of Private Law, including the Insurance Law.</td></tr>
<tr><td>Genealogy of law</td><td>The common law system</td><td colspan="2">Both are the civil law system. In terms of external influence, Japan’s Insurance Law is mainly influenced by Germany and France, while China is mainly affected by Taiwan and the Anglo-American legal system.</td><td>The common law system</td><td colspan="2">Japan and China are the civil law system, and their securities laws are mainly affected by the US’s securities laws.</td></tr>
<tr><td>Type of the public or private law</td><td>There is no such division in the US.</td><td colspan="2">The insurance contract law is private law, while the insurance business law is public law.</td><td>There is no such division in the US.</td><td colspan="2">Securities transaction rules mostly belong to private law, and securities supervision mainly belongs to public law.</td></tr>
<tr><td>the main sources of law</td><td>Case laws, the Insurance Law of each state, and the model laws of NAIC, etc.</td><td>The Commercial Code, Insurance Law, Insurance Business Law, etc.</td><td>Insurance Law and CIRC’s regulations</td><td>Case laws, Securities Law of 1933, SEC’s regulations and rules, the blue sky, etc.</td><td>Financial Instruments and Exchange Act, etc.</td><td>Securities Law and CSRC’s regulations</td></tr>
<tr><td>Legislative purposes</td><td colspan="3">Article 1 of Japan’s Insurance Law is the content for the establishment, performance, and alteration of insurance contracts. Its primary purpose is to protect the rights and interests of the parties concerned. There are multiple objectives in American law and Chinese law. In addition to protecting the rights and interests of the parties concerned, they also clearly define the objectives of maintaining market order and promoting economic development.</td><td>Investor protection, fair and orderly market, system risk prevention, etc.</td><td>Contributing to the sound development of the national economy and the protection of investors (Art. 1 of the FIEA)</td><td>Protecting investors, the economic order, and public interests, etc.</td></tr>
<tr><td>Basic principles</td><td colspan="3">Principle of reasonable expectation, insurable interest, indemnity, good faith, and equity, etc. As for the insurable interest of personal insurance, American law mainly lies in the judging “economic interest, Japan's law adopts the doctrine of consensus, and China’s law adopts the doctrine of “relatives” and “consensus”.</td><td colspan="3">The important principles are publicity, information disclosure, and anti-fraud. The fiduciary duty of financial institutions is stipulated in American law and Japanese law, including the principle of suitability.</td></tr>
<tr><td>Transaction rules</td><td>Applicable objects</td><td colspan="3">Insurance law mainly applies to the primary market of insurance, that is, between the issuer of insurance and the buyer of insurance (policyholder and insurer). The secondary market of insurance (reinsurance) is not the focus of the content of insurance law. As for specific</td><td colspan="3">The Securities Act of 1933 in the US applies to the primary market of securities, while the US’s Securities Exchange Act of 1934, Japan’s FIEA, and China’s Securities Law mainly apply to the secondary market of securities, i.e., among investors. The primary market of</td></tr>
</table>

		products, there are many kinds of insurance in American law, such as property insurance, life insurance, health insurance, fire insurance, and liability insurance. Japan and China also have these types of insurances. However, on this basis, Japan also has the division of life insurance and damage insurance (property insurance, accident insurance, and health insurance), while China's insurance mainly divides property insurance and life insurance.			securities (issuer and investor) is not the focus of China's Securities Law. As for specific products, there are more than 30 types of securities in American law; there are also many kinds of financial instruments in Japan, e.g., bonds, stocks, especially the collective investment scheme as a general definition for financial instruments. However, there are only stocks, corporate bonds, government bonds, and investment funds in China's Securities Law.		
	Contracting parties	The insured and insurer	Policyholder and insurer, and the insured and beneficiary as the related parties of the contract.		It involves investors, brokers, intermediaries, and other participants. As for investors, there is no further distinction between investors in China's Securities Law, but Japan classifies investors into general investors and professional investors. The latter includes the specific investors and qualified institutional investors (Art. 34 & 63 of the FIAC).		
	The content of the contract	Although the standard contract is adopted, the three countries pay attention to the substantive fairness of the contract content and incline to protect the vulnerable position of policyholders, e.g., the adverse interpretation to the insurer in the case of dispute about the contract clauses. However, there are some differences. E.g., Article 58 of Japan's Insurance Law stipulates three situations of the insured's the rescission right of contract ("loss of trust relationship"), which China does not have such provisions.			Securities transaction mainly focuses on the concept of openness and publicity so that investors can make a practical judgment on the value of securities. Based on this, the legislation establishes information disclosure, anti-fraud rules, and other supporting rules. What the legislation protects is that investors can purchase securities products with the necessary information to achieve the purpose of fair trading. As for the quality of securities, investors need to make their judgments. In terms of the validity of securities transaction, the legislation adopts the strict externalism, and the real meaning of investors is hardly concerned.		
	Duties of the institution	Fiduciary duty, the obligation to explain, the obligation to pay insurance benefit, etc. (No fiduciary duty in china's Insurance Law)			The duty to disclose, fiduciary duty, etc. (No fiduciary duty in china' Securities Law)		
Supervision rules	Authorities	States, self-regulatory organization	Financial Services Agency	CIRC	SEC, the self-regulatory organization, etc.	Financial Services Agency, Securities and Exchange Surveillance Commission	CSRC
	Forms of organization	Joint-stock Co., Mutual Insurance Co.	Joint-stock Co., Mutual Insurance Co.	Limited liability co., Joint-stock co.	They are mainly joint-stock companies.	Joint-stock company	Limited liability co., Joint-stock co.
	Self-regulatory organization	NAIC	The Life Insurance Association of Japan, The General Insurance Association of Japan	Insurance Association of China	The New York Stock Exchange, NASD, etc.	Self-Regulatory Organization	Securities Association of China
	Regulatory Content	Solvency is the primary task of supervision; the authorities also supervise in terms of access threshold, marketing, and sales, etc.			The authorities mainly regulate information disclosure and the trustee's obligations. The former includes a disclosure at the time of issuance and continuous disclosure; the latter includes the duty of care and duty of loyalty.		
Private (civil) remedy	Limitation of action	The contract parties can negotiate the time, usually for one year.	Three years	Two years	Two years after the discovery of illegal acts, or five years after the violation	Three years or seven years (Art. 20 of the FITC)	Two years
	Civil liability	Civil liability is mainly contractual liability. E.g., if the insurer breaches the contract, the policyholder can claim payment of insurance money and foreseeable loss compensation. However, malicious breach of contract by the insurer can also constitute a tort action, requiring punitive damages in American law.			Civil liability is mainly tort liability, and the US adopts the class action while China adopts the representative action		

2.2.2 China's Laws for Financial Products

In the following paragraph, we will discuss the principles and rules for financial products in China's laws.

2.2.2.1 The common principles: taking "separate operation and divided supervision" as an example for analysis

China's laws have stipulated three major universal principles of financial activities. Firstly, the principles of voluntariness, fairness, and making compensation for the equal value shall be observed. They reflect into the general principles of China's civil law,[176] and the financial laws, e.g., the principle of equality, voluntariness, and compensation, as stipulated in Article 4 of China's *Securities Law.* Secondly, the "good faith" is referred to as the "empire provision" in private law. It is not only the basic principle to the financial activities but also the basis for making legal interpretations or for filling up the loopholes of laws. China's financial laws expressly observe the principle of good faith, e.g., the parties to insurance activities shall follow the principle of good faith in their exercise of rights and performance of obligations.[177]

Thirdly, the principle of "separate operation and divided supervision" should be followed in the financial industry,[178] and the principle has the following three aspects content:

(1) As for the operation of the finance industry, China adopts a strict market access standard by severe approval.[179] They should follow many strict requirements and procedures, e.g., application, approval before the start of business and company registration, etc. For example, an insurance company to be formed shall meet: the insurance company's main shareholders shall have a sustainable capability to make profits, have good credit, have no record of a material violation of laws or regulations in the last three years, and have a net assets value of not less than 200 million yuan.[180]

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[176] Article 3 and 4 of the *General Principles of the Civil Law of the People's Republic of China* has stipulated the principles of voluntariness, fairness and making compensation for equal value; Article 4 and 5 of the *General Rules of the Civil Law of the People's Republic of China* has stipulated the principles of voluntariness and fairness.
[177] See Article 5 of the *Insurance Law.*
[178] Article 43 of the *Law of the People's Republic of China on Commercial Banks,* Article 6 of the *Securities Law of the People's Republic of China*, Article 8 of the *Insurance Law of the People's Republic of China* and Article 7 of the *Measures for the Administration of Trust Companies* has all expressly stipulated and established the principle of "separate operation and divided supervision".
[179] Irrespective of insurance companies, securities companies or the establishment of commercial banks, trust companies or fund companies, what has been adopted by the legislation are all "approval-ism", meaning that they need to be approved by the government or authority.
[180] See Article 68 of the *Insurance Law.*

The applicant shall apply in writing to the CIRC, and submit a written application for formation, a feasibility study report, a formation preparation plan, each investor's business license or other background data, etc.[181]

(2) In the business operation process, financial institutions are all under strict supervision from the corresponding authorities. If there is any large risk in their business operation, some supervision measures might be imposed on them, such as rectification and takeover. For example, where any illegal operation of a securities company or any major risk thereof seriously disturbs the order of the securities market or injures the interests of the relevant investors, the CSRC may take such supervisory measures as suspending its business for rectification, designating any other institution for trusteeship, take-over or cancellation.[182] In terms of the insurance industry, China also takes the principle of prevention and restriction, e.g., the dealing of bankruptcy issues of an insurance company.[183]

(3) The principle of "separate operation and divided supervision" requires the banking, insurance, securities, and trust companies separately establish, and then puts them under the supervision of corresponding authorities. For instance, insurance business shall be run by a lawfully established insurance company or other insurance organizations that are prescribed by laws or administrative laws or regulations. No other entities or individuals can be allowed to run the insurance business,[184] and the CIRC shall carry out the supervision and administration of the insurance industry.[185] As for securities business, it must be run by a company that is approved and established by the CSRC to engage in the business operation of securities, and no other entities or individuals can be allowed to run securities business.[186]

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[181] The establishment of a securities company also abides stringent legal requirements, e.g., Article 124 of the *Securities Law* stipulates that the establishment of a securities company shall meet a number of requirements, e.g., the major shareholders having the ability to make profits continuously, enjoying good credit, and having no irregular or rule-breaking record over the latest 3 years, and its net asset being no less than 0.2 billion yuan.

[182] See Article 153 of the *Securities Law of the People's Republic of China*.

[183] The CIRC pays attention to the supervision over financial status and strengthened supervision over solvency during the business operation of an insurance company. Even if an insurance company has the risk of bankruptcy, supervising party still will do whatever it can do to take measures in helping the insurance company to avoid the risk of bankruptcy. Once an insurance company is lawfully revoked or declared as bankruptcy in accordance with law, the *Insurance Law of the People's Republic of China* will still insist on safeguarding the lawful interests of the insured and keeping the insurance market stable. For example, according to Article 92 of China's *Insurance Law*, where an insurance company which operates life insurance business is abolished or is declared bankrupt, it must assign its life insurance contracts and liability reserve funds to another insurance company which operates life insurance business; where it cannot reach an assignment agreement with another insurance company, the CIRC shall designate an insurance company which operates life insurance business to accept the assignment.

[184] See Article 6 of the *Insurance Law of the People's Republic of China.*

[185] See Article 9 of the *Insurance Law of the People's Republic of China.*

[186] See Article 122 and Article 123 of the *Securities Law of the People's Republic of China*. And, the centralized and

2.2.2.2 Specific rules on financial products in China

China divides the financial industry into four sectors, namely bank, insurance, securities, and trust, with separate legislation for each of them. Also, at the level of legislative technique, China adopts a legislation mode that unifies the law of contracts and supervision, e.g., China's *Insurance Law* includes the law of insurance contracts and the law on the insurance industry.[187] Therefore, specific rules on different financial products show in the corresponding laws (shown in the following table[188]).

Table: the different rules among financial products in China

Business entity	Insurance company	Securities company	Fund company	Trust company	Commercial Bank
Type of product	Insurance products	Securities product	Securities investment fund	Nominal trust product	Bank product (e.g., deposit, loan)
Applicable laws and rules	Insurance Law and the CIRC's regulations	Securities Law and the CSRC's regulations	Securities Investment Fund Law and the CSRC's regulations	Trust Law and the CBRC' regulations	Commercial Bank and the CBRC's regulations
Applicable relationship	(1) Policyholder and insurer; (2) Insurer and CIRC	(1) Investor and issuer; (2) Issuer and CSRC	(1) Fund-holders and Fund-manager; (2) Fund manager, fund custodian, and CSRC	(1) Trustor and trustee; (2) Trustee, custodian, and CBRC	(1) Depositor, lender, and bank; [189] (2) Bank and CBRC
Nature of the private relation	Debtor-creditor relation	Right–interest relation	Right–interest relation	Trust relation	Debtor-creditor relation
Authorities	CBIRC	CSRC	CSRC	CBRC	CBIRC
Applicable principles	Fairness, free will, good faith (Art.11), Insurable interest (Art. 12)	Openness, fairness, and impartiality (Art.3), free will, compensation, good faith (Art.4)	Free will, fairness, good faith (Art.4)	Free will, fairness, good faith (Art.5)	Equality, free will, fairness, good faith (Art.5)
Transaction procedures	the policyholder applies for insurance, and the insurer agrees to underwrite the insurance (Art.13)	Applying for opening a securities account (Art.107), entrusting transaction (Art.106), etc.	A fund contract is formed when an investor pays for the fund shares for which the investor subscribes. (Art.60)	A trust established in the form of trust contract shall come into existence when the contract is concluded. (Art.8)	In granting loans, a commercial bank shall sign a written contract with a borrower. (Art.37)
Contract termination (redemption)	The policyholder has arbitrarily relieved right of contract (Art.15); the insurer has certain statutory right to terminate the contract, e.g., "policyholder maliciously causes an insured	Freedom to buy and sell, but there are any restrictive provisions of laws on the term of transfer, shall not be purchased or sold within the restricted term (Art.42)	Redemption is formed when a fund-share holder files a redemption request, and the redemption takes effect when the fund shares registration institution confirms the redemption. (Art.66)	Any of the causes for termination as prescribed in the trust documents happen; the purposes of the trust have already been realized or cannot be realized at all; etc. (Art.53)	voluntary deposit and free withdrawal (Art. 29)

unified supervision and administration of the national securities market shall be carried out by CSRC. See Article 7 of the *Securities Law of the People's Republic of China*.

[187] The insurance contract law and the insurance business law are set and issued respectively in Japan, while China adopts the model of unified legislation, which was mainly influenced by the "Insurance Law" in Taiwan. The primary purpose of choosing this kind of mode in China is to reflect the two legislative goals of formulating insurance contract and supervising insurance industry at the same time. It provides not only basic protecting the legitimate rights and interests of the policyholder and the insurer but also basic rules for the operation of the insurer. See Wu Dingfu, *Interpretation of Insurance Law of the People's Republic of China*, (Beijing: Chinese Financial & Economic Publishing House, 2009), pp.1-2.

[188] The content of the table is based on the comparison of the fundamental laws such as *Insurance Law, Securities Law, Securities Investment Fund Law, Trust Law, and Commercial Bank Law* in China.

[189] Commercial banks involve many kinds of relationships, such as deposit-loan relationship, intermediary relationship, settlement accounts relationship, and other relationships (e.g., collecting funds, buying, and selling agent). See Shi Tiantao, *Rediscovery of Commercial Relations and Mission of Current Commercial Law*, 6 Tsinghua University Law Journal 136, 144 (2017).

	incident" (Art.27), violation of telling the truth (Art. 16).				
Marketing	unrestricted	Private securities shall not adopt public advertising (Art.9)	Private funds shall not adopt public advertising. (Art.91)[190]	unrestricted	unrestricted
Major rights of purchasers	entitled to claim the insurance money (Art.12)	right to earnings (Art. 25), right to know certain information (Art.23)	Sharing income from fund assets; Exercising their voting rights regarding matters deliberated at the fund-share holders' meeting; etc. (Art.46). Investors can consult or copy some information. (Art.75)	The trustor has the right to know how his trust property is managed and utilized He also has the right to ask the trustee to make explanations. (Art.20)	Commercial banks shall protect the legal rights and interests of the depositors against the encroachment of any entity or individual (Art. 6); paying interest to depositors (Art.29).
Major obligations of purchasers	Telling the truth (Art.16), paying the premium (Art. 14), notifying the insurer when the risk greatly increases (Art.52), reducing losses (Art.57), notifying the insurer after knowing the occurrence of an insured incident (Art.21), etc.	Generally, securities are credentials for rights and interests without civil obligations.	No provision on purchasers' obligations	No provision on trustors' obligations	Obtaining loans by cheating (Art.82)
Major rights of financial institutions	some statutory rights to terminate the contract (Art.16)	An issuer has the right to select a securities company for underwriting at its own will (Art. 27); A securities company may enjoy its right of independent management and its operations shall not interfere. (Art. 130)	Getting the fund management fee (Art.22)	The trustee has the right to get remuneration. (Art.35)	Commercial banks shall carry out business following laws free from any interference by entities or individuals. (Art.4)
Major obligations of financial institutions	The obligation to explain (Art.17), paying indemnity or insurance benefits (Art.10), the obligation of confidentiality (Art 116), bearing the expense of reducing losses (Art.57), etc.	The information as disclosed by issuers and listed companies shall be authentic, accurate and complete and shall not have any false record, misleading statement or major omission. (Art.78); keeping confidential the accounts as open for their clients (Art.41)	The obligations of good faith, prudence, and diligence;(Art.9); the obligations of information disclosure (Art.74)	The trustee shall abide by the provisions of the trust documents and handle the trust affairs for the utmost interests of the beneficiary. The trustee shall fulfill his duties and perform the obligation of being honest, trustworthy and cautious, and managing effectively. (Art.25) paying trust benefits to the beneficiaries (Art.34), etc.	Keeping secret for depositors (Art.29); shall not delay or refuse to pay the principals or interests of the deposits (Art.33), etc.
Beneficiaries	The insurance applicant shall obtain the consent of the insured when designating the beneficiary (Art.39); the insurance money shall be deemed the legacy of the insured when the beneficiaries are unidentified (Art.42)	No provision on the beneficiary	No provision on the beneficiary	The beneficiary enjoys the beneficial right of the trust since the day on which the trust takes effect (Art.44). The beneficial right of the trust of the beneficiary may be transferred and inherited. (Art.48)	No provision on the beneficiary

[190] A non-publicly offered fund shall not raise capital from any entity or individual other than qualified investors and shall not be publicized or promoted to unspecific investors through public media such as newspapers and journals, radio stations, television stations and Internet or in manners such as lectures, seminars and analysis meetings. See Article 91 of *Securities Investment Fund Law of the People's Republic of China (2015 Amendment).*

Compensation mechanism for purchasers	Insurance Security Fund (Art.100)	Securities Investor Protection Fund (Art.126)	setting aside a risk reserve from the fund management remuneration (Art. 22)	No provision	Deposit Insurance [191]
Capital operation and requirements	the principles of solidity and safety (Art.106), setting a guarantee fund at the rate of 20% of its total registered capital (Art.97), the liability reserve funds (Art.98), the provident funds (Art.99), having the minimum solvency (Art.101)	It's prohibited for any unqualified capital to go into the stock market. (Art.59)	Fund assets shall be used for stocks and bonds, and their derivatives. (Art.72) Fund assets shall not be used for the underwriting of securities, Engaging in any investment with unlimited liability, etc. (Art.73)	The trust property must not offset the debt caused by the trustee's inherent property; the trust property of different trustors must not offset each other. (Art.18)	Commercial banks shall work under the principles of safety, fluidity, and efficiency (Art.4)
Forbidden acts	deceiving an insurance applicant, insured or beneficiary; refusing to perform the obligation of paying indemnity or insurance benefits, etc. (Art.116)	Prohibiting inside trading (Art.50); Prohibiting manipulating the securities market (Art.55); Prohibiting fraud (Art.57)	Making any false records, misleading statements or major omissions, etc. (Art.77)	The trustee must not take advantage of the trust property to seek profits for his own. (Art.26)	Bank shall lawfully use its permit for operation. No permit for operation may be forged, altered, transferred, leased or lent. (Art. 26)
Main References	*Insurance Law*	*Securities Law*	*Securities Investment Fund Law*	*Trust Law*	*Commercial Bank Law*
Major common points	(1) Legislative purposes: maintaining the social and economic order and public interest, and promoting the sound development of the economy. (2) Basic principles: equality, free will, fairness, good faith, and"separate operation and divided supervision". (3) As for transaction rules, there all have anti-fraud rules; they all involve multiple legal subjects and intermediary service agencies, etc. (4) In terms of supervision, they all belong to franchise operations and have demanding requirements to access the market, etc. (5) Their legal liability system consists of criminal liability, administrative liability, and civil liability; Besides, the provisions of civil liability and criminal liability are general, while the provisions of administrative liability are detailed, etc.					

2.2.3 Rules Differences between Insurance and Securities Products: Taking China as An Example

2.2.3.1 Special rules in the *Insurance Law*

Insurance Law in China was enacted in June 1995; after that, the law had come through the 2002 Amendment, 2009 Amendment, 2014 Amendment, and 2015 Amendment. The object of the following rules analysis is the existing *Insurance Law,* the *Insurance Law* (2015 Amendment).

2.2.3.1.1 Special principles in the *Insurance Law*

Theoretically, the principles of insurance mainly include the "principle of good faith," the "principle of insurable interests," the "principle of indemnity," the "principle of proximate cause," and the "principle of fairness."[192] However, in the General Provisions of China's *Insurance Law,* only the "principle of legality" (Article 4), the "principle of good faith" (Article 5), and the principle of "separate operation and divided supervision" (Article 8) are expressly provided.[193] Other principles (e.g., the

[191] Commercial banks shall buy deposit insurance under this Regulation. See Article 2 of *Deposit Insurance Regulation*, Order No. 660 of the State Council (2015).
[192] See Zou Hailin, *New Development of Insurance Law*, (Beijing: China Social Sciences Press, 2015), p.53.
[193] In American law, there is usually the doctrine of reasonable expectations; that is, the court should consider what

"principle of insurable interests") show in the specific provisions of the *Insurance Law*. The following principles are principles exclusively found in the *Insurance Law,* but not available in the *Securities Law*.

Firstly, the principle of insurable interests when an insurance contract is concluded. To avoid the moral hazard, an applicant for personal insurance shall, when entering into an insurance contract, have an insurable interest to the insured;[194] The insured in property insurance shall have an insurable interest in the subject matter insured when an insured incident occurs.[195] Otherwise, the contract shall be null and void.[196]

Secondly, the principle of indemnity stresses that the insurance coverage provided from the insurer is only limited to the actual loss incurred to the insured as a result of the insurance accident. In other words, the insured cannot obtain compensation, which is higher than the loss incurred. The limit of the compensation should be at this point that it allows recovery to the status before the insurance accident in question takes place, meaning that the insured cannot obtain any additional benefit ("the amount of insurance benefit is equal to or less than the amount of damage").[197] The insured amount shall not exceed the insurable value. In the case of excess, the excess shall be invalid, and the insurer shall refund the corresponding amount of insurance premium to the insurance applicant.[198] However, this principle only applies to property insurance; it does not apply to personal insurance.[199] The jurisprudence behind it lies in that the life and body involved in personal insurance cannot be measured and calculated by cash amount.

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kind of reasonable expectations for the policyholder in insurance contracts. Although China does not stipulate the principle, it can reflect in some Articles in China's Insurance Law, e.g., the adverse interpretation to the insurer when the contract is doubtful.

[194] See Warnock v. Davis, 104 U.S. 775, 779 (1881). There are apparent differences in personal insurance interests between China and the United States. First, the scope of relatives in China is larger than that in the United States. Secondly, the personal insurance interest in labor relations in the United States is limited between employers and essential employees, but there is no such restriction in China. The identification of personal insurance interests in the United States is mainly based on the economic interest relationship between the insured and the insurer, while it is based on the blood relationship in China. See Li You, *Definition of Meaning and Systematic Position of Personal Insurance Interests*, 6 Political Science and Law 144, 154 (2017).

[195] See Article 12 of *Insurance Law of the People's Republic of China.*

[196] See Article 31 of *Insurance Law of the People's Republic of China.*

[197] The total indemnity paid by all insurers in overlapping insurance shall not exceed the insurable value. Each insurer shall be liable to pay indemnity according to the proportion between its insured amount and the total insured amount, except as otherwise provided for by the contract. See Article 56 of *Insurance Law of the People's Republic of China.*

[198] See Article 55 of *Insurance Law of the People's Republic of China.*

[199] For the occurrence of an insured incident such as death, injury, disability or illness caused to the insured by the conduct of a third party, after the insurer pays insurance money to the insured or beneficiary, the insurer shall have no right to recover the money from the third party, but the insured or beneficiary shall still have the right to claim compensation against the third party. See Article 46 of *Insurance Law of the People's Republic of China.*

Thirdly, the principle of proximate cause used in determining the causal relationship between the cause of an insurance accident and the damages. It is the prepositive procedure that leads to paying insurance benefit by the insurer, other than the rule used to determine causal relation in a case where the general civil liability is involved.[200] After an insured incident occurs, the insurance applicant, insured, or beneficiary claiming indemnity or insurance benefits against the insurer under the insurance contract shall provide the insurer with all available certificates and materials related to the determination of the nature, cause, degree of damage, etc. of the incident.[201] If a single reason causes the damage, it is relatively straightforward for us to determine the cause of an insurance accident. However, if there are multiple reasons, we will determine the real cause of an insurance accident according to the principle of proximate cause.[202] It requires the policyholder to provide the proof,[203] which is to prove the causal relationship existing between "the cause of the insurance accident, the extent of damage" and covered loss.

2.2.3.1.2 Special transaction rules in the *Insurance Law*

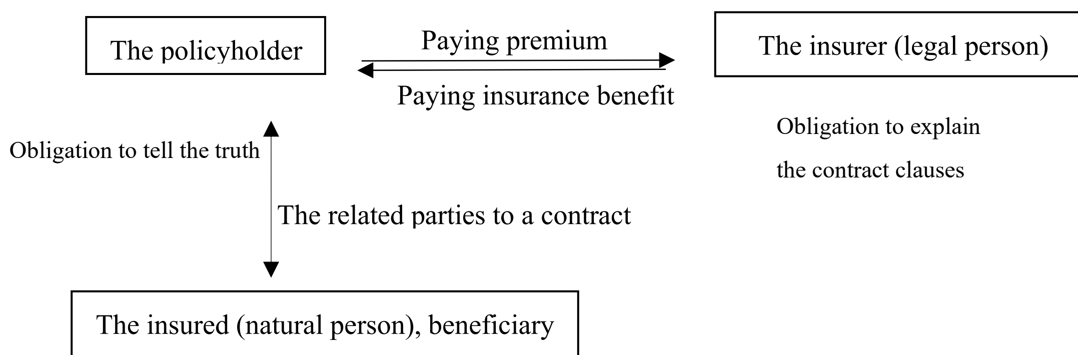
Comparing with China's *Securities Law*, the transaction rules, as found in the *Insurance Law,* mainly show the following particularities.

Firstly, as for the subject of the insurance contract, an insurance contract is an agreement in which the rights and obligations concerning the said insurance are agreed between the policyholder and the insurer.[204] The parties concerned in an insurance contract are the policyholder and the insurer, which is different from the Anglo-American law system in which the contract subjects are the insurer and the insured. The insured and the beneficiary under China's *Insurance Law* are related parties to a contract. Take the personal insurance contract depicted in the *Insurance Law* as an example; the following figure is the basic structure of an insurance transaction. It is worth noting that personal insurance shall be a type of insurance that takes the life and

[200] The rule of presumption of causality is generally adopted in the civil liability of securities law, namely, "fraud on the market theory". For example, Article 19 & 21 of the *Financial Instruments and Exchange Act*; Article 18 of *Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market* (Legal Interpretations No. 2[2003]).
[201] See Article 22 of *Insurance Law of the People's Republic of China.*
[202] In many kinds of proximate causes, the main and key causes are usually used as the criteria for judging in China. This rule is also adopted in the US. See *Lynn Gas & Electric Co. v. Meriden Fire Insurance Co.*, 33 N.E. 690, 692 (Mass. 1893).
[203] Article 64 of China's *Civil Procedural Law* provides that the one who claims shall be the one obliged to produce proof.
[204] See Article 10 of the *Insurance Law.*

body of human beings as the subject matter insured.[205] In this sense, a legal person is an essential subject of private law created by the law; hence, it bears no biological characteristics that come with a natural person, such as the lifespan. It is also an indication that the insured of personal insurance is limited to natural persons, excluding legal persons, while the insurer has to be a legal person rather than an individual.

Figure. The relationships under an insurance contract



Secondly, in terms of the formation of an insurance contract, the legislation has exerted strict control over the moral risk of an insurance contract, e.g., the requirements on insurable interests.[206] If an insurance contract takes death as the condition for payment of insurance money, and the insured has not consented and recognized the insured amount, the contract shall be null and void.[207] In practice, in concluding an insurance contract, a policyholder has a hesitation period (e.g., ten days), so does the insurer (e.g., ten days). [208] There are no such features in the formation of a securities contract.

Thirdly, the rights and obligations of an insurance contract. The *Insurance Law* has not expressly stipulated too many provisions on the rights between subjects of the insurance contract. This fact mainly shows in the followings: the policyholder, the insured and the beneficiary have the right to claim insurance benefit when an insurance accident takes place and the right to terminate the contract arbitrarily,[209] and those

205 See Article 12 of the *Insurance Law*.
206 See Article 12 of the *Insurance Law*.
207 See Article 34 of *Insurance Law of the People's Republic of China*.
208 In American law, there is usually a ten-day period of hesitation for the insured in an insurance contract. See Neb. Rev. Stat. 44-32. 130 (2001).
209 See Article 12 & 15 of China's *Insurance Law*. The policyholder has the right to arbitrary termination of an insurance contract. There are some reasons as follows. It is difficult for the policyholder to realize the occurrence probability of insurance accident fully. It is also difficult to know whether the insurance benefit can satisfy the need for risk diversification. Therefore, the policyholder should be granted the right that not to be bound by the contract, and have a chance to cancel the contract at any time. See Chang Min, *Insurance Law*, (Beijing: Law Press, 2012), pp.79-80.

provisions involving "waiver" and "estoppel."[210] The rights of the insurer are those circumstances in which it shall have the right to terminate the contract, e.g., in the event where the policyholder fails to perform its obligation of telling the truth (the duty to inform),[211] intentionally committing insurance fraud or causing an insured incident.[212]

In terms of the significant obligations of an insurance contract, the *Insurance Law* has expressly specified the different obligations between a policyholder and an insurer. Significant obligations of the policyholders are the following. (1) The obligation to pay a premium.[213] The policyholder may pay an insurance premium to an insurer in a lump sum or installments as agreed upon in the insurance contract.[214] In case the policyholder fails to pay the premium on time,[215] it may likely cause adverse legal consequences, such as the suspension of the contractual effect or the reduction of insurance benefit.[216] (2) The obligation of telling the truth; Where the insurer inquiries about the subject-matter insured or about the insured when entering into an insurance contract, the insurance applicant shall tell the truth.[217] (3) After knowing the occurrence of an insured incident, the insurance applicant, insured, or beneficiary shall notify the insurer promptly. Where the insurance applicant, insured or beneficiary fails to do so intentionally or for gross negligence, which makes it difficult to determine the nature, cause, degree of damage, etc. of the insured incident, the insurer need not pay indemnity or insurance benefits for the undeterminable part.[218] (4) The notification obligation in case of increased danger. Where the degree of the peril of the subject

210 According to Article 16 of China's *Insurance Law*, if the insurer knows the truth which the insurance applicant fails to tell when they enter into an insurance contract, the insurer shall not rescind the contract; and if an insured incident occurs, the insurer shall pay indemnity or insurance benefits. This is called "waive" and "estoppel" in American law. When the insurer has reason to cancel the policy, it expressly or implicitly voluntarily waives this right. Namely, the policyholder continues to pay the premium and trusts that the insurance benefit can be paid. The insurer will lose the right to defense at this circumstance. See John F. Dobbyn, *Insurance Law*, (Beijing: Law Press, Chinese translation edition, translated by Liang Peng, 2008), p.212, 217.

211 See Article 16 of *Insurance Law of the People's Republic of China.*

212 See Article 27 of *Insurance Law of the People's Republic of China.*

213 After an insurance contract is formed, the insurance applicant shall pay an insurance premium as agreed upon, and the insurer shall start to assume the insurance liability from the time as agreed upon. See Article 14 of *Insurance Law of the People's Republic of China.*

214 See Article 35 of *Insurance Law of the People's Republic of China.*

215 Under American law, the subject of an insurance contract is the insured and the insurer. The insured shall bear the obligation to pay the premium.

216 If the insurance applicant fails to pay the current installment of the insurance premium beyond 30 days after the day when the insurer sends a payment notice or beyond 60 days after the day as agreed upon, the validity of the contract shall be suspended, or the insurer may reduce the insured amount according to the contract, except as otherwise provided for by the contract. See Article 36 of *Insurance Law of the People's Republic of China.* By contrast, the grace period in American law is usually set at 30 or 31 days. See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), p. 269.

217 See Article 16 of *Insurance Law of the People's Republic of China.*

218 See Article 21 of *Insurance Law of the People's Republic of China.*

matter insured dramatically increases during the term of validity of the contract, the insured shall notify the insurer promptly as agreed upon in the contract, and the insurer may increase the insurance premium or rescind the contract as agreed upon in the contract.[219] (5) The obligation to rescue. When an insured incident occurs, the insured shall endeavor to take necessary measures to prevent or reduce losses.[220]

Significant obligations of the insurer are the following. (1) The obligation to explain. Where an insurance contract is concluded using the standard clauses of the insurer, the insurer shall provide an insurance policy with the standard clauses attached and explain the contents of the contract to the insurance applicant. If the insurer fails to make a warning or express explanation, those clauses shall be invalid.[221] (2) The obligation to pay insurance benefit - the most dominant obligation bearable by the insurer, and also serves the policyholder's purpose of signing an insurance contract.[222] (3) The obligation to assume necessary and reasonable expense, which mainly includes the rescue cost and the loss-survey charge.[223] (4) The insurer shall issue an insurance policy or any other insurance certificate to the insurance applicant promptly.[224] (5) The duty of confidentiality. Insurance companies and their staff shall be prohibited from divulging any trade secret of an insurance applicant or insured known in the process of business activity.[225]

Fourthly, the *Insurance Law* has stipulated some special clauses about the Insurance Contract, but none of them are found in the *Securities Law*. For example, the

[219] Where the insured fails to perform the notification obligation prescribed in the preceding paragraph and an insured incident occurs because the degree of peril of the subject matter insured greatly increases, the insurer shall not be liable to pay indemnity. See Article 52 of *Insurance Law of the People's Republic of China.*
[220] The necessary and reasonable expenses paid by the insured for preventing or reducing losses to the subject matter insured after the insured incident occurs shall be at the expense of the insurer. See Article 57 of *Insurance Law of the People's Republic of China.*
[221] See Article 17 of *Insurance Law of the People's Republic of China.*
[222] See Article 10 of *Insurance Law of the People's Republic of China.*
[223] The necessary and reasonable expenses paid by the insured for preventing or reducing losses to the subject matter insured after the insured incident occurs shall be at the expense of the insurer. The amount of such expenses shall be calculated separately from the indemnity for losses to the subject matter insured, and shall not exceed the insured amount. See Article 57 of *Insurance Law of the People's Republic of China.*
[224] See Article 13 of *Insurance Law of the People's Republic of China.*
[225] See Article 116 of *Insurance Law of the People's Republic of China.*

incontestable clause,[226] the false age clause,[227] the grace period clause,[228] the reinstatement clause,[229] the suicide clause,[230] and the cash value clause.[231]

2.2.3.1.3 Special supervision rules in the *Insurance Law*

For the prevention of the risk involved in insurance operations and also for the protection of the lawful interests of the policyholder, the insured and the beneficiary, the *Insurance Law* mainly carries out its supervision from the following several aspects.

Firstly, China has put forward stringent requirements on the solvency of the insurer. In order to strengthen the solvency, the *Insurance Law* has proposed some statutory requirements on those aspects, including the paid-in registered capital and the guarantee funds. In terms of the registered capital, the appropriate amount of capital is an essential factor of an insurance company's solvency. The minimum amount of the registered capital of an insurance company is RMB 200 million, and the CIRC may adjust the minimum amount of the registered capital of an insurance company according to the business scope or scale of the insurance company, but the amount shall not be less than the minimum amount of 200 million yuan.[232] Besides that, the registered capital of an insurance company must be paid-in monetary capital.[233] As for the guarantee funds, through the statutory requirement of depositing a certain amount of guarantee funds, it can ensure that the insurer is always in possession of a certain amount of "actual capital". An insurance company shall set aside a guarantee fund at the rate of 20% of its total registered capital, deposit it with a bank designated by the CIRC, and use it for no

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[226] E.g., if the insurer knows the truth which the insurance applicant fails to tell when they enter into an insurance contract, the insurer shall not rescind the contract; and if an insured incident occurs, the insurer shall pay indemnity or insurance benefits. See Article 16 of *Insurance Law of the People's Republic of China.*

[227] Where the insurance applicant falsely declares the age of the insured and the real age of the insured fails to meet the age requirement in the insurance contract, the insurer may rescind the contract, and refund the cash value of the insurance policy as agreed upon in the contract. An insurer's exercise of the right to rescind an insurance contract shall be subject to paragraphs 3 and 6 of Article 16 of this Law. See Article 32 of *Insurance Law of the People's Republic of China.*

[228] The grace period is 30 days or 60 days. See Article 36 of *Insurance Law of the People's Republic of China.*

[229] Where the validity of an insurance contract is suspended, the validity of the contract may resume after the insurer and insurance applicant reach an agreement upon consultation and the insurance applicant makes up the underpaid insurance premium. See Article 37 of *Insurance Law of the People's Republic of China.*

[230] Where the insured in a contract which takes death as the condition for paying insurance money commits suicide within two years after the contract is formed or the validity of the contract resumes, the insurer shall not be liable to pay insurance money, unless the insured is a person without the civil conduct capacity at the time of suicide. See Article 44 of *Insurance Law of the People's Republic of China.*

[231] Where the insurance applicant rescinds the contract, the insurer shall refund the cash value of the insurance policy as agreed upon in the contract within 30 days from the day of receipt of the notice of contract rescission. See Article 47 of *Insurance Law of the People's Republic of China.*

[232] See Article 69 of China's *Insurance Law.*

[233] When China's *Company Law* amended in 2013, the registered capital is adopted for ordinary companies. However, the paid-in registered capital is still implemented in some particular industries, such as insurance, securities.

purpose other than repayment of debts at the time of liquidation of the company.[234] Also, the insurance companies shall set aside various liability reserve funds,[235] should set aside provident funds,[236] shall pay contributions to the insurance security fund.[237] All those measures are the supportive mechanisms formulated in order to strengthen the solvency of the insurance companies. If there is a risk to its solvency, the CIRC takes measures including ordering an increase of capital or reinsurance, limiting the scope of the business, and restricting the payment of dividends to shareholders according to the actual circumstances.[238] Where an insurance company seriously fails to meet the solvency requirements, the CIRS may take–over it.[239]

Secondly, the restriction of the liability for risk self-retention.[240] The self-retained insurance premium in the current year of an insurance company which operates property insurance business shall not exceed four times the sum of its "actual capital" and provident funds.[241] However, this is not the case for an insurance company who runs a personal insurance business because there is a regular rule on the occurrence of insurance accidents for personal insurance; hence, its risk forecast is relatively accurate. The occurrence of an insurance accident for property insurance is irregular and lacks stability; therefore, the amount of reserve funds for property insurance is larger than that for personal insurance in general.[242]

Thirdly, reinsurance is also the way for the insurer to diversify their business risks. The liability assumed by an insurance company for each risk unit, namely, the maximum loss caused by a single insured incident, shall not exceed 10 percent of the sum of its actual capital and provident funds. The insurer shall reinsure the excess part.[243]

Fourth, Insurance companies must use funds according to the principles of solidity and safety. They may only use their funds in the following forms: (1) Bank deposits. (2)

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234 See Article 97 of China's *Insurance Law.*
235 See Article 98 of China's *Insurance Law.*
236 See Article 99 of China's *Insurance Law.*
237 See Article 100 of China's *Insurance Law.*
238 See Article 143 of China's *Insurance Law.*
239 See Article 144 of China's *Insurance Law.*
240 See Qin Youtu & Fan Qirong, *Insurance Law*, (Beijing: Higher Education Press, 2003), p.435.
241 See Article 102 of China's *Insurance Law.*
242 Risk self-retention refers to the limit of liability assumed by an insurance company among the total sum insured for a "risk unit" of a particular type of insurance, which is the limit of liability compensable by an insurance company. See Qin Youtu & Fan Qirong, *Insurance Law*, (Beijing: Higher Education Press, 2003), p.436.
243 See Article 103 of *Insurance Law of the People's Republic of China.*

Trading in bonds, stocks, shares of securities investment funds, and other negotiable securities. (3) Investment in real estate.[244]

2.2.3.2 Special rules in the *Securities Law*

China's *Securities Law* issued in December 1998; after that, the law had come through the 2004 Amendment, the 2005 Amendment, the 2013 Amendment, the 2014 Amendment, and the 2019 Amendment.

As we have discussed in the previous paragraph, securities, as a pattern of direct financing, the rules found in China's *Securities Law* is to protect investors by advocating the philosophy of information disclosure. Therefore, specific rules of the *Securities Law* are set forth with a focus on information disclosure. For example, Article 3 of the *Securities Law* is the publicity principles, which are that the issuance of securities and its trading activities must adopt the principles of openness, fairness, and impartiality. By "forcing" the issuer to disclose relevant information, including the public issuance and information disclosure after such issuance, the *Securities Law* allows the investors to identify the value of securities, such as the stocks and bonds of a corporation on its own, thereby making their decisions on whether or not to buy them.[245]

2.2.3.2.1 Special transaction rules in the *Securities Law*

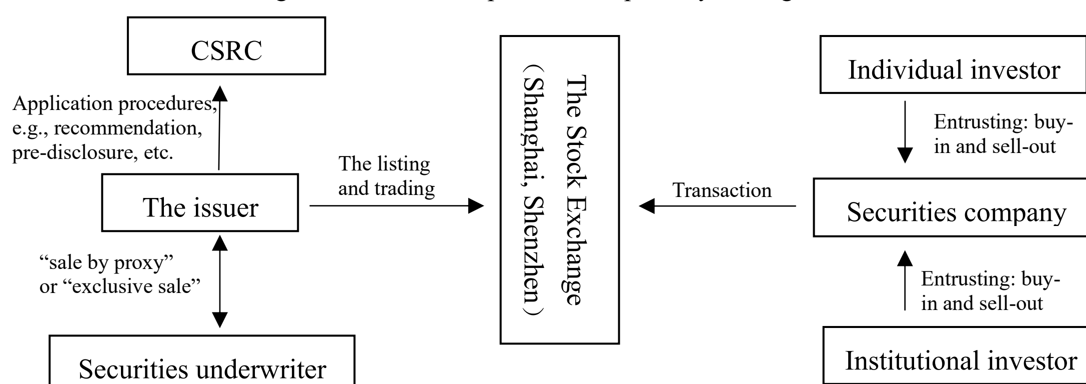
The stock transaction in the listed companies is the most symbolic acts of the securities transaction. The following is a picture describing the model of the transaction and its relations in the stock market. The transaction relations are relatively complex, as being different from insurance transactions, e.g., the investors have to entrust a securities company by an agent, not allowed to trade directly with each other. Thus, the transaction involves various legal subjects, e.g., issuers, investors, the Securities Exchange, and securities dealers, etc. The investors include not only the natural person but also the legal person. Besides, there exist certain restrictions on the investment qualification of those purchasers in certain circumstances under the *Securities law* and the *Securities Investment Fund Law*.[246]

[244] See Article 106 of *Insurance Law of the People's Republic of China.*

[245] In the issuance of government bonds, the *Securities Law* exempts them from the obligation of information disclosure. The reasons are that government bonds are based on the credibility of the government and take government finance as the payment guarantee.

[246] E.g., the practitioners in stock exchanges, securities companies and securities registration and clearing institutions, the functionary of securities regulatory bodies, as well as any other personnel who have been prohibited

Figure. the relationships under the publicly trading of stocks



Firstly, there are special provisions for the forms and the places of the securities exchange. In terms of the form, Article 39 still adopts a traditional expression, which is that the securities as purchased or sold by the parties involved in securities trading may be in paper form.[247] However, in practice, both the Shanghai Stock Exchange and Shenzhen Stock Exchange have realized the paperless securities trading, which is to establish an individual securities account at a securities company and open a capital account at a bank. Also, the *Securities Law* has made special provisions on the trading place of securities. Based on the specific trading place, the securities trading divides into the "transaction on exchange" and the "curb exchange." "Transaction on exchange" occurs in a place where securities transactions are carried out generally by public and centralized biding,[248] whereas the "curb exchange" is mainly targeted at unlisted securities transactions.[249] Thus, there are strict restrictions on the trading places of the securities, which is different from the transactions of insurance products.

Secondly, the securities trading procedure is quite complicated, especially the case for the securities trading procedure of listed companies. In general, investors need to observe the following necessary procedures: (1) Establishing an account; An investor

by any law or administrative regulation from engaging in any stock trading shall not, within their tenures or the relevant statutory term, hold or purchase or sell any stock directly or in any assumed name or in the name of any other person, nor may they accept any stocks from any other person as a present. See Article 43 of *Securities Law of the People's Republic of China.*

[247] The securities as purchased or sold by the parties involved in securities trading may be in paper form or in any other form as approval by the CSRC. See Article 39 of *Securities Law of the People's Republic of China.*

[248] In the block trading, it adopts the negotiation price, that is, "one-to-one" trading mode. For example, trading of securities on the Shenzhen Stock Exchange may be conducted by block trading if the conditions are met, e.g., for a single A-share trade, the trading volume is not less than 300,000 shares, or the trading value is not less than two million yuan. See Section 6 "Block Trading" of *Trading Rules of the Shenzhen Stock Exchange* (No. 138 [2016] of the SSE).

[249] The securities market in American law includes the market in the field and over-the-counter (OTC) market, such as the New York Stock Exchange (large mature enterprises), Nasdaq market (growth enterprises), regional exchanges and electronic exchanges, information bulletin exchanges, and local over-the-counter markets.

who entrusts a securities company to undertake any securities trading shall apply for opening a securities account. A securities registration and clearing institution shall open the securities account for the investor in his name.[250] (2) Entrusting transaction; An investor shall conclude an entrustment agreement with a securities company on securities trading, open a securities trading account in a securities company and entrust the securities company, in written form, by telephone or any other means, to purchase or sell securities on its behalf.[251] (3) The principle of "giving priority to price and time" is followed to match trading automatically; (4) The liquidation and capital settlement procedure.[252]

Thirdly, the rights and obligations involved in securities transactions. The transaction relation under the *Securities Law* has mainly reflected a kind of equity relation. Investors shall enjoy the right to earnings and management rights. The former refers to the right to return on assets, which mainly includes profit distribution, appreciation, and participation in the distribution of the remaining property. The latter refers to taking part in making important decisions and the right to vote for managerial affairs, e.g., the vote of managers. As for the obligations, the *Securities Law* has not set forth fiduciary duty, but chiefly stressed the obligation of information disclosure on the part of those subjects, including the issuers, as well as the prohibited acts for them.[253] For example, *Securities Law* in China has made relatively detailed provisions on information disclosure to be performed by listed companies as follows. (1) The information as disclosed by issuers and listed companies according to law shall be authentic, accurate, and complete and shall not have any false record, misleading statement, or major omission.[254] (2) Directors, supervisors, and senior managers of a listed company shall guarantee the authenticity, accuracy, and integrity of the information as disclosed by the listed company.[255] If the information has any false record, misleading statement or major omission, the directors, supervisors and senior managers of a listed company, together with the issuer or the listed company shall take several and joint liabilities of compensation, unless he or she can prove that he or she has no fault therein.[256] (3) The content of information disclosure involves the advance,

[250] See Article 106 & 107 of *Securities Law of the People's Republic of China.*
[251] See Article 108 of *Securities Law of the People's Republic of China.*
[252] See Article 108 of *Securities Law of the People's Republic of China.*
[253] "Authority to establish a fiduciary duty for brokers and dealers". See Section 913 (g) of the *Dodd-Frank Act.*
[254] See Article 78 of *Securities Law of the People's Republic of China.*
[255] See Article 82 of *Securities Law of the People's Republic of China.*
[256] See Article 85 of *Securities Law of the People's Republic of China.*

ongoing, and afterward circumstances. For example, the stocks (publicly issued) or the corporate bonds (publicly issued), the information includes financial statements, midterm report, annual report,[257] temporary reports on the major event occurred.[258] (4) Some acts in violation of the "publicity principle" are expressly forbidden, such as insider trading,[259] the manipulating the securities market,[260] and the fraudulent acts.[261]

Likewise, for securities dealers, a securities company that engages in the underwriting of securities shall carry out verification on the authenticity, accuracy, and integrity of the financing documents of public issuance.[262] For the securities broker, a securities company shall not make any promise to its clients on the proceeds as generated from securities trading or on compensating the loss as incurred from securities trading by any means.[263] Also, in order to prevent any interest conflict between different businesses and to improve the internal control system, a securities company shall undertake its operations of securities brokerage, underwriting, self-operation, and asset management individually and may not mix them up.[264]

2.2.3.2.2 Special supervision rules in the *Securities Law*

The doctrine of supervision adopted by the *Securities Law* in carrying out the supervision over securities is mainly around the public disclosure of information, and its emphasis is different from the supervision on solvency as it is in the case of insurance. Apart from the information disclosure, the *Securities Law* has also formulated strict provisions on the aspects of issuance.

Firstly, regarding the issuance of securities, the *Securities Law* has stringent requirements on those aspects, including the condition and the procedure. Securities are issued in the form of direct financing – selling securities products to investors. Because securities, as a voucher proving the rights and obligations between the issuer and the investor, represents a kind of credit, in order to protect the interests of those investors

[257] See Article 79 of *Securities Law of the People's Republic of China.*
[258] See Article 81 of *Securities Law of the People's Republic of China.*
[259] See Article 50 of *Securities Law of the People's Republic of China.*
[260] See Article 55 of *Securities Law of the People's Republic of China.*
[261] See Article 56 of *Securities Law of the People's Republic of China.*
[262] See Article 19 of *Securities Law of the People's Republic of China.*
[263] See Article 135 of *Securities Law of the People's Republic of China.*
[264] See Article 128 of *Securities Law of the People's Republic of China.*

and for maintaining the order of the securities market, the law requires the availability of some conditions for issuing securities publicly.[265]

For example, if it is an initial public offering (IPO) of stocks by an issuer, it then requires the issuer to have a complete and well-operated organization, the capability of making profits continuously, a sound financial status, no false record in its financial statements over the latest three years and no other significant irregularity either, etc.[266] It further requires the company to submit the resolution of the general assembly of shareholders, the prospectus, the financial statements, the name and address of the bank that receives the funds as generated from the public offering of stocks on behalf of the company, the name of the underwriting institution as well as the relevant agreements, etc.[267]

Secondly, in the case of public issuance of securities by an issuer, it shall be underwritten by a securities company.[268] Article 28 stipulates two ways of underwriting, namely "sale by proxy" (an entrustment relation) and "exclusive sale" (a sales relation).[269] The term for sale by proxy or exclusive sale shall not exceed more than 90 days.[270] Where a securities company engages in the business of underwriting securities, it needs to meet certain legal conditions, which is that its bottom-line registered capital shall be RMB 500 million yuan.[271]

Thirdly, the public issuance and listing of securities have to go through the procedures for inquiry and approval, which is carried out by the CSRC. Generally, the first step should be a recommendation, declaration, and pre-disclosure procedures. The insurer should prepare application documents, hire an institution with the qualification of recommendation as to its recommender,[272] and let the recommender recommend and declare to the CSRC.[273] After the submission of the application documents, the

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[265] It shall be deemed as a public issuance under any of the following circumstances: (1) Making a public issuance of securities towards unspecified objects; (2) Making a public issuance of securities to accumulatively more than 200 specified objects. See Article 9 of *Securities Law of the People's Republic of China.*

[266] See Article 12 of *Securities Law of the People's Republic of China.*

[267] See Article 13 of *Securities Law of the People's Republic of China.*

[268] See Article 27 of *Securities Law of the People's Republic of China.*

[269] Based on whether the underwriter bears the risk of issuance, the underwriting is divided into two types: "sale by proxy" or "exclusive sale" in China. There are many ways of securities sales in American law, such as underwriting, consignment, bidding, etc. See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.55.

[270] See Article 31 of *Securities Law of the People's Republic of China.*

[271] See Article 120 of *Securities Law of the People's Republic of China.*

[272] See Article 16 of *Securities Law of the People's Republic of China.*

[273] See Article 33 of *Measures for the Administration of Initial Public Offering and Listing of Stocks* (Order No. 141 [2015] of CSRC).

company should also pre-disclose relevant application documents. The second step is CSRC's acceptance of such application, the initial review of such application, and sending such application to review committee for their review. Upon receipt of such an application document by CSRC, it shall decide on whether or not they will accept that application within five working days.[274] Upon the application documents are accepted, the Issuance Supervision Department of the CSRC shall carry out an initial review on the application documents received from the issuer, and then the Issuance Review Committee shall review it again. The third step should be the examination and approval procedure. The CSRC shall, within three months as of accepting an application for securities issuance, decide on approval or disapproval according to the statutory requirements and procedures.[275] Once the application is approved,[276] the issuer should issue stocks within six months. Otherwise, the approval document will be invalid and has to be re-approved by the CSRC before issuing stocks.[277]

2.2.4 Differences between Legislative Purposes: Taking the Protection of Product Purchasers as An Example

What is behind legal provisions is a reflection of the legislative purpose. A law usually has multiple normative goals. For example, Article 1 of both the *Insurance Law* and the *Securities Law* has multiple purposes, e.g., "regulating the acts of the parties concerned," "safeguarding the economic order and public interests of the society," "promoting the economic development," "protecting the lawful rights and interests of the parties concerned," etc. (See below table)

Table: Legislation Purposes of the *Insurance Law* and *Securities Law*

	Insurance Law	*Securities Law* [278]
Article 1: Legislative Purpose	(1) regulating insurance-related acts; (2) protecting the lawful rights and interests of the parties concerned in insurance-related acts; (3) strengthen the supervision and management on insurance industry; (4) safeguarding the economic order and public interests of the society; (5) promoting the healthy development of the insurance business.	(1) regulating the issuance of securities and transaction acts; (2) protecting the lawful interests of the investors; (3) safeguarding the economic order and public interests of the society; (4) promoting the development of the socialist market economy.

[274] See Article 34 of *Measures for the Administration of Initial Public Offering and Listing of Stocks* (Order No. 141 [2015] of CSRC).
[275] See Article 24 of *Securities Law of the People's Republic of China.*
[276] In the case of disapproval for stock issuance, an issuer may, 6 months after the CSRC makes a decision on disapproval, file again an application for stock issuance. See Article 39 of *Measures for the Administration of Initial Public Offering and Listing of Stocks* (No. 122 of the CSRC).
[277] See Article 37 of *Measures for the Administration of Initial Public Offering and Listing of Stocks* (No. 122 of the CSRC).
[278] The legislative purposes in the US include investor protection, fair and orderly markets, control of systemin risk, and competition.

Among those multiple purposes mentioned above, "regulating insurance-related acts" or "regulating the issuance of securities and transaction acts" are differences arising out the different objects to be regulated. As for purposes, such as "safeguarding the economic order and public interests of the society" and "promoting economic development", they should be included into the two laws since they serve the role of the two laws in adjusting the effects of both the insurance industry and the securities industry on economic development of the nation. The primary purpose of the two laws in China lies in the protection of the lawful rights and interests of the product purchasers.[279] However, in terms of protecting the lawful rights and interests of the securities investors and policyholders, the two laws have different ideas and approaches.

2.2.4.1 Differences between the ideas and methods of protecting product purchasers

Under a securities transaction of the second market, the subjects of a contract are generally among investors, not between investors and issuers. Investors only enjoy rights, but not along with the obligations. Because the securities itself is merely a voucher of equity representing the rights and interests (without obligations) "carried" by it. So, the transfer of securities right owned by an investor is considered as a disposition of its right; thus, it can be transferred to the counterpart of a transaction without the need to obtain a promise from the insurer. This characteristic is different from the transfer of other civil rights.[280] For example, under the *Insurance Law*, if the subject matter insured is assigned, the insured or the assignee shall notify the insurer promptly.[281] Therefore, there exist some differences in the transfers between the securities and insurance, and the difference is a reflection of the characteristic of liquidity owned by securities. Because securities are the standardized voucher of equity with an equal nominal amount on every security, so does the equity being represented by it. Thus, it is replaceable and trading the unspecified investors, involving a lot of buyers and sellers who have such securities, which further forms a "many-to-many" mode for the trading of securities through centralized competitive bidding in the securities market.

[279] One of the purposes is "protecting the lawful rights and interests of the parties concerned in insurance-related acts" in China's Insurance Law. According to this, the expression "the parties concerned in insurance-related acts" contain broad subjects, such as the policyholder, the insured, beneficiary, the insurer, and assistants (e.g., agent, broker, etc.). In other words, the legislative purpose does not emphasize the inclining protecting the policyholder's right and interests because the contract parties are equal as the contractual relationship. However, many specific rules have shown the concept of inclining protection to the policyholder, e.g., the adverse interpretation to the insurer.

[280] Where the obligee assigns its rights, it shall notify the obligor. Such assignment will have no effect on the obligor without notice thereof. See Article 80 of *Contract Law of the People's Republic of China*.

[281] See Article 49 of *Insurance Law of the People's Republic of China.*

However, the insurance contract carries the rights and obligations between the policyholder and the insurer. Although the transaction adopts a standard form of contract, it is not a standardized voucher of equity. The rights and obligations under the contract have to be agreed between the policyholder and the insurer through negotiation, especially the obligations in the contract since its realization depends on the performance of the counterpart of the contract; otherwise, the rights under the contract are unable to be realized. In this sense, those rights and obligations are differentiated ones, e.g., a different premium may be paid or charged because of different dangerous conditions to the subject-matter of the insurance. The rights and obligations can not transfer in a standard form to any other people in the society. As a result, the insurance transactions are usually required to take the form of "one to one." Namely, the liquidity of insurance product restricts by its specific factors. Also, personal insurance is generally with a long term, which may last ten years, 15 years or even throughout one's lifetime. Though the policyholder has the right to terminate the personal insurance contract arbitrarily, there is usually not too much cash value (cash surrender value) on the policy in case of early termination of the said contract. Also, there are some restrictions on the transfer of an insurance contract.[282] For example, an insurance policy issued under a contract that takes death as the condition for payment of insurance money shall not be transferred or pledged without the written consent of the insured.[283] Unlike this, in securities trading, though the investors have no right to terminate their contractual relationship with the issuer arbitrarily,[284] they may transfer the share to a third party to realize the purpose of " withdrawing capital."[285] The capability for the investors to transfer their securities to a third party to sell and buy shares mutually, the liquidity of the securities, then relies on an open and transparent market for the realization of effective distribution of capital.

[282] In American law, the transfer of property insurance policies requires two conditions: first, the transferee must have an insurable interest to the insured property; second, the consent of the insurer is required. As for the transfer of life insurance, if the policyholder takes himself as the insured, the transfer is not restricted; if it makes others as the insured, it can only be transferred to the person who has the insurable interest to the insured. See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), pp.184-185.

[283] See Article 34 of *Insurance Law of the People's Republic of China.*

[284] E.g., when an investor subscribes shares and becomes a shareholder of the company, normally, it can not request the company or the issuer to return the invested capital.

[285] Under some instance, the investor, who votes against the resolution of the shareholders' meeting, may request the company to purchase its stock rights at a reasonable price. For example, a limited liability company is going to merge with others, to be split up, or transfer the major properties of the company to others. See Article 74 of *Company Law of the People's Republic of China (2018 Amendment).*

Given the differences between the abovementioned transactions, there are different methods for the protection of purchasers at the transaction level. There is not too much intervention from the *Securities Law* concerning the content of the transaction contract; it maintains is still the "concept of information disclosure" and provisions in that law focus on information disclosure. Investors rely on the information to decide on their choices of securities, so they are quite concerned with the relevant information about the target enterprises that they intend to invest.

For this reason, the issuer must completely disclose all the critical information about the value of the securities. Besides that, the subjects for the information disclosure are not only the issuers but also other subjects, such as the director and senior manager of the issuer, securities exchange, securities service institutions and supervisors, who are all the possible bearers of the obligation of information disclosure.[286] Also, some typical securities-related unlawful acts are prohibited and published because securities are sensitive to information. It is speculative, risky, and easily affected by supply-demand relationships, hence it is easy to cause unlawful acts (e.g., insider trading, disclosing false information). Therefore, the legislative purposes of the *Securities Law* focus on information disclosure to realize fair and transparent trading.

Although in the *Securities Law*, there are inclined rules set for the protection of individual disadvantaged investors, this by no means a significant protection concept followed by the law. Additionally, the securities trading adopts the strict externalism to determine the effectiveness of securities transaction for enhancing the liquidity of securities, and the externalism hardly takes into account the real meaning of investors in the securities transaction.

Under the insurance transactions, there are also the ways of information disclosure, such as the "obligation to tell the truth" on the part of the policyholder, the "obligation to explain" on the part of the insurer.[287] However, the ways are not the central doctrine

[286] When investors acquire listed companies, they also need to undertake the obligation of information disclosure. For example, Chapter IV of the *Securities Law* stipulates that "the acquisition of listed companies" includes many investors' information disclosure obligations.

[287] It should be noted that the securities law focused on information disclosure does not mean that there are no information disclosure rules in insurance law. The insurance law also requires that insurance companies need to disclose information to the policyholder so that the policyholder can find more suitable and satisfying insurance products. For example, in American law, most state insurance regulators have public information offices, which dedicate to publishing insurance information to the public. See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), p.2.

of the transaction rules.[288] Under the "one to one" transaction mode, the insurer usually has an advantaged position in the course of the contract is signed, such as the negotiation capabilities, economic strength. Thus, the *Insurance Law* adopts the concept of offering inclined protection to the policyholders, the insureds, and the beneficiaries. Primarily, many provisions on rights and obligations focus on "insurance recipient - oriented rights," which is the "paternalism" to prevent the insurer from cheating or oppressing policyholders.[289]

Firstly, there is an examination and approval procedure for the formulation of the clauses of the insurance contract.[290] Secondly, for the standard clauses, the insurer performs the obligation to warn and explain. If the insurer fails to perform such obligation, the clause will be ineffective.[291] Thirdly, some standard clauses shall not be valid, e.g., "exempting the insurer from any legal obligation or aggravating the liability of the policyholder", or "excluding any legal right of the policyholder, insured or beneficiary".[292] Fourthly, there exists an interpretation adverse to the insurer. If there are two or more different interpretations of the clause, the court or the arbitral institution shall interpret the clause in favor of the insured and beneficiary.[293] Finally, the inclining protection also reflects in those measures, including the restriction of the right of the insurer to terminate a contract, restraining the right of the insurer to defense, etc.[294] Based on this, it is clear that the "legislative concept of inclined protection" is thoroughly implemented in the *Insurance Law*,[295] which is different from the "legislative concept of information disclosure," as found in the *Securities Law.*

[288] The securities acts, using the device of disclosure, were not applied to traditional insurance. See Tamar Frankel, *Variable annuities, Variable Insurance and Separate Account*s, 51 Boston University Law Review 177, 212 (1971).
[289] "There are basic differences in techniques and philosophies between state insurance regulation and federal securities regulation. Insurance regulation is paternalistic and secretive." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1082 (1973).
[290] Article 135 of the *Insurance Law* stipulates that the insurance clauses and premium rates for insurance products which concern the public interest, law required compulsory insurance products and newly developed life insurance products shall be subject to the approval of the CIRC. See Article 135 of *Insurance Law of the People's Republic of China.*
[291] See Article 17 of the *Insurance Law.*
[292] See Article 19 of the *Insurance Law.*
[293] See Article 30 of *Insurance Law of the People's Republic of China.*
[294] See Wu Dingfu, *Interpretation of Insurance Law of the People's Republic of China*, (Beijing: Chinese Financial & Economic Publishing House, 2009), p.2.
[295] In American law, it has always been a convincing theme and reason to help the vulnerable groups on the information; especially, it is more necessary in the insurance industry because the insured is too weak compared to the insurer. See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), p.2.

Regarding the level of supervision,[296] some special protection funds are mandatorily established to protect purchasers, e.g., the "securities investor protection fund" in Article 126 of the *Securities Law* and the "insurance protection fund" in Article 100 of the *Insurance Law.* However, there are still other different methods available with the two laws for the realization of the supervision to protect product purchasers. The major characteristics of the insurance operations rely on asset-liability and the functional guarantee.[297] Thus, it is necessary to strengthen the solvency of the insurance companies and to use sufficient assets to prevent the risk of liabilities, which achieve its protection of the rights and interests of the policyholders.[298] Namely, the *Insurance Law* regards the solvency as the core of its supervision on the insurer. Thus, in terms of the risk-bearing, the policyholder does not need to bear the general investment risk bearable by the insurer. In theory, if in the case where the insurer goes bankrupt, the policyholder may not be able to obtain the insurance benefit promised by the insurer. However, even if the insurer goes bankrupt, Article 92 of the *Insurance Law* also stipulates other measures, such as the takeover, to maintain the interests of the policyholder. Unlike this, under the securities transaction, the legal risks assumed by the investors are not only the risk of the capital invested but also the bankrupt risk of the target companies or the securities companies.[299] The supervision for securities is to ensure the investors' right to know and to solve information asymmetry so that they will be enabled to identify the investment risks on their own, and their investment decision will be built based on adequate information, making it fair for risk self-bearing.

2.2.4.2 Differences between the civil relief rules

"No relief, no right" is an ancient legal maxim. For both the *Insurance Law* and the *Securities Law*, their legal responsibility systems are all consisted of civil liabilities, administrative liabilities, and criminal liabilities and are all dominated by provisions on

[296] Both the *Insurance Law* and the *Securities Law* realize their supervision and management on public rights through governmental intervention. The necessity of government intervention lies in preventing unfair market competition, asymmetry, unequal bargaining capability between parties, and safeguarding public interests. See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), pp.1-3.

[297] The policy holder pays the premium first to obtain the promise made by the insurer to pay insurance benefit at a time in the future when the agreed insurance accident takes place, so there is a great time difference in it between the payment obligations of the parties concerned in a contract.

[298] "The main purpose of insurance regulation is to insure integrity of the financial condition of insurance companies." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1082 (1973).

[299] In foreign countries, it is usual for insurance companies to go bankrupt, but there is no insurance company going bankrupt in China until now; and there is only one bankrupt in the bank industry, namely Hainan Development Bank. However, the bankrupt is normal in the securities industry, and many securities companies have bankrupted, such as Anshan Securities Company, Dalian Securities, Fuyou Securities Company, Jiamusi Securities Company, etc.

administrative liabilities. Also, the principle of the "priority of civil liability" has established under such legal responsibility system, meaning that if anyone violates the present Law and shall be subject to civil liabilities of compensation and payment of fines and penalties, and if his properties are not sufficient to cover all the payment at the same time, he shall bear civil liabilities.[300] Under the legal responsibility system, there are some differences in the civil relief methods.[301]

In the context of the *Insurance Law,* civil liabilities refer to the legal consequences that the parties concerned in an insurance contract have to assume in case of failing to perform their civil legal obligations. The civil liabilities are mainly the following: (1) The liability for contracting fault. It means that before the conclusion of the insurance contract, the policyholder has violated the obligation of telling the truth, or the insurer has violated the obligation to explain. (2) The liability for breach of contract. It mainly refers to the liability to be assumed by the parties concerned in an insurance contract in case the acts committed by them violate the contents of the said insurance contract. For example, if the insurer fails to perform the obligation of paying the insurance benefit, it shall compensate the insured or beneficiary for any loss suffered, in addition to paying the insurance benefit.[302] Where the policyholder or insured intentionally causes an insured accident, the insurer shall have the right to rescind the insurance contract and refuse to pay indemnity or insurance benefits.[303] (3) The liability of unjust enrichment. If policyholder obtains the insurance benefit by insurance frauds, including intentionally causing an insured accident, the same paid shall be refunded or compensated to the insurer.[304] (4) The tort liability. It is the liability bearable by a civil subject for the physical or property damages that it has caused to other people due to his or her fault. For example, an insurance broker who causes any loss to a policyholder or an insured shall assume compensatory liability for his fault.[305]

In general, the burden of proof for the abovementioned insurance-related civil liabilities follows the rule that the one who claims shall be the one obliged to produce proof. For instance, where the policyholder violates the obligation of telling the truth,

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[300] See Article 220 of *Securities Law of the People's Republic of China.*
[301] Despite of the ambiguous provisions on civil liabilities as in chapters concerning legal liabilities, still there are some provisions involving civil liabilities are scattered in other chapters of the law. Those provisions are mainly focused on securities frauds, such as the disclosure of false information, as well as on the violation of the normative requirements of the law on information disclosure.
[302] See Article 23 of *Insurance Law of the People's Republic of China.*
[303] See Article 27 of *Insurance Law of the People's Republic of China.*
[304] See Article 27 of the *Insurance Law.*
[305] See Article 128 of *Insurance Law of the People's Republic of China.*

the deliberate act or gross negligence must be distinguished based on the subjective imputation of the policyholder,[306] and the insurer shall provide the proof to prove it.[307] However, there are also some circumstances where an inversed burden of proof is adopted. For example, in order to reduce the burden of proof imposed on the policyholder, as for the perform of the burden of proof concerning the "obligation to explain" on the part of the insurer, the rule that the one who claims shall be the one obliged to produce proof may not need to be applied. The insurer shall bear the burden of proof for its performance of the obligation to explain expressly.[308]

Under the *Insurance Law,* the basis of the right to claim mainly relies on the insurance contract, and consequently, the insurance-related civil liabilities mainly show in the contractual liabilities. However, the civil liabilities in the context of the *Securities Law* show in the liability for tort because under the "many to many" transaction mode. The obligations of the issuers appear in the form of a general requirement for conformity, and the obligations are the statutory requirements raised by the *Securities Law* rather than contract-based agreement, because there is barely any room left for negotiation in the securities transaction of the second market, the non-face-to-face transaction mode for securities. If violated, infringe upon the rights of a majority of unspecified investors or damages public interests. Thus, the basis of the right to claim relies on the *Securities Law*. Besides, the securities-related civil lawsuit adopts the form of a "representative action" or "class action," and many trading rules are different from insurance. For example, the relief measure of returning property, in general, is not included in the *Securities Law*, but the emphasis is the relief of indemnity. More importantly, the civil relief in the *Securities Law* is much more complicated than the same in the *Insurance Law*.

Firstly, there are different subjective faults on the part of different subjects. If an issuer or listed company has any false record, misleading statement, or significant omission, and thus incurs losses to investors in the process of securities trading, the issuer or the listed company shall bear the liabilities of compensation. Any director, supervisor, and the senior manager shall take several and joint liabilities of

306 See Article 16 of *Insurance Law of the People's Republic of China.*
307 As it has been specified by Article 6 of the *Interpretations made by Supreme People's Court on Several Questions Concerning the Application of the Insurance Law of the People's Republic of China (Legal Interpretations No. 2013[14])*, the obligation of telling the truth is limited to the scope and content asked by the insurer, and where the parties concerned have dispute over such scope or content, the insurer shall bear the burden of proof.
308 See Article 13 of the *Interpretations made by Supreme People's Court on Several Questions Concerning the Application of the Insurance Law of the People's Republic of China (Legal Interpretations No.14 [2013[).*

compensation unless he can prove that he has no fault therein. Where any shareholder or actual controller of an issuer or a listed company has any fault, he or it shall bear several and joint liabilities of compensation together with the relevant issuer or listed company.[309]

Secondly, the unlawful acts, in the context of securities trading, mainly refers to those acts in violation of Article 3 of the *Securities Law*, such as the misleading statement or major omission, which violate principles of openness, fairness, and impartiality. Investors need to assume the burden of proof concerning the issuer's violations.

Thirdly, there exists damages. For example, the scope for the false statement maker to bear the liability for civil compensation in the securities transaction market shall be limited to the losses caused to the investors due to the false statement. The actual losses of the investors shall include (1) loss in investment margin; (b) commission and stamp duty for the loss in investment margin.[310]

Finally, it adopts the rule of "presumption of causation" to prove a relationship between the unlawful acts and damages.[311] Namely, if an investor is under any of the following circumstances, the court shall ascertain that there is causality between the false statement and the damage consequence: (1) what the investor invests are securities directly related to the false statement; (2) the investor buys the securities on the date of enforcement of the false statement or after that, until the date of reveal or correction; (3) the investor suffers a loss on the date of reveal or correction of the false statement or after that, due to his sale or continuing holding of the securities.[312]

In conclusion, for the rules above adopted by China on financial products, they share common characteristics, e.g., the adoption of strict market access rules, and adopt the different normative logics, and rules settings are also provided based on different financing patterns. The legal methods for insurance mainly focus on strengthening the solvency of the insurer and implements the legislative concept of inclined protection on

[309] See Article 85 of *Securities Law of the People's Republic of China.*
[310] See Article 30 of *Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market (Legal Interpretations No.2 [2003]).*
[311] It should be noted that the principle of proximate cause in the Insurance Law is to identify the causal relationship between the cause of insurance accident and the loss of subject-matter insured, which is to determine the performance of the insurer's obligation to pay insurance benefit, and it is not the causal relationship in civil liability.
[312] See Article 18 of *Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market (Legal Interpretations No.2[2003]).*

the policyholders. However, the *Securities Law* mainly follows such methods, including the philosophy of "information disclosure," the prohibition of fraudulent acts, and the prevention of conflicts of interests.[313] In doing so, both of them have provided different ways of protection and relief rules for insurance and securities products purchasers, respectively. Based on this, if a financial product is identified as insurance or securities, then the application of its rules follows the corresponding insurance law or securities law. It will not give rise to any significant dispute in case it is for the application to any financial product with a single and confirmed function, such as traditional life insurance and stock. However, under the principle of "separate operation and divided supervision", if a financial product has hybrid financial properties, then disputes or dilemmas can be found in terms of its application under the existing laws in China. Moreover, the best example of this is the investment-linked insurance.[314]

2.3 A Critical Review of the Application of Transaction Rules to Investment-linked Insurance

This section focuses on analysis and review on the status quo for the application of laws to investment-linked insurance.

2.3.1 Article 2 of the *Insurance Law*: Insurance Protection and Investment Risk-bearing

2.3.1.1 Investment function and non-insurable investment risk of investment-linked insurance

The investment-linked insurance is defined as insurance product by CIRC, and insurance guarantee is the required element; hence, it is no doubt that the rules in the *Insurance Law* apply to it. For example, in terms of the principle of insurable interests, since the insurance generally regards the life and physical body of the insured as the subject-matter, in this sense, if a policyholder chooses to buy insurance, then it must have the insurable interests to the insured, thus to solve its qualification for buying insurance for the insured.[315] Article 12 and Article 31 of China's *Insurance Law* have

313 "The securities acts, using the device of disclosure, were not applied to traditional insurance." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 212 (1971).

314 Unlike buyers of insurance, investors in mutual funds are essentially contracting for investment advisory services and the advantages of diversified investments." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1082 (1973).

315 See Li You, Definition of Meaning and Systematic Position of Personal Insurance Interests, 6 Political Science and Law 144, 154 (2017).

expressly confirmed the principle of insurable interests and the types of insurable interests a policyholder may have. In other words, the relation between a policyholder of investment-linked insurance and the insured must comply with the types listed in the *Insurance Law;* otherwise, it is not qualified to buy investment-linked insurance.

Although there is no dispute over its application of the *Insurance Law*, there are many unconformities when it comes to the application of the specific provisions. First of all, the investment-linked insurance is not in full compliance with the connotation and scope of insurance as prescribed in Article 2 of *Insurance Law*, because the investment features of the investment-linked insurance have are beyond the function of traditional life insurance. What needs to be specified is that in terms of the concept of the "investment" itself, it bears connotations in both the broad and narrow sense. In particular, any capital input or arrangement done in order to receive the return on it can all be called an investment in a broad sense.[316] Judging from the traditional life insurance itself, it bears particular investment nature, e.g., contract clauses on cash value, an invariable insurance benefit, money-saving function have reflected this aspect of the traditional life insurance which is that it bears the investment nature in a broad sense.[317] However, an investment in a narrow sense is the equity investment in which the investors bear investment risk and share returns on investment.[318] The word, investment as contained in those laws in China, e.g., the *Securities Law,* is mainly referred to as "investment" in a narrow sense. The policyholder in traditional life insurance does not assume the investment risk being faced by the insurer; thus, it does not belong to the scope of investment in a narrow sense. The investment-linked insurance incompletely fits the "definition of insurance" in the *Insurance Law*, which shows in the following two aspects.

The functional scope of investment-linked insurance is not limited to an insurance guarantee. In Article 2 of the *Insurance Law,* it has made a specific definition of the insurance:

In this Law, the term "insurance" means the commercial insurance activities where an insurance applicant pays an insurance premium to an insurer under an insurance contract and the insurer pays indemnity for the property loss caused by the

[316] The nature of these clauses is not regarded as an investment in a narrow sense. The reason is that these clauses, as part of life insurance, are based on mathematical techniques such as death risk pool and the law of large numbers.
[317] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 196 (1971).
[318] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 196 (1971).

occurrence of a potential incident specified in the insurance contract or pays insurance benefits when the insured dies, becomes disabled or sick or reaches a specified age, time limit or any other condition specified in the contract.[319]

This provision has made the term clear that the policyholder obtains the promise made by an insurer as to pay insurance benefit upon the occurrence of the agreed insurance accident by paying the premium as the consideration, thus achieving the effect of risk aversion and is guaranteed. This definition is a kind of common understanding people have about the insurance. Theoretical understanding of insurance more often refers to the definition in this clause as well. For example, we have scholars who directly quote[320], indirectly quote[321] the definition in their works, or give further stress on the role of insurance in helping each other out or on its characteristic of spreading risk on the basis that insurance is a kind of contractual act.[322] It shows that there is no essential difference, that is, based on Article 2 of the *Insurance Law*, the insurance is considered to be a contractual act. It has the effect of spreading risk and providing an economic guarantee. For investment-linked insurance, it provides a "mortality risk guarantee," and there is no doubt this product has the particular effect of providing an economic guarantee. However, investment-linked insurance is not purely a product providing an insurance guarantee, which is more often focuses on investment function and financial management.[323] Once a policy is presented as an investment device, a hedge against inflation, or a "guaranteed investment," a person might well be moved to purchase the policy for its investment features.[324] Therefore, the amount of insurance benefit paid eventually depends on the performance of the investment account, including the assumption of all investment risks about investment account as well, which runs counter to the concept on insurance risk guarantee.

Additionally, the investment risk under investment-linked insurance is not the insurable risk by the "insurance" mentioned in the *Insurance Law.* No insurance without the risk; the actual existence of risk is the objective basis for the formation of an

[319] Article 2 of *Insurance Law of the People's Republic of China.*

[320] It does not define insurance but directly refers to the definition of insurance in the China's *Insurance Law*. See Jia Linqing, *Insurance Law*, (Beijing: China Renmin University Press, 2014), p.3; Wang Yujing, *The Basis and Practice of Insurance Law*, (Beijing: China University of Political Science and Law Press, 2014), p.2; Liu Jingwei, *Insurance Law*, (Xiamen: Xiamen University Press, 2010), p.3.

[321] E.g., see Zou Hailin, *Insurance Law*, (Beijing: Capital University of Economics and Trade Press, 2004), p.1.

[322] See Li Yuquan, I*nsurance Law: Theory and Practice*, (Beijing: Higher Education Press, 2007), p.5; Li Jianfei, *Insurance Law*, (Beijing: Peking University Press, 2014), p.8; Gao Yu, *China's Insurance Law*, (Beijing: Higher Education Press, 2015), p.9.

[323] Policyholders also participate in it for investment purpose. See Li Yanrong & Zhou Weiling, *Comparative Study on Stock-picking Ability of Investment-linked Insurance—Based on T-M Model*, 1 Zhejiang Finance 67, 67-72 (2012).

[324] Tamar Frankel, *Regulation of variable life insurance*, 48 Notre Dame Law 1017, 1026 (1973).

insurance system.[325] Thus, there is a question; namely, the "investment risk" is also a kind of risk, so whether it is possible to include it into the scope of insurable risks as found in Article 2, and achieve the target of risk guarantee or insurance protection? Article 2 of the *Insurance Law* has not expressly specified what kinds of risks are insurable risks. Thus, it has not solved the essential relation between risk and insurance and also has not specified what kinds of risks are the ones that require an insurance system to provide a guarantee. In other words, if the investment risk under the investment-linked insurance also falls into the scope of insurable risks for insurance, then this product is also in the "scope" covered by the guarantee function of the insurance and has not deviated from the definition of insurance in Article 2.

Therefore, as for ILI, it only includes the provision of either mortality or pure endowment insurance guarantee and does not cover the investment risk. In other words, ILI cannot be regarded as an insurance product to achieve the protection function of traditional insurance, because policyholder still bears the risk. It also cannot satisfy the definition of insurance in Article 2 of the *Insurance Law*.

2.3.1.2 The lack of rules on investment account and one-sided application of "caveat emptor"

Since the investment-linked insurance is not in full compliance with the definition of insurance in the Insurance Law, it creates the asymmetry of this "insurance" between the fact and the judicial application, which further causes the one-sided application of "caveat emptor."

As mentioned above, insurance rules are regarded as a normative logic for indirect financing, wherein the insurer bears the investment risk – the so-called "caveat venditor." For securities, as a way of direct financing, its investors assume the investment risk – the so-called "caveat emptor." Caveat emptor means "let the buyer beware", that is the buyer should maintain prudent in commodity trading. If the buyer is not beware, he/she may bear the risks on commodity, e.g., the quality risk of the commodity. For example, in Article 27 of the *Securities Law*, after the issuance of stocks, an issuer shall be responsible for any flux in its operations or profits by itself. The investment risk shall be borne by investors themselves.[326] Though the stock is the

[325] A peril, for instance, is a cause of loss, while a hazard is an event that creates, or increases, peril. Risk itself is a broader concept. See Erik Banks, *Alternative Risk Transfer: Integrated Risk Management through Insurance, Reinsurance, and the Capital Markets*, (West Sussex: John Wiley & Sons, Ltd, 2004), p3.

[326] Where a stock is issued, an investment risk as incurred from any change of the issuer's business or proceeds shall be borne by the relevant investors themselves. See Article 7 of *Measures for the Administration of Initial Public*

object being regulated under this clause, in judicial practice, this is not limited to stock, but also includes the applicability for other financial products as well. As for the dispute over a financial planning contract, in judicial practice, "caveat emptor" is often regarded as the basis for the distribution of investment risk and assumption of responsibilities, and thus the lawsuit filed by the buyer is dismissed for this reason. For example, many courts hold that one should pay extreme attention to a series of documents signed by oneself and has a thorough understanding about many important issues concerning the purchased financial planning products, such as the specific content, investment risk, rate of return, redemption and held-to-maturity investments.[327] One should know the possible risks the financial planning product in question may have and that the expected return does not represent an actual return or a guaranteed return when signing the agreement.[328]

As for investment-linked insurance, many courts also adopt the rule of "caveat emptor" when handling relevant disputes. For example, in the case of *Gong Longxing v. ICBC*,[329] the appellant claimed that he purchased the investment-linked insurance in a name called "Life & Wisdom Win-Win – Lifelong Type" based on the promised return made by the bank staffs; therefore he requested the appellee to assume the loss as a result of his purchase of the investment-linked insurance in dispute. The appellee argued that the purchase of the product by the appellant was a voluntary act. The court finally ruled that it lacked evidence to prove what was claimed by the appellant that there was a fault in the process of selling the agent produced by the company, the appellee, corresponding investment risk should be borne by himself. Moreover, as to those contract clauses in the product description stating that it is likely to have a negative value for the actual return, the appellant, as a person with full capacity for the civil act, should know the significance and importance of his signature.[330] Although the court did not expressly introduce the term "caveat emptor" for this case, the legal basis behind the judgment of this case made by the court was still "caveat emptor." For another example, many courts maintain an acceptable attitude towards the clause in the contract --"as for the participating insurance, universal insurance or investment-linked insurance products, I hereby have read the insurance clause, a reminder for taking out

Offering and Listing of Stocks (No. 122 of CSRC).

[327] See *Lin Jiangyin v. Standard Chartered Bank (China)*, No. 569 (Business) of Shanghai First Court (2009).

[328] See *Pang Xingyuan v. Huaxia bank*, No. 24 (Business) of Shanghai First Court (2010).

[329] See *Gong Longxing v. ICBC*, No. 1910 (Business) of Shanghai First Court (2017).

[330] See *Gong Longxing v. ICBC*, No. 1910 (Business) of Shanghai First Court (2017).

the personal life insurance policy and product description, understand the characteristics and uncertainty of the insured interests, and am willing to assume relevant risk.” What is behind this view is nothing but a reflection of the principle of “caveat emptor” for investment risk-bearing.[331]

Based on the design and features of investment-linked insurance itself, it is the policyholder who assumes the investment risk of the investment account. In this sense, it is understandable that the “caveat emptor” is applied in investment-linked insurance in judicial practice, because “caveat emptor,” as a principle for risk distribution in the context of the market economy, is an assumption of risk by a rational-economic man. Risk is doomed to be accompanied by securities investment; the return is considered as a compensation for risk, while the risk is deemed as the price for the return.[332] However, the judicial practice emphasis on the application of “caveat emptor” as a reason for the assumption of investment risk by the policyholder, but the conditions for the application of such principle are neglected. The preconditions for “caveat emptor” rely on “information asymmetry,” “suitability on the part of the investors,” and “righteousness of supervision.”[333] However, those preconditions are absent for investment-linked insurance until now. Firstly, rules on securities investment mainly adopt the system of information disclosure to reduce the phenomenon of information asymmetry during the trading. Judging from the fact that currently, the *Securities Law* can not be applied to investment-linked insurance, which, at the level of basic laws, only relies on the obligation to explain bearable by the insurer to provide information to the policyholder. The provision of information is gravely insufficient for the policyholder. Secondly, the investment account adopts the trust structure,[334] and it has avoided a trust investment threshold of 1 million yuan for a natural person in China,[335] which does not match the investment risk-bearing capabilities of many policyholders themselves. Thirdly, the traditional financial supervisory system in China has “solidified” the area between “supervisor” and “the one who is being supervised,” allowing the investment account to wander in the vacuum space for legal supervision.[336]

331 See *Mai Jintao v. Chinese People's Life Insurance*, No. 8898 (Civil) of Guangdong First Court (2017).

332 See Chen Jie, *The Evolution of the Role of Investors to Financial Consumers*, 5 Chinese Journal of Law 84, 85(2011).

333 See Xu Ming & Lu Wendao, *Judicial Application and Legalization of the Principle of Caveat Emptor in Securities Exchange*, 4 Securities Law Review 216, 218(2011).

334 For example, the Instructions of Taikang Investment-linked Insurance Product.

335 See Article 6 of *Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds* (No.1 [2009] of CBRC).

336 This is not only investment-linked insurance but also universal insurance. Since 2010, along with China’s approval of the business operation of a group of new life insurance companies, investment-featured life insurance,

Thus it can be seen that there is a tendency of one-sided application of "caveat emptor" in judicial practice, which has caused the inadequate protection of the investment interests for investment-linked insurance.

2.3.2 Article 5 and Article 16 of the *Insurance Law*: the Principle of Good Faith and the Obligation of Telling the Truth

In Article 4 of the *Insurance Law of* 1995, it stipulates that the principle of good faith. In the 2002 Amendment of the law, the principle of good faith was separated and then set a separate clause to stipulate this principle (Article 5) – "the parties to insurance activities shall follow the principle of good faith in their exercise of rights and performance of obligations."[337] In doing so, the role and status of the principle in insurance activities are stressed.[338] What is slightly different from the principle of "good faith" in the civil law is that the principle of good faith in the context of the *Insurance Law* is more often referred to as the "principle of utmost good faith" in theory.[339]

In terms of the applicable subject for "good faith," this principle is not limited to parties or related parties to an insurance contract. It has also raised the demand for a ban on fraud sales to other people, including the insurance agent, etc. For example, insurance agents, insurance brokers, and their practitioners shall be prohibited from those acts, including deceiving an insurer, policyholder, insured or beneficiary, and hiding any important information on an insurance contract from the policyholder.[340] In

represented by universal life insurance, has become the main products of those companies. The public much favor those products, and among them, universal life insurance is known as the "star product" of all Chinese life insurances. However, this doesn't last long. Since 2015, financial powers represented by insurance companies continue taking part in merging and acquiring some listed companies with relatively decentralized equities and good qualities, which has aroused attention from the supervision level. On December 3rd, 2016, Liu Shiyu, the former Chairman of the China Securities Regulatory Commission, had said that I hope Asset Managers will not act as the luxury people who are rich but lack in education or taste, the "demons" that incite and create troubles or the banes who murder people for their properties. Later on, the China Insurance Regulatory Commission temporarily suspended the Universal Life Insurance business available in some life insurance companies. This series of incidents had put the universal life insurance onto the "waves", tipping it instantly from a "star product", much favored by the public to a "drowning dog". Besides, it has triggered the worries about and discussion on such insurance by the public. In China, since there are many legal predicaments with respect to the regulations on investment-featured life insurance, despite on the condition that this does not explicitly violate the prohibitive provisions set forth by the law, more often, the operation of this product is being run in the so-called legal gray area. There are also disputes on the subject scope of the obligation of telling, because Article 16 of the Insurance Law only specifies the policyholder, and does not specify whether the insured and the beneficiary are the subjects of the obligation of telling.

337 See Article 5 of China's *Insurance Law*.

338 See Carter v. Boehm, (1766) 97 Eng. Rep. 1162 (C). "A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party". See Marine Insurance Act 1906, 6 Edw. 7, c. 41, § 17 (Eng.).

339 "The utmost good faith is the fundamental principle of the insurance law." See Ren Zili, *Examining the Utmost Good Faith Principle of Insurance Law*, 3 Jurist 106, 106(2010).

340 See Article 131 of the *Insurance Law.*

practice, the sales by an insurance agent are the major channel for the selling of insurance products.[341] As of the end of 2016, the number of insurance agents has reached 6.572 million.[342] However, the system of insurance sales-agent in China is not well regulated, with many insurance agents failing to completely perform their obligations to explain, giving a misleading or incomplete statement or even entice customers by false advertising.[343] Therefore, it is significant to regulate insurance agents and other insurance activities by the principle of good faith.

The content of the principle of good faith shows in various aspects. This thesis will mainly analyze the obligation to tell the truth and the obligation to explain. The insurance contract is the particular legal relationship in which information asymmetry is found between parties to the contract, and advantageous and disadvantageous information can be found in both parties. For the subject-matter of insurance, there is more information possessed by the policyholder than that possessed by the insurer; as for the standard clauses of the contract, the insurer is superior to the policyholder in those aspects, e.g., the economic status and strength. Therefore, based on the principle of good faith, the *Insurance Law* imposes the obligation of telling the truth on the policyholder and the obligation of explaining on the insurer, which is to balance the rights and interests of the parties concerned.[344] In judicial practice concerning investment-linked insurance, the violation of the principle of good faith is the primary reason to file a lawsuit. For example, in the case of *Zhao Bin v. Ping An Insurance Company of China, Ltd.*, the parties concerned signed a personal insurance contract, titled as “Ping An Century Financial Planning Insurance,” with the said company. The dispute in this lawsuit mainly concentrated on whether the obligation of explaining or the obligation of telling the truth violated deliberately. The court expressly applied the principle of good faith as the basis to make a judgment on this case, holding that good faith principle is the fundamental principle of insurance contracts, thereby requesting all parties to the insurance contract to follow this principle. Specifically, the principle

[341] In 1992, AIA introduced the model of "insurance agent" into China and became the main channel of life insurance marketing in China. Before 1992, China's insurance marketing model was based on the direct sales of insurance company employees. See Fang Youheng, *The Characteristics of Insurance Demand and the Evolution of Insurance Marketing Model*, 11 Management and Administration 64, 64(2007).
[342] The date comes from the official website of Netease Finance and Economic，available at http://money.163.com/17/0405/08/CH8CL0MG0025816D.html, latest visited on Jan. 20, 2019.
[343] See “the Sohu News”, available at http://stock.sohu.com/20130824/n384947543.shtml，latest visited on Jan. 20, 2019.
[344] See Zou Hailin, *New Development of Insurance Law*, (Beijing: China Social Sciences Press, 2015), p.65.

includes the obligation of explaining and the obligation of telling the truth, etc.[345] The following paragraph will analyze difficulties encountered in the application of the obligation of telling the truth to investment-linked insurance. Those difficulties mainly show in the content of the obligation of telling the truth and its legal consequences.[346]

Regarding the content of the obligation of telling the truth, the policyholder needs to tell the insurer about all the facts that may have an impact on the risk measurement. If the insurer inquiries about the subject-matter insured or about the insured when entering into an insurance contract, the policyholder shall tell the truth.[347] From the fact that "being intentionally or "for gross negligence" is identified as matters affecting the insurer's decision on whether to underwrite the insurance or raise the insurance premium, as found in Sub-article 2 of Article 16.[348] It shows that the adoption of the expression, "relevant matters" as the substitution for the expression of "important matters,"[349] which also indicates that the law adopts the pattern of "the limited telling" rather than the pattern of "the unlimited telling." However, as to the judgment that "the limited telling" is limited to "relevant matters" "affecting the insurer's decision on whether to underwrite the insurance or raise the insurance premium," it remains unclear and also has dispute as to whether this judgment is made from the perspective of the policyholder or the insurer. In Article 6 of the *Judicial Interpretation on Insurance Law (II)*, it confines the "relevant matters" about the obligation of telling the truth as prescribed in Article 16 to "the scope and content inquired by the insurer." It suggests that the "relevant matters" should be confirmed based on the scope of what is inquired by the insurer; namely, it is up to the judgment of the insurer. However, the CIRC has stated that even if the insurer has not expressly inquired, if the policyholder knows or should have known that certain vital matters relate to risk of the subject-matter of the insurance, the said policyholder should also properly inform it.[350] Being guided by the CIRS, as long as objectively the "relevant matters" are essential, the policyholder should inform truthfully; otherwise, it is a violation of such obligation.

In the case of *Zhou Gongwei et al. v. Ping An Insurance Company of China, Ltd.*,

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345 See *Zhao Bin v. China Pingan*, No. 85 (Business) of Shanghai Second Court (2003).
346 There are also disputes on the subject scope of the obligation of telling, because Article 16 of the Insurance Law only specifies the policyholder, and does not specify whether the insured and the beneficiary are the subjects of the obligation of telling. See Fan Qirong, *Insurance Law*, (Beijing: China Legal Publishing House, 2001), p.138; See Wang Hualiang, *On the Duty of Disclosure As A Rule of Behavior*, 12 Law Science Magazine 121, 121-123(2011).
347 See Article 16 of China's *Insurance Law.*
348 See Liang Peng, *Research on "Important Facts" in Insurance Law*, 8 Insurance Studies 83, 83(2007).
349 See Article 16 of China's *Insurance Law.*
350 See *Responding to Issues Related to Insurance Contract Disputes* (No. 36 [2006] of CIRC).

the Plaintiff, Zhou bought the investment-linked insurance from Ping An Insurance Company of China, Ltd., and considered Su as the insured and the beneficiary in 2001, and the Ping An Company underwrote the insurance and issued the insurance policy. In 2005, the insured, Su was diagnosed as having enteric necrosis, Zhou then asked the insurer for the insurance benefit, but the insurer refused to assume the insured liability and notified Zhou that the contract was terminated. The insurer claimed that after the contract was signed by Zhou, the premium was not paid in the agreed time, which resulted in the suspension of the effect of the contract. Afterward, the effect of the contract was resumed after Zhou applied, made up the underpaid insurance premium, and obtained consent from the insurer. However, in the process of resuming the effect of the contract, the insurer inquired about the health condition of Su. At that time, both Zhou and Su filled "no" in the options for questions on the contract, such as whether the insured has been hospitalized, whether the insured has received any clinical examination or whether the insured has received any surgical treatment. Later on, the insurer found out that Su had ever gone to a hospital to see a doctor before the effect of the contract was resumed. Therefore, the insurer refused to assume the insured liability and terminated the contract based on the fact that the policyholder and the insured had not performed their obligation of telling the truth. The court held that in the process of resuming the effect of the contract, Zhou did not truthfully tell the insurer of the health condition of Su when he answered the inquiry from the insurer. This act has a fairly enough impact on the decision made by the insurance company as to whether or not the effect of the insurance contract should be resumed. Therefore, the insurer shall not assume the obligation to pay the insurance benefit and have the right to terminate the contract.[351]

The content of the obligation of telling the truth should be important matters that may affect the insurer's decision on whether to underwrite the insurance or adjust the insurance premium. In this case, the insured was diagnosed as having enteric necrosis, this thing happened after the contract resumed its effect, but the hospital had not examined the insured as having this disease when the insured went to see a doctor in the hospital before the contract resumed its effect. It would be too stringent for both the policyholder and the insured if we confirm the policyholder's failure to perform the obligation of telling the truth. It merely based on the fact that negative answers were

[351] See *Zhou Gongwei v. China Pingan*, the case comes from Peking Database (No CLI.C.876600).

filled in the options for questions on the Health Declaration in the contract, such as whether the insured has been hospitalized, whether the insured has received any clinical examination or whether the insured has received any surgical treatment. It will further follow Article 16 of the *Insurance Law* to vest the right to terminate the contract to the insurer. Besides that, the legal consequence of the failure to perform the obligation of telling the truth also remains unclear and leaves many disputes as well. For example, if the policyholder violates the obligation of telling the truth and the insurer has the right to terminate the contract without the need to return the premium, can the policyholder still be allowed to require the return of its premium or capital in the investment account. The right to terminate a contract, as stipulated in the *Insurance Law*, is only limited to the content of an insurance part, excluding the investment part in the investment-linked insurance. If the policyholder's failure to perform the obligation of telling the truth has caused the insurance part to be invalid, this event can not directly lead to the invalidity of the investment part. Its amendment and validity are subject to the further judgment made based on the effectiveness of the insurance part.

2.3.3 Article 10 of the *Insurance Law*: the Change of the Role of the Subject of the Contract

2.3.3.1 Multiple roles of the policyholder and the insurer, and the change of contractual relations

As for the term "policyholder," "insurer," and "insurance contract" contained in an insurance contract, Article 10 of the *Insurance Law* has made the corresponding definitions. In particular, the "insurance contract" is the agreement in which the right and obligation relations between a policyholder and an insurer in insurance are agreed. The policyholder refers to a person who enters into an insurance contract with the insurer and should pay the premium under the agreement in the contract. The insurer refers to an insurance company that enters into an insurance contract with the policyholder and assumes the responsibility to compensate or to pay insurance benefit. Among those legal relations, the statuses and the roles for the policyholder and the insurer are sole and specific. However, in the investment-linked insurance, the statuses of the parties to a contract are not limited to the role of the "policyholder" and the role of the "insurer."

The legal form of an investment-linked product is the investment-linked insurance contract; wherein there are insurance part and investment part. The insurance part is the

same as what is provided for traditional life insurance. Roles defined for the policyholder and the insurer remain the same as what is provided in Article 10. However, as discussed in the previous paragraph, the operation mode of the investment-linked insurance account reflects that the relation between the parties concerned is the entrusted financial relationship – "entrusted by someone to manage the property on that one's behalf."[352] Once a policyholder invests the premium into the investment account, as an entrusting party, it entrusts an insurance company to operate its investment and financial management. Under this circumstance, the status of the purchaser of the investment-linked insurance is not limited to the status of policyholder, but also concurrently the status of the trustor and investor. Correspondingly, the "insurer," not only needs to assume the responsibility to pay the insurance benefit but also needs to assume the contractual obligations of entrusted financial planning as a result of the establishment of an investment account, in this sense, concurrently it has the statuses of the trustee and the asset manager.[353] For this reason, the statuses of the parties to an investment-linked insurance contract have beyond the definitions of "insurance contract", "policyholder," and "insurer" which are in the *Insurance Law.*[354]

Multiple roles of the policyholder and the insurer have further reflected the changes in contractual relations. For example, in a traditional life insurance contract, contractual rights and obligations are set forth around the interests of the insured. [355] Though the subject parties to an insurance contract are the policyholder and the insurer,[356] the *Insurance Law* adopts the "insurance recipient - oriented" thought in setting forth the rules on the rights and obligations involved in an insurance contract. In other words, a personal insurance contract should focus on the interests of the insured and regard the provision of guarantee to the insured as its primary function. More attention should be given to the protection of the interests of the insured when constructing relevant systems and confirming the obligations of the parties to the

[352] See Li You, *The Legal Effect of the "Minimum-Guaranteed Interest Rate Clause" for Universal Insurance*, 2 Insurance Studies 119, 119 (2018).
[353] The relationship between the policyholder and the insurer is similar to that of trust. See Wang Xinjun & Liao Shichang, *Theory and Practice of Insurance Law*, (Taibei: Angle Press, 2006), p.367.
[354] In the US, it respect to relationship variable insurance contracts, in addition to the contract, there is a relationship between security issuer and investor. See Clifford E. Kirsch, and Dodie Kent, *An Introduction to Variable Insurance Product*, Variable annuities and variable life Insurance regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), pp.1-19.
[355] For example, "The insured is basically a creditor of the company. He has no control over the management of the company's business or over the use of the reserves funding his policy." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 212 (1971).
[356] See Article 10 of the *Insurance Law.*

contract and their interested parties.[357] However, under investment-linked insurance, it can not analyze the distribution of the rights and obligations merely around the insured, because when it comes to the investment account, the direction and control over the investment policies, as well as the purchase and redemption of investment units are all determined by the policyholder. The distribution of the rights and obligations in connection to them are all centered on the policyholder.

For example, the ownership of the cash value is indefinite when an insurance contract is terminated. If the insurer has paid the insurance premium for two full years or more, the insurer shall refund the cash value of the insurance policy as agreed upon in the contract.[358] However, this has not expressly specified as to whether the cash value should be returned to the policyholder or the insured; hence, there are two viewpoints, namely the "the theory of exclusive possession by policyholder" and "the theory of non-exclusive possession by the policyholder." Although the ownership of the cash value can be determined based on the agreement in the contract, the problem remains as there is still a dispute over the ownership of the cash value when it has not been expressly specified in the contract. If we consider this from the fact that the life insurance contract is centered on insurance recipient, then the insured takes his or her life as the subject-matter of the underwritten insurance. In light of this, the cash value should belong to the insured, which conforms with the "insurance recipient -oriented" thought. As to why the policyholder buys insurance for the insured, it is something that concerns the internal relations of the contract, but not the basis that determines the ownership of the cash value. In other words, the distribution of these contractual rights and obligations does not follow the general principle of "the one that invests shall be the one that receives benefits and assumes responsibilities," which is adopted in securities trading. However, for the investment account, the insurer carries out investment operations following the instruction given by the policyholder. Also, what is represented by this investment account is the expectation of the policyholder towards an increase in the returns on investment, and the rights and interests that need to be protected are the rights and interests to the investment conducted by the policyholder. If we follow the general principle for commercial trading, which is "the one that invests shall be the one that receives benefits and assumes responsibilities," the cash value of

[357] See Zou Hailin, *New Development of Insurance Law*, (Beijing: China Social Sciences Press, 2015), p.107.
[358] See Article 45 of the *Insurance Law.*

the investment account shall belong to the policyholder.

Apart from that, the changes in contractual relations are also reflected by the participation of the "trustee." According to the CIRC's requirements, all assets in the investment account shall be entrusted for custody.[359] Thus, the investment-linked insurance contract also involves the trustees for the capital in the investment account, which is the commercial bank, trust agency, etc., which, in the role of a trustee, becomes a related party to the investment-linked insurance contract. Therefore, the parties concerned or related parties in the legal relations established by the investment-linked insurance contract are beyond the assumption made by the *Insurance Law* about the parties concerned or related parties to an insurance contract.

2.3.3.2 The unclear content of obligations in the role of a "manager" or a "trustee" of the investment account for the insurer

The investment account has changed the framework of the rights and obligations for parties to a traditional life insurance contract. Obligations of the insurer, as stipulated in the *Insurance Law* (the obligation to explain and the obligation to pay the premium), also can not satisfy the obligations required for the insurer in the role of a "manager" or a "trustee" of the investment account.

It generally assumes that in the legal relations of assets management, a trustee should bear the fiduciary duty. Nevertheless, though the *Trust Law* in China has established the fiduciary duty on the part of the trustee, based on the "separate operation and divided supervision," rules from the *Trust Law* on fiduciary duty can not be directly applied to the non-nominal trust products. In other words, except for nominal trust products, the fiduciary duties bearable by trustees of other financial products are missing. At the level of departmental regulations, different regulatory agencies have raised different demands for the products under their supervision (see below Table). This also leads to less considerate protection of the rights and interests about the investment conducted by the policyholder of investment-linked insurance, and an unfair legal phenomenon as it is.

Table. The main duties of the trustee

Products	Investment-linked insurance	Securities Investment Fund	Trust plan of assembled funds	Management plan of collective asset	Banks' financial management product

[359] See Article 7 of *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance* (No. 32 [2015] of CIRC).

Issuer	Insurance company	Fund company	Trust company	Securities company	Commercial bank
Fiduciary duty	Non-expressing	Expressing clearly	Expressing clearly	Non-expressing	Non-expressing
Investment limitations	The investment accounts and insurance company assets shall not be traded, transferred, etc.	Investment with unlimited liability, illegal lending, illegal guarantees, etc., shall not be allowed.	No guarantee shall be provided to others for more than 30% of the month of incomes, etc.	No borrowing, lending, or mortgage of capital	No direct investment in credit assets, etc.
Related party transactions	No provision	No provision	No provision	No unfair related party transactions shall be allowed.	No unfair related party transactions shall be conducted
Information disclosure	Announcement of the unit price of investment account once a week; Announcement of detailed information every six months; Annual report of policy status, etc.	Annual report of the fund, semi-annual report of the fund, etc.	Quarterly report on trust fund management, fund utilization, and income statement, etc.	Accurate and complete asset management report at least quarterly	Disclosure of relevant information on financial activities every quarterly, semi-annual, annual, and other periodic reports.
References	Insurance Law; the No. 32 [2015] of CIRC; the No.3 [2009] of CIRC; Trust Law; the No.1 [2009] of CBRC, etc.[360]				

2.4 A Critical Review of the Application of Supervision Rules to Investment-linked Insurance

2.4.1 The Lawful Principle in Article 4 of the Insurance Law & Query To "Illegal Fund-raising"

What is required by the lawful principle in Article 4 of the *Insurance Law* is the observation of an existing order of law, which not only includes the level of fundamental laws but also includes administrative rules and regulations issued by the State Council or departmental regulations. Lawful principle bears particular abstractive nature in terms of its content. It also has the universality in terms of its legal application, meaning that this principle is not only required to be applied to insurance activities but is also applicable to activities or acts other than insurance. There is no doubt that the "investment-linked insurance" has to obey laws, administrative laws or regulations, respect social morality, and shall not do anything that harms the public interests of the society.[361] However, when a new financial product appears, and there is no timely "response" from the fundamental laws, and there will be challenges to its legality.

The CIRC has defined the investment-linked insurance as a new type of personal insurance product and has enacted a series of regulations for its supervision, including

[360] See *Notice on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance* (No. 32 [2015] of CIRC); *Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (No.3 [2009] of CIRC); *Measures for the Administration of Securities Investment Fund Management Companies* (No. 84 of CSRC); *Measures for the Administration of Information Disclosure of Securities Investment Fund* (No.19 [2004] of CSRC); *Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds* (No.1 [2009] of CBRC); *Measures for the Administration of the Customer Asset Management Business of Securities Companies* (No. 93 of CSRC); *Measures for the Supervision and Administration of the Wealth Management Business of Commercial Banks* (No. 6 [2018] of CBRC); *Measures for the Administration of the Sale of Wealth Management Products of Commercial Banks* (No. 5 [2011] of CBRC).

[361] See Article 4 of the China's *Insurance Law*.

that the issuance of the product has to be approved by the CIRC. Thus it can be seen that there is no legality issue for the investment-linked insurance product itself because the authority has been approved. However, the problem lies in that the characteristics of investment-linked insurance has broken through the normative framework for traditional life insurance and spreads out to cover several financial sectors. It has violated the principle of "separate operation and divided supervision" established by fundamental laws, including the *Insurance Law* and further violated the lawful principle as in Article 4 of the *Insurance Law.*[362] What is even worse is that the issuer of the investment-linked insurance may be challenged by criminal liabilities, such as "the crime of fraud in financing" and "the crime of illegally absorbing public deposits."[363] For example, the case in which Wu, the former Board Chairman of An Bang Group, was accused of having committed the crime of raising funds through fraud and official embezzlement crime was trialed at Shanghai No.1 Intermediate Court in 2018.

In this case, the Procuratorate accused Wu of having committed those unlawful acts: (1)ordered the company to develop some new insurance products(e.g., investment-linked insurance) and took the lead on the product design; (2)authorized the fabrication of false declaration materials, e.g., financial statement; (3)swindled the CIRC to get sales approval, raised funds from the public; (4)ignored supervision rules to assign sales index in a super large scale forcefully; (5)increased capital for An Bang Group and An Bang Insurance twice via super fund-raising; (6)fabricated the solvency, and disclosed false information; (7)kept giving false publicity.[364] The Court held that the acts of the defendant have constituted "the crime of fraud in financing" and "the crime of official embezzlement," and should be imposed a combined punishment for the crimes committed.[365] The case is highly controversial.

According to the literal interpretation, there is a relatively flexible room for the definition of "illegal" and "fund-raising" per se. If we view it from the Judicial Interpretation made by the Supreme People's Court, "illegal" is mainly evaluated from four factors – "whether it has been approved," "whether it has been advertised

[362] However, regulators seem to have tacit understanding of this phenomenon.
[363] If some financial products are issued with the minimum guaranteed income, this may make the financial management behavior evolve into a deposit behavior, and is questioned by the crime of illegally absorbing public deposits. See *Xinjiang Procuratorate v. Jinxin Trust*, No. 55 (Criminal) of Higher People's Court of Xinjiang Uygur Autonomous Region (2006).
[364] See China Court, available at <https://www.chinacourt.org/article/detail/2018/03/id/3251437.shtml >, latest visited on May 11,2019.
[365] See Xinhua Net, available at < http://www.xinhuanet.com/2018-05/10/c_1122811094.htm >, latest visited on May 11,2019.

publicly," "whether it is promised to repay the capital and interest" and "whether it is targeted at different objects."[366] The An Bang Insurance is an insurance company approved by the CIRC before its establishment, so do the financial products it has issued; therefore, it does not conform to the circumstances of "faked company" and "forged policy." The insurer's ignorance of supervision rules while issuing and selling financial products are no doubt irregularities. However, whether this has constituted "the crime of fraud in the financing," there is still some room left for discussion. The word "illegal" as in "crime of illegal fund-raising" should refer to the lack of legal basis in the significant aspects of the fund-raising process, such as the subject, qualification, and contract about it, or only a completely false fund-raising act. If the fund-raising act has a legal basis in the aspects above and has merely violated supervision rules in relevant fields, it is not appropriate to identify it as an "illegal fund-raising," but only a "rules-violating fund-raising."[367]

2.4.2 Article 8 of the *Insurance Law*- Franchised Insurance Operation & Cross-Industry Operation by Investment-linked Insurance

The insurance can only be operated by an insurance company, excluding the possibility for any other institution to engage in the operation of the insurance business.[368] Article 8 has also expressly stipulated that the insurance companies shall not engage in the bank, securities, and trust businesses, meaning that they shall not engage concurrently in any business other than insurance business. This article includes two aspects of things.

Firstly, the insurance business can be divided into property insurance business and personal insurance business. The same insurer can not engage in the operation of property insurance and personal insurance concurrently. The reasons behind it are the

[366] Whoever absorbs funds from the general public (including entities and individuals) in violation of the provisions of the state laws on financial management, which concurrently meets the following four conditions, shall be deemed to have met the condition of "absorbing public savings illegally or in disguised form" as prescribed in Article 176 of the Criminal Law, except as otherwise provided for by the Criminal Law. 1. absorbing funds without the legal approval of the relevant department or under the disguise of lawful business operations; 2. publicizing by means of media, recommendation fairs, leaflets or mobile phone text messages, etc.; 3. promising to repay the principal and interests or make payments in the form of currency, real objects, equities, etc. within a certain time limit; and 4. absorbing funds from the general public, i.e. unspecified people. Whoever absorbs funds from his relatives, friends or specific person within an entity without publicity in the society shall not be deemed to have met the condition of absorbing public savings illegally or in disguised form. See Article 1 of I*nterpretation of the Supreme People's Court of Several Issues on the Specific Application of Law in the Handling of Criminal Cases about Illegal Fund-raising* (Interpretation No.18 [2010] of the Supreme People's Court).

[367] See Che Hao, Discussing the crime of fund-raising fraud from the case of Wu Xiaohui, available at< http://www.law.pku.edu.cn/xwzx/pl/64114.htm >, latest visited on May 19,2019.

[368] See Article 8 of the *Insurance Law.*

following factors. (1) The subject-matters and terms of property insurance and personal insurance are different. Property is shorter than personal insurance in terms, but the risk of property insurance is more significant than personal insurance. (2) In terms of the underwriting technology, distinct differences can be found between property insurance and personal insurance in the underwriting formalities, the calculation of the premium, and the compensation of the insurance benefit, if the two are run concurrently, it is inevitable that one may attend to one thing and lose another. (3) If the same insurer runs the property and personal insurance concurrently, its business will be too large and complicated; thus, it is hard to cope with capital. As a result, its solvency will be affected.[369] For this reason, the adoption of separate operations between property insurance and personal insurance within the insurance industry promotes the stable operation of the insurance industry. It is stipulated in the *Insurance Law* enacted in 1995 that the same insurance company can not run property and personal insurance at the same time. However, this principle becomes loose in the 2002 Amendment of the *Insurance Law,* which stipulates that property insurance companies can also run short term life insurance after the CIRC approves it. In the 2004 Amendment of the *Insurance Law,* there are even looser provisions on businesses run by an insurance company, and there are flexible miscellaneous provisions. More specifically, the businesses approved by the CIRC are allowed. However, the companies that can be approved by the CIRC remain to be within the business scope of the traditional insurance industry, as CIRC has no right to approve financial businesses involving securities or banking industries.

Table. The change for the internal operation in the insurance industry

No.	Insurance Law	Main content
1	*Insurance Law (1995 Amendment)*	Article 91: One insurer is ***not allowed*** to undertake property insurance and life insurance concurrently.
2	*Insurance Law (2002 Amendment)*	Article 92: No insurer is allowed to engage in property insurance and life insurance concurrently; however, an insurance company undertaking property insurance business may undertake ***short-term health insurance*** and ***accidental injury insurance businesses*** upon verification of the CIRC.
3	Insurance Law *(2009 Amendment)*	The same as above (2002)
4	*Insurance Law (2014 Amendment)*	Article 95: No insurer is allowed to engage in property insurance and life insurance concurrently; however, an insurance company undertaking property insurance business may undertake ***short-term health insurance*** and ***accidental injury insurance businesses*** upon verification of the CIRC. Insurance companies shall ***operate insurance business within the scope of business approved*** by the CIRC.
5	*Insurance Law (2015 Amendment)*	The same as above (2014)

Secondly, the "separate operation" requires differentiation between the insurance industry and other financial businesses. There is no dispute over the application of

[369] See Shi Tiantao, *Commercial Law*, (Beijing: Law Press, 2018), p. 676; Qin Youtu & Fan Qirong, *Insurance Law*, (Beijing: Higher Education Press, 2003), p.429.

Article 8 to traditional and typical insurance products. However, since the mixed operation in the financial industry has become the trend for current financial development, many products have taken measures to circumvent the law to comply with the trend. They adhere to "separate operation" at the nominal level of the law, but in fact, they have broken through such principle. Investment-linked insurance is just a case of this type, for apparently, it is in the form of insurance, but essentially, it has covered three fields, namely the insurance, securities, and trust. However, this phenomenon is not limited to investment-linked insurance; those previously discussed products, e.g., the assets management plans, are all cases of this type. The consequence arising out of this is that those products have broken through the limit of "separate operation", the supervisors can do nothing but to manage what is within their scope of a business, and supervise only those products within their scope of authority. As a result, this has caused a phenomenon that for virtually the same product, there are many policies enacted by various authorities.

2.4.3 The Safe Use of the Capital in Article 106 of the *Insurance Law* and Exemption for Investment-linked Insurance

As previously discussed, insurance, as a means of indirect financing, the legislation has imposed strict regulations on those aspects of it, which includes the solvency of the insurer and the use of its assets. Under the principle of safety for the use of the insurance capital, the specific use of insurance funds by China has experienced a process of constant relaxing its supervision and has encountered a conflict between upper and lower level laws for the use of the funds of investment-linked insurance.

In the 1980s, the insurance industry was being supervised by the People's Bank of China, and the insurance capital was mainly invested in the form of bank deposits. The enactment of the *Insurance Law* in 1995 somehow loosened the control over the scope of investment for insurance capital, but the investment was still limited to bank deposits, government bonds, and financial bonds. Later on, the supervision authority also enacted a series of regulations, with which the investment scope for insurance capital was expanded to fields including securities, real estate and equities (See below Table), especially for the 13 new rules enacted by the CIRC in 2012, which further expanded

the investment scope of insurance.[370] The existing *Insurance Law* has stipulated an insurance company shall set aside a guarantee fund at the rate of 20% of its total registered capital,[371]shall set aside various liability reserve funds,[372] shall have the minimum solvency appropriate for its scale of business and degree of risk,[373] and must use funds according to the principles of solidity and safety.[374] The use of the funds of an insurance company must limit to bank deposits, buying and selling negotiable securities, such as the bonds, stocks or fund-shares, real estate investment, or other use of funds as prescribed by the State Council.

Table: Regulations on the Utilization of Insurance Capital

No.	Name of Regulations	Content	Status
1	Provisional Regulations Governing the Administration of Insurance Enterprises[375]	Article 17. The State body for insurance management may regulate the method of utilizing all reserve funds for insurance enterprises, and insurance enterprises must abide by these regulations.	Expired
2	Insurance Law (1995)	Article 104: The operation of funds of an insurance company is confined to bank deposits, purchasing of government bonds, financial bonds, and other way of fund operation provided for by the State Council.	Revised
3	Provisional Regulations on the Administration of Insurance[376]	Article 33: The use of the insurance fund is limited to the following: (1) Bank savings; (2) Buy and sell government securities; (3) Buy and sell financial securities; and (4) Other uses as stipulated by the State Council.	Expired
4	Insurance Law (2002)	Article 105: No insurance company may use its funds to set up any security operation organization or enterprise irrelevant to insurance.	Revised
5	Interim Measures for the Administration of Insurance Companies' Investing in Enterprise Bonds (No.74 [2003] of CIRC)	Insurance companies may invest in enterprise bonds.[377]	Expired
6	Interim Measures for the Administration of Stock Investments of Insurance Institutional Investors	Engaging in stock investments[378]	Effective
7	Measures for the Administration of the Pilot Program of the Indirect Investment of Insurance Funds in Infrastructure Projects (No. 1 [2006] of CIRC)	the indirect investment of insurance funds to the infrastructure projects	Expired
8	Interim Measures for the Investment of Insurance Funds in Real Estate (No.80 [2010] of CIRC)	Article 2: Insurance funds may be invested in infrastructure real estate, non-infrastructure real estate, and real estate-related financial products.	Effective
9	Interim Measures for Equity Investment with Insurance Funds (No.79 [2010] of CIRC)	Article3: Insurance funds may be directly or indirectly invested in the equity of an enterprise	Effective
10	Issues concerning the Pilot Program of the Asset Management Product Business of Insurance Asset Management Companies (No. 124 [2013] of CIRC)	Article 1: Insurance asset management companies can sell standardized product shares to investors and raise funds.	Effective
11	Interim Measures for the Administration of the Utilization of Insurance Funds (No.3 [2014] of CIRC)	Article 6 The utilization of insurance funds shall be limited to the following forms: (1) Bank deposits; (2) Trading in negotiable securities such as bonds, stocks, and shares of securities investment funds; (3) Investment in real estate; (4) Other forms of fund utilization as prescribed by the State Council.	Expired

[370] See Interpretation of "13 New Policies"，http://insurance.hexun.com/2012/xzxz13/#xzjd，latest visited on May 20,2019.
[371] See Article 97 of China's *Insurance Law.*
[372] See Article 98 of China's *Insurance.*
[373] See Article 101 of China's *Insurance Law.*
[374] See Article 106 of China's *Insurance Law.*
[375] Promulgated on March 3, 1985 by the State Council.
[376] The People's Bank of China promulgated a set of provisional regulations on the administration of insurance on August 16, 1996, which became effective the same day.
[377] Enterprise bonds as mentioned herein refer to the enterprise bonds issued upon approval of the state authority and rated as AA or the above level by the credit rating agencies accredited by the regulatory department. See Article 1 of *Interim Measures for the Administration of Insurance Companies' Investing in Enterprise Bonds* (No.74 [2003] of CIRC).
[378] Stock investment shall mean the activity that an insurance institutional investor engages in or entrusts a qualified institution to engage in the trading of stocks, convertible company bonds, and other stock market products. See Article 2 of *Interim Measures for the Administration of Stock Investments of Insurance Institutional Investors* (No.12 [2004] of CIRC).

12	Measures for the Administration of the Utilization of Insurance Funds (No. 1 [2018] of CIRC)	Article 6 The utilization of insurance funds shall be limited to the following forms: (1) Bank deposits; (2) Trading in negotiable securities such as bonds, stocks, and shares of securities investment funds; (3) Investment in real estate; (4) Investment in equity; (5) Other forms of fund utilization as prescribed by the State Council.	Effective

The CIRC defines Investment-linked insurance as personal insurance, which indicates that this insurance also needs to follow the principle of safety for the use of insurance funds. However, along with the evolution of the supervision carried out by the former CIRC on investment-linked insurance, it might be found that its logic for the use of the funds of investment-linked insurance is a process of shifting from the observance of the principle of safety for the use of the insurance funds to the application of the exemption.

In 2000, for the capital operation of investment-linked insurance, the CIRC still followed the line of thought adopted by the traditional life insurance in using its funds, thereby it stipulated that the deposits at national commercial banks and national bonds, together, should not less than 20% of its funds (No. 26 [2000] of CIRC). Later on, the CIRC gradually loosed its safety control over the use of the funds of investment-linked insurance. In 2003, it stipulated that the ratio of investment funds can be as high as 100% (No. 6 [2003] of CIRC), while the ratio of corporate bonds can be as high as 100% of the total assets on that account (No. 74 [2003] of CIRC). By the year 2004, the ratio of investment in stocks can be as high as 100% (No. 12 [2004] of CIRC). By the year2010, the line of thought adopted by the CIRC on the use of the funds of investment-linked insurance is expressly independent of the funds of other insurance products (No. 9 [2010] of CIRC). After that, regulations adopted by the CIRC on the use of insurance funds have all regarded investment-linked insurance as an exemption.

It is reasonable for us to take an approach that is different from the approach taken for the use of the funds of traditional insurance when it comes to the use of the funds of investment-linked insurance. The utilization of the funds of investment-linked insurance shall be independent of the funds of other insurance products in terms of asset segregation, asset allocation, and investment management, among others, and the CIRC shall develop the specific measures.[379] However, the CIRC stipulates assets be allocated to investment accounts include current assets, fixed-income assets, listed equity assets, infrastructure investment plans, real estate-related financial products, and

[379] See Article 20 of the *Measures for the Administration of the Utilization of Insurance Funds* (No. [2018]1 of CIRC).

other financial assets.[380] Also, it shall comply with the relevant regulatory provisions of the CIRC on the utilization of capital. In this regard, provisions of the CIRC on the utilization of insurance funds have expressly specified the application of the exemption for the utilization of the capital of the investment-linked insurance. There are some contradictions concerning the rules of the regulatory system on the use of the funds of investment-linked insurance.

Table: Regulations on the Capital Utilization of Investment-linked Insurance

No.	Name of Regulations	Content	Status
1	Interim Measures for the Management of Investment-linked Insurance (No. [2000]26 of CIRC)	The sum of bank deposits and treasury bonds must not be less than 20%. (Article 11)	Expired
2	Interim Measures for Insurance Companies to Invest in Securities Investment Fund Management (No. [2003]6 of CIRC)	An investment account with an investment fund ratio of 100% may be established. (Article 10)	Effective
3	Interim Measures for the Administration of Insurance Companies' Investing in Enterprise Bonds (No.74 [2003] of CIRC)	An investment account may be established of which the maximum proportion of investment in enterprise bonds is 100%. (Article 7)	Expired
4	Interim Measures for the Administration of Stock Investments of Insurance Institutional Investors (No.12 [2004] of CIRC)	In an investment account set up by an insurance institutional investor for investment-linked insurance, the proportion of stock investments maybe 100%. (Article 16)	Effective
5	Interim Measures for the Administration of the Utilization of Insurance Funds (No.9 [2010] of CIRC)	The utilization of funds for investment-linked insurance products shall be independent of the utilization of funds for other insurance product. (Article 17)	Expired
6	Interim Measures for the Administration of the Utilization of Insurance Funds (No.3 [2014] of CIRC)	The utilization of funds for investment-linked insurance products shall be independent of the funds of other insurance products. (Article 17)	Expired
7	Measures for the Administration of the Utilization of Insurance Funds (No. 1 [2018] of CIRC)	The utilization of funds of investment-linked insurance products shall be independent of the funds of other insurance products in terms of investment management, etc., and the specific measures shall be developed by the CIRC. (Article 20)	Effective

2.5 The Ignored Protection of Investment Interests for Policyholder: Taking the Obligation to Explain as An Example

Based on the analysis above, it shows the defects of the transaction rules or the conflicts among the rules for the use of the insurance capital, etc. The essential cause lies in that the investment-linked insurance has broken from the design of traditional life insurance, the rules on the rights and obligations it involves, and its supervision rules are all different from the assumed framework of the traditional life insurance. For this reason, if authorities define investment-linked insurance as insurance and restrict the application of its rules to the *Insurance Law*, which will bring many rule challenges. In other words, China is in short of a due response to fundamental laws of investment-linked insurance, making some properties of its fundamental laws appear to be vague and resulting in the lack of rules applicable to the non-life insurance part. The direct consequence and major impact of this phenomenon are that the investment account

[380] See Article 4 of the *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insuranc*e (No. 32 [2015] of CIRC).

bearing the characteristic of direct financing can not again be regulated by the *Securities Law, Securities Investment Fund Law, Trust Law,* etc. It results in an ignored protection of the rights and interests of investment. For example, the policyholder bears the investment risk and the application of the rule of "caveat emptor" on it, but is unable to gain equal protection from the investment rules, which may have violated the fundamental law theory of the consistency between rights and obligations.[381] Based on the preceding analysis, under the idea of the regulations on direct financing, the primary rule is "disclosure", while based on the existing laws applicable to the investment-linked insurance, at the fundamental law level, the information based on which the policyholder makes its decisions only relies on the obligation to explain on the part of the insurer. However, the information provided by this obligation to explain can not be regarded as the whole information rules. It is not available to the policyholder for making decisions on the purchase of investment-linked insurance, and it should not be considered as a surrogate system for the obligation of information disclosure. Therefore, in the following paragraph, this thesis will take the obligation to explain on the part of the insurer as an example to review, under the current status quo, the lack of protection for the rights and interests about the investment made by the investors.[382]

2.5.1 The Obligation to Explain in Article 17 of the *Insurance Law*: Hard to Resolve the Situation on Its Own

The obligation to explain is based on the level of good faith on the part of the insurer to help the policyholder to understand the content of a contract.[383] Article 17 of the *Insurance Law* has stipulated the obligation to explain on the part of the insurer in the form of statutory duty. However, the information provided by this obligation shall not be considered as the whole information rules.

Firstly, the object of the obligation to explain shall not contain the whole content of the contract. The obligation to explain is divided into a general obligation to explain and a special obligation to explain according to Article 17. The former refers to the general standard clauses of the insurance contract, which shall be explained and

[381] The rights and obligations in the investment-linked insurance between policy-holder and insurer should be re-balanced under *Insurance Law*. See Li Pengxi, *Legal Regulations on Sharing the Risk of Unit-linked Life Insurance,* 4 *Seeker* 114, 114-117 (2015).

[382] As Frankel said, two features in the investment contract give rise to the need for protection under securities acts: control and management of the investment is in the hands of someone other than the investor; the risk is borne by the investor. See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 Boston University Law Review 177, 214 (1971).

[383] See Zou Hailin, *New Development of Insurance Law*, (Beijing: China Social Sciences Press, 2015), p.173.

clarified by the insurer, while the latter mainly refers to the contractual clauses that exempt the responsibilities bearable by the insurer and must be especially reminded or explained.[384] Obviously, for those exemptions, the insurer must explain and clarify. For those general clauses, not all of them require a further explanation or clarification from the insurer, because either the policyholder usually can understand them or they simply do not need to be explained. Namely, the insurer doesn't have to explain all the content of a contract. Otherwise, it will only increase the cost of concluding a contract. There is a viewpoint that holds that only for those crucial questions (e.g., clauses on rights and obligations) that can affect the choice of the policyholder as to whether or not to buy the insurance and how to buy it, the insurer must explain them.[385] Though Article 39 of China's *Contract Law* has also stipulated that the provider of standard clauses shall explain this article covers the exemptions to the counterpart of the contract, not all the contents of the contract, but merely those exemptions. The contents to be explained by the insurer under the obligation to explain, as stipulated by the *Insurance Law*, are exemptions in the form of standard clauses and essential rights and obligations stated in the general clauses, not all the contents within a contract. The investment function added to the investment-linked insurance makes the policyholder assume investment risk, which has broken the assumption made by the traditional insurance law on the objects of the obligation to explain.

Consequently, the configuration of the system function of the traditional insurance law is hard to support the provision of all the information required by the investment-linked insurance. Needless to say that the purpose of buying investment-linked insurance by the policyholder is even more concentrated on investment and financial management, rather than insurance guarantee. If we merely limit the objects of the obligation to explain to what has been provided under the original framework of the *Insurance Law*, then we will not be able to make sure that the policyholder performs the content of the investment part in the contract is based on a thorough understanding of the same.

Secondly, as for the time of the obligation to explain is to be performed, the obligation is generally considered as a pre-contract obligation that has to be performed before the concluding and signing of a contract. As for the due information disclosure

[384] See Article 17 of the *Insurance Law.*

[385] See Wu Yongmin & Hu Bin, *A Reflection on and Reconstruction of China's Insurance System of Insurer's Explanation Obligation*, 3 Journal of Zhejiang University (Humanities and Social Sciences) 88, 92(2010).

for the investment account, in general, there requires a continuing beforehand and ongoing information disclosure. For example, during the beforehand information disclosure, information, such as risk reminders, interest demonstrations, and basic features of the product, should be included in the product description of the investment-linked insurance. During the information disclosure conducted beforehand or in the process, the insurer should disclose investment information on the investment account to the policyholder, such as the investment strategy, the unit price of the investment, information on returns, as well as the provision of a report on the policy status regularly. Therefore, such a wide range of information concerning the investment account can not be replaced by the obligation of explaining, although the obligation and information disclosure are all information provision systems that are set to make it possible that the choice made by the purchaser is based on sufficient information.

2.5.2 Judicial Dispute over the Insufficient Information Provided by the Obligation to Explain

Over recent years, in China, there are many disputes in lawsuits concerning financial products caused by the information asymmetry, and damage against the rights and interests of the consumers.[386] What is being regulated by Article 17 is the traditional life insurance, not the investment part of the investment-linked insurance, which is easy to cause judicial disputes. In judicial application concerning investment-linked insurance, there is the main issue of superficial performance of the obligation to explain by the insurer, which further weakens the protection of the policyholder.

There has always been a debate about the standard in performing the obligation to explain. From the reply from the Supreme People's Court about the "express explanation" mentioned in Article 17, an "express explanation" has to be made to the policyholder or its representative in writing or orally to let the policyholder understand the real meaning and legal consequence of a specific clause.[387] Article 13 of the *Judicial Interpretation on Insurance Law* (II), it also further requires the insurer to bear the burden of proof on whether it has performed the obligation to make a specific explanation. Thus it can be seen that in judicial practice, it adopts the standard of actual

[386] See the Typical Cases of Financial Trial in Shanghai Court, <http://shfy.chinacourt.gov.cn/article/detail/2016/06/id/1913401.shtml >, latest visited on May 23,2019.
[387] See The response of the Research Office of the Supreme People's Court to the Question on How to Understand the "Explicit Description" in Article 17 of the Insurance Law (No. 5 [2000] of the Research Office of the Supreme Court).

performance for this obligation to explain, which requires the policyholder to achieve the purpose of understanding the contract. Nevertheless, this inversed burden of proof appears to have reduced the burden of proof on the part of the policyholder. However, Article 13 of the *Judicial Interpretation on Insurance Law* (II) also stipulates that where the policyholder confirms it by signing or stamping a seal on relevant documents or through any other form permissible, it shall be deemed as the insurer has truthfully performed the obligation to explain. In practice, the insurer has established the column of “Declaration from the Policyholder” in the contract and requires the signature from the policyholder to prove the obligation to explain has been performed. The stress on the insurer’s superficial performance of the obligation to explain runs counter to safeguarding the interests of the policyholder, which has caused the continuous occurrence of disputes of this type,[388] e.g., the case of *He Zhiqing v. Ping An Insurance (Group) Company of China, Ltd.*

In this case, the policyholder, Ms. He bought the investment-linked insurance, and she was the insured and beneficiary; from the insurer, Ping An Insurance Company of China, Ltd. agreed to underwrite the insurance and issued the insurance policy. The dispute was caused by the loss incurred to the investment made under this insurance. The plaintiff, He claimed that the salesman of the insurer stated that this insurance has relatively high returns and has no risk at all at the time of purchasing this insurance. The insurer defended that the contract in dispute was signed between both parties through negotiation. Thus, it was a valid contract. In the application form, it made clear that the customer should understand the clauses of the insurance contract. If there is any inconsistency between “the explanations and clarifications made by the salesman of the insurance company on matters relating to the insurance” and “what is written on the application form or stated in the clauses of the insurance contract made by the insurer”, the former shall be invalid. Besides that, since there is no seal affixed to the publicity materials, it is not authentic. Finally, the court dismissed the lawsuit filed by He, holding that the plaintiff announced that she had fully understood the clauses of the insurance contract by signing in the column of “Declaration from the Policyholder and the Insured.”[389] The focus of the dispute of this case relies on whether there was any fraudulent act in the selling of this product. To prove this, the plaintiff presented a record of the conversation she had with the salesman on which there was a signature from the

[388] See *Yang Baiqin v. China Life Insurance*, No. 55 (civil) of Beijing Fourth Court (2017).
[389] See *He Zhiqing v. China Pingan*, the case comes from Peking Database (No CLI.C. 876595).

salesman. The court held that because the salesman and the plaintiff are relatives and this was only a record with the salesman's signature without his appearing in court to testify, this record of conversation could not be deemed as the basis to identify the fact of this case. The court also regarded the signature signed by the policyholder in the declaration column as the basis to prove that she had fully understood the content of the contract. Thus, it can be seen that in this case, the court has been stringent with its requirements for the policyholder to produce proof. For another example, in *Song Zhibin. v Tai Ping Life Insurance Company, Ltd.*, the policyholder claimed that the agent misled him by falsely telling him that among others, the dividend will be higher than the bank interests. However, this did not win support from the court either.[390]

2.6 Chapter Summary

Chapter two mainly discusses issues of three aspects, namely, the major characteristics of ILI, the logic adopted in the regulation of financial products, and the law application for ILI in the context of the existing legal system.

By comparing and analyzing ILI with those products, including the traditional life insurance, participating insurance, universal insurance, and a collective financial management plan, we may find that ILI is a kind of financial management product bearing insurance guarantee, available with any traditional insurance and investment, a functional innovation. Moreover, essentially, it has adopted the legal structure of trust, thereby making it a new composite financial product that covers three big fields: insurance, securities, and trust.

In modern law, different rule applications are set for different financial products; behind it is mainly a reflection of the logical differences between direct and indirect financing in risk distribution. In terms of insurance (indirect financing) rules, irrespective of American, Japanese, or Chinese laws, stringent restrictions are made against aspects such as the solvency of the insurer, the safe use of the capital, etc., so as to ensure that the insurer can realize its commitment to the policyholder. In terms of the securities (direct financing) rules, we are mainly implementing the idea by the establishment of a system of rules centered on information disclosure, thus providing information based on which the investors can make decisions and assume risks on their

[390] See *Song Zhibin v. Tai Ping Life Insurance Co.*, No. 6044 (civil) of Heilongjiang First Court (2016).

own. Based on this, despite the differences in specific rules between the insurance laws and securities laws of various countries due to diversified state conditions, the jurisprudences behind those differences in rules are all reflections of different principles of risk distribution between direct and indirect financing. For example, in terms of the idea and method adopted within the laws in China on the protection of the purchasers of insurance and securities products, the relief rules provided to them by the private law have evident differences, with the former mainly shown by the relief approach from the perspective of contract law, and the latter mainly shown by the relief approach from the perspective of tort law, which further results in the different rules set forth on subjective faults, unlawful acts, damages, and causality on the parts of the subjects of civil liabilities.

Despite ILI having multiple legal attributes, public power institutions in China still define the nature of ILI as an insurance product and limit the law application to insurance law and its corresponding supervisory rules, which consequently has caused the inadequate application of rules. In terms of the application of the rules for ILI, the investment function of ILI does not match the definition of insurance in Article 2 of the *Insurance Law* and the investment risk itself is also not an insurable risk; therefore, it has caused an absence of regulations on investment account and the one-sided application of "caveat emptor" at the judicial level. ILI also abides by the good faith principle; differences are found in the content of the obligation to tell on the part of the policyholder and the legal consequence in case of violation, especially the interpretation on the return of premium under the circumstances of deliberate acts or culpable negligence. The policyholder and the insurer to ILI have changed their single identity under the traditional life insurance to multiple identities. Consequently, this has caused changes in the rights and obligations of the parties concerned. At the level of supervision over ILI, there are differences between the use of funds by ILI and by traditional insurance. It has broken the principle of "classified management and classified supervision," and has thus generated many supervision problems.

To sum up, the complexity and the composite nature of ILI have resulted in the inadequate application of both the transaction rules and the supervisory rules on ILI, and many rules are either missing or inappropriate, which results in the failure to give adequate protection to the investment interests of ILI.

Chapter Three The Legal Attributes of the Investment-linked Insurance and Its Regulation Approaches

Chapter Two has analyzed many problems that investment-linked insurance has caused to the existing laws. How for the current laws to give a response to them? First of all, it requires us to carry out a detailed analysis of the legal attributes of the investment-linked insurance itself. The US's financial regulations have long been deemed as the most efficient regulation system across the world,[391]and there has been a full discussion on financial products including the variable annuity and the variable life insurance, so the provisions in their corresponding financial laws also have relatively high value for a reference. In this part, we start our discussion from two typical cases found in the history of US law in this respect. In particular, by analyzing the line of thought adopted in the two cases to make the judgments, we have further analyzed the legal attributes of the investment-linked insurance and the approaches for its regulation.

3.1 The Line of Thought Revealed by the Judgments of Two Typical US's Cases

3.1.1 Court Judgment: Variable Annuities Were Securities

The judicial case, the *SEC v. Variable Annuity Life Insurance Company* (VALIC), occurred in the US in 1959, has a significant impact on the subsequent determination of the legal attributes of the variable life insurance.[392] In the VALIC case, the SEC, as the plaintiff, filed a lawsuit against VALIC, claiming the registration with and the disclosure to SEC by the latter in accordance with the *Securities Act of 1933* and the *Investment Company Act of 1940;* otherwise, the variable annuity shall not be sold. Federal Court held that variable annuities were securities rather than insurance, and

[391] See the Ministry of Finance People's Republic of China, the US's Financial Regulation, < http://www.mof.gov.cn/mofhome/guojisi/pindaoliebiao/cjgj/201407/t20140708_1109871.html >, latest visited on June28, 2019.

[392] The case is early in the United States to judge the legal attribute of variable life insurance. At the same time, the case is the judgment of the Federal Supreme Court to overturn the first instance of the District Court of Columbia and the second instance of the circuit court of appeal of the District of Columbia. After three trials, based on the characteristics of the case and the principle of case law following precedent, the case has a greater impact on the subsequent cases.

hence they could not be exempted from the application of the Federal Securities Act. The Court held:

> "The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a pro rata share of what the portfolio of equity interests reflects—which may be a lot, a little, or nothing. We realize that life insurance is an evolving institution. Common knowledge tells us that the forms have greatly changed even in a generation. And we would not undertake to freeze the concepts of 'insurance' or 'annuity' into the mold they fitted when these Federal Acts were passed. But we conclude that the concept of 'insurance' involves some investment risk-taking on the part of the company. The risk of mortality, assumed here, gives these variable annuities an aspect of insurance. Yet it is apparent, not real; superficial, not substantial. In hard reality the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense."[393]

As it can be seen from above, the logic adopted by the court in making the judgment lies in that a variable annuity is absent of the guaranteed payment of a fixed return which is available with any traditional insurance, and the investment risk is thus not to be assumed by the insurer; consequently, the guarantee that should come with any insurance can not be obtained as a result of the uncertain amount of the death benefit for a variable annuity, so the variable annuity was determined as not being insurance. However, the transfer of investment risk, as was stressed by that court, was only described abstractly as "some investment risk-taking," but there were no specific provisions on the extent to which the investment risk was to be assumed.

Shortly after this case, there was another product called Flexible Fund Annuity in the US market. What is different from the variable annuity in the VALIC case is that firstly, the premiums, in a fixed amount, which is paid monthly by a policyholder of this product before the policy matures,[394] is entered in an independent and flexible fund account, which is further invested (most of the capital is invested in common stocks) and operated by the insurer to acquire a return on it. Secondly, the cash value for this product over the first year should be no less than 50% of the net premiums with an increase each year and may reach an amount which is 100% of the net premiums by the 10th year. Thirdly, when the product matures, the policyholder can elect to have the insurance benefit paid by the insurer in a lump sum or have its fund in the account transferred to the general reserves of the company and then paid by the insurer regularly.[395] Based on those characteristics, it can be known that based on the variable annuity in the VALIC case, the flexible fund annuity is an annuity product regarding the major points of the case judgment, thus requiring the insurer to assume the certain

[393] *SEC v. Variable Annuity Life Ins. Co*., 359 U.S. 65, 71 (1959).
[394] Before the expiration of the policy, it is called the pay-in period, and after the expiration, it is called the pay-out period.
[395] See *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 205 (1967).

investment risk. Despite this, SEC in the US still held that this annuity product belonged to securities and required the registration with and the disclosure to it by such annuity product, therefore a dispute was caused and a lawsuit was filed to the court, which was the renowned case of *SEC v. United Ben. Life Ins. Co* (UBLIC).

In the UBLIC, "the SEC contended that the pre-maturity phase of the contract was separable and constituted a 'security' under the Securities Act."[396] The court of the first instance for this case held that the annuity in dispute should be viewed as a whole, and if it was to be included in the category of insurance, then the insurer would have to assume the major part of the investment risk relating to this annuity. This policy, in particular, has the guaranteed minimum cash value before it matures and can also be transferred into an annuity with fixed payment once it matures in addition to a guarantee featuring a relatively large amount of fixed payment, so in this sense, the whole contract should be endowed with the nature of insurance. Hence, the annuity in dispute should be exempted from the application of *Securities Act*.[397] The Court of Appeal further affirmed the case.[398] However, based mainly on the following reasons, the US's Supreme Court overturned the rulings made by the courts of first and second instance.[399]

> The 'Flexible Fund' program completely reverses the role of the insurer during the accumulation period. Instead of promising to the policyholder an accumulation to a fixed amount of savings at interest, the insurer promises to serve as an investment agency and allow the policyholder to share in its investment experience. The insurer is obligated to produce no more than the guaranteed minimum at maturity, and this amount is substantially less than that guaranteed by the same premiums in a conventional deferred annuity contract. The fixed-payment benefits are adjusted to reflect the number of dollars available, as opposed to the conventional annuity where the amount available is planned to reflect the promised benefits.[400]
>
> The insurer may plan to meet the minimum guarantee by split funding—that is, treating part of the net premium as it would a premium under a conventional deferred annuity contract with a cash value at maturity equal to the minimum guarantee and investing only the remainder—or by setting the minimum low enough that the risk of not being able to meet it through investment is insignificant. The latter is the course United seems to have pursued. In either case the guarantee cannot be said to integrate the pre-maturity operation into the post-maturity benefit scheme. United could as easily attach a 'Flexible Fund' option to a deferred life insurance contract or any other benefit which could otherwise be provided by a single payment. And the annuity portion of the contract could be offered independently of the Flexible Fund.[401]
>
> And while the guarantee of cash value based on net premiums reduces substantially the investment risk of the contract holder, the assumption of an investment risk cannot by itself create an insurance provision under the federal definition. The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized.[402]

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[396] See *SEC v. United Ben. Life Ins. Co*., 387 U.S. 202, 202 (1967).
[397] See *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 202(1967).
[398] See *SEC v. United Ben. Life Ins. Co*., 359 F.2d 619 (D.C. Cir. 1966).
[399] See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 65 (1959).
[400] *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 208 (1967).
[401] *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 208-209 (1967).
[402] *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 211 (1967).

3.1.2 The Consideration of Institutional Conception in the Line of Thought Being Adopted in Making Judgments

Despite the fact that both the VALIC case and the UBLIC case have all stressed the importance of risk-bearing to insurance, neither case has made any specific explanations on the assumption of investment risk. In other words, it requires the insurer to bear how much of or precisely in what amount of the investment risk before the "product" can be deemed as in compliance with the category of insurance. In VALIC case, whether the amount of the payment for variable annuity merely relies on the investment performance of the insurer, thus it is believed that the "insurance attribute" of the annuity in dispute is not a substantial one[403] and has no true underwriting of risks.[404] However, the court pointed out that though the "fixed payment" and the "transfer of risk" are the key factors that constitute the insurance, it remains to be ambiguous and unclear in terms of the relation between "insurance attribute" and "investment attribute" of the variable annuity and when it comes to a specific judgment in this respect. In the UBLIC, the lower court held that VALIC judges too narrowly if it is merely based on the absence of the assumption of material investment risk.[405] However, it has not indicated that under what circumstance the assumption of investment risk is not a dominant method to be used in making the judgment. Notwithstanding the abovementioned, the court did not quantify the assumption of investment risk, though its consideration of the assumption of investment risk for the variable annuity in question can be analyzed from its statement.

Firstly, in VALIC case, the majority opinion is that the traditional insurance has the guarantee for a fixed payment, while for a policyholder of variable insurance, since its guaranteed return merely relies on the investment performance of the insurer, and there is no guarantee of return on investment; hence there is no real assumption of risk. Thus it can be seen that whether or not there is any guarantee for a fixed return is something that should be considered when it comes to the assumption of risk involved in a variable annuity. Secondly, as Brennan held in the concurring opinion, while these contracts contain insurance features, they have to a very substantial degree element of investment contracts as administered by equity investment trusts.[406] Therefore,

[403] See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71 (1959).
[404] See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 73 (1959).
[405] See *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 210 (1967).
[406] See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 91 (1959).

"Flexible Fund" arrangements require special modifications of state law and are considered to appeal to the purchaser not on the usual insurance basis of stability and security but the prospect of "growth" through sound investment management.[407] In other words, the weight of the characteristics of the investment contract in variable annuity also needs to be taken into account when it comes to the assumption of investment risk. Thirdly, the court shall analyze the weight of investment factors in the annuity in dispute from the incentive perspective.

From the status made by the Supreme Court of the US on a variable annuity, the judgments made on VALIC case and UBLIC case respectively are based on whether the insurer assumes the investment risk. In the VALIC case, the investment risk involved in the variable annuity is regarded as the critical element for the judgment on the variable annuity in dispute, so the absence of a fixed payment means the failure to achieve the functions of insurance, which are to maintain stability and to provide a guarantee. In UBLIC case, the annuity in dispute bears specific characteristics of a fixed payment, the policyholder does not completely bear the investment risk, and the insurer also bears some. However, the Federal Court maintained that the characteristic of a promised minimal fixed payment available with the annuity in dispute still can not make it fall into the category of insurance. In fact, what has been followed by this line of thought on judgment is still from the perspective of the conception of the insurance system itself, the insurance is affirmed to have the institutional function as being a risk guarantee. Insurance is the pooling of fortuitous losses by transfer of such risks to insurers, who agree to indemnify insureds for such losses, to provide other pecuniary benefits on their occurrence, or to render services connected with the risk.[408] The reason that causes many differences between the value of insurance as being a risk guarantee and the investment lies in that the insurance system have different approaches for risk-bearing, and also two completely different purpose-driven orientations are formed as a result.

3.2 Different Institution Function and Judgment Factors between Insurance and Securities

The abovementioned typical case has revealed the difference between the

[407] See *SEC v. United Ben. Life Ins. Co*., 387 U.S. 202, 211 (1967).

[408] See George E. Rejda & Michael J. McNamara, *Principles of Risk Management and Insurance*, (New York: Pearson Education, 2014), p.5.

institutional conception of insurance and securities, which also requires us to raise further questions as to the functional differences and judgment factors between insurance and securities.[409]

3.2.1 Homogeneous Risk Pool and the Application of Mathematical Techniques in Risk-sharing

At the legal level, both the life insurance policy and other policies are essentially a kind of contract.[410] The policyholder shall not bear any guarantee risk under the insurance contract after the premium has been paid by it as consideration. Instead, it is the insurance company that shall assume all the risks within the scope of guarantee after that.[411] The reason this payment promise can be realized is mainly that the premium and insurance benefit is paid as per the calculation results obtained by taking into account those factors, including age, health condition, sex, etc. in several mathematical techniques used for that purpose, such as the probability theory, the speculation theory and the law of large numbers. Eventually, the risk transferred from an individual is spread among the public. In other words, an insurer can turn the impossibility of the rule for predicting the risk of loss for an individual into the possibility of the rule for predicting the risk of loss for the whole population. This method, changing the impossibility on the part of an individual to the possibility on the whole, is the law of large numbers. To expressly describe it, if a random experiment has been carried out under completely the same condition for "n" times, during which a specific incident has occurred for "m" times, then the estimation of the probability of occurring such incident during each experiment, "p," can be given by the ratio between m and n (m/n), a number which is at somewhere between 0 and 1.[412] It is found, after the implementation of a large number of experiments involving this incident, a stable averaged result is shown because a lot of random phenomena have been mutually offset due to their contingency - this mathematical rule is also referred to as the law of large numbers. The application of this rule in the field of insurance is to assume that X_k（k=1,2,⋯,n）represents the loss a policyholder suffers from a risk incident, whereas the expected value of the loss

409 "The main purpose of life insurance is to provide protectionfor beneficiaries against loss due to the death of the insured. The main purpose of investment is to secure a return on capital." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1082(1973).

410 See Spencer L. Kimball, *Cases and Materials on Insurance Law*, (Little, Brown and Company, 1992), p.414.

411 It should be noted that the risk transfer refers to the transfer of the legal effect of the underwriting risk to the insurer, rather than the risk itself.

412 See Hossack, Pollard, Zehnwrith, *Actuarial Basis of Non-life Insurance*, (Beijing: China Financial Publishing House, Chinese translation edition, translated by Wang Yuxian, 1992), p.26.

of risk incident is μ, and each policyholder has the same expectation for loss and with the same standard deviation, then for any condition in which $\varepsilon > 0$ and $n \to \infty$, we have the following formula:

$$\lim_{n\to\infty} P\{\left| \frac{1}{n}\sum_{k=1}^{n} X_k - \mu \right| < \varepsilon\} = 1$$

What has been reflected by the value in above square brackets is the absolute value of the difference between average loss as a result of the accumulation of particular risk and the policyholder's expected value of the loss, a number which is less than ε. When "n" tends to be a positive infinity ($n\to\infty$), the average value, $\frac{1}{n}\sum_{k=1}^{n} X_k$, will continuously get closer to the expected value μ, meaning that in case $n\to\infty$, it is an inevitable event that the average value is in proximity to the expected value.

Generally speaking, the number of "n" as in the above equation should not be less than 25 under such circumstances where there is no evident deviation for its distribution.[413] As for insurance, the policyholder transfers the risk that is unwilling to assume or cannot assume to the insurer. The insurer pools those insurable risks to form a homogeneous risk pool and then uses mathematical methods, such as the law of large numbers, to spread the risks. It is not only advanced technical processing that should be carried out by the insurer as the insurance underwriter but also an insurance contract it has concluded with the policyholder,[414] more specifically, the foundation based on which the substantiality of the performance of the obligation for a fixed payment can be realized. Though the insurance, such as the catastrophe insurance, has to some extent reduced the reliance on the law of large numbers, but has not changed the primary effect the law of large numbers has on the insurance system and even has vested special "characters" into the insurance.

In early times, maritime merchants introduced those risk-transferring and spreading methods into the seafaring and thus formed a common practice of sharing, namely the overall average system. By the middle ages, European countries have developed many mutual insurance organizations covering the aids for many serious

[413] See Hossack, Pollard, Zehnwrith, *Actuarial Basis of Non-life Insurance,* (Beijing: China Financial Publishing House, Chinese translation edition, translated by Wang Yuxian, 1992), p.83.
[414] From the perspective of the law, gambling is an agreement between different parties which takes the occurrence of an uncertain event as the sole foundation for the transfer of property. Unlike insurance transfer or risk diversification, gambling produces extra risks. See Xu Defeng, *The Legal Regulation Gambling*, 3 Social Sciences in China 147, 207-208(2016).

diseases. By the early modern time, various kinds of commercial insurance, i.e., reinsurance, etc., appeared one after another. In such a process, the form of insurance has been developed from mutual insurance organizations to commercial insurance companies and then to the advent of reinsurance and co-insurance. Despite the breakthrough made in terms of the organization forms and the risk-taking techniques, the essential idea of the insurance, namely the risk-transferring and the provision of a guarantee, remains unchanged. What is different from the mutual insurance organizations is that in the commercial insurance, notwithstanding some dilution found in the initial awareness of the mutual assistance, the intention of the policyholder in buying insurance is not directly based on the need for a kind of mutual assistance. However, policyholders give the payment of the premium via an insurance contract, thus granting the insured a promise that the insurer will offer the insurance benefit in case of an agreed insurance accident. It is still a spread of risk among many policyholders through the application of the "law of large numbers," and there is no change as to the risk-spreading and risk guarantee that come with insurance. In our lives, the repeat hearing of sayings like "buying insurance equals buying safeness; what you bought is nothing but to be rest-assured with it" is a direct reflection of insurance. We have scholars who have pointed out that the most significant function available with the insurance system lies in that the various losses incurred in one's daily life as a result of various personal or property risks or the risks of liabilities for other people are spread out among and compensated by a "commonality."[415] Specific to life insurance, its primary purpose is to ensure a stable life for the beneficiary after the death of the insured. If the primary purpose of a contract is for medical service or investment service, even though this contract bears specific characteristics of the insurance, it can not be called an insurance contract.[416] Therefore, insurance is a "counter-risk system," which spreads the individual risks among the whole by relying on several mathematical techniques represented by the law of large numbers.[417] It is a system that not only carries on a mutual assistance spirit characterized by "I do for you, and you do for me,"

[415] See Jiang Chaoguo, *Basic theories of Insurance Law*, China University of Politic Science and Law Press, 2002, p.19.

[416] "The main purpose of a life insurance contract must be the protection of beneficiaries. If the predominant purpose of the contract is other than protection-for example, the provision of health services, the service and repair of fluorescent lights, or investment services, the contract is not a contract of insurance, even though it contains some insurance features." See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 193 (1971).

[417] "For the insurance company insurance is a business of assuming risk through pooling and distribution, a special technique that individuals cannot perform for themselves unless they can become self-insurers." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1082(1973).

but also achieves a guaranteed stable life. If our life remains stable always, then it is entirely unnecessary to have insurance.[418] It is not only the essential function concerning the connotation of insurance but also the fundamental difference that distinguishes it from investment, liability for tort, and social assistance.

In theory, we have different aspects in exploring the constitutive elements of insurance, which mainly are the "four elements theory," namely the "risk pool," the "premium," the "transfer of risk" and the "damage,"[419] the "five elements theory," namely the "specific risk accident," the "ensure of loss compensation and stable lives," the "collection of a majority of economic entities," the "reasonable basis for calculation" and the "economic system"[420] and the "six elements theory," namely the "commonality," the "risk," the "homogeneity," the "need for compensation," the "compensational nature" and the "independent right to make legal claims."[421] Also, some scholars have noted that the necessary condition of life insurance is the "death risk pool."[422] By analyzing those viewpoints, the abovementioned constitutive elements of insurance can be divided into two perspectives, the "economic level" and the "legal level." At the "economic level," the elements that are being stressed are those elements, including the "risk pool," the "collection of a majority of economic entities," the "reasonable basis for calculation," the "homogeneity" and "economic compensation." Those elements, in essence, are the demand from mathematical techniques represented by the law of large numbers. At the "legal level," the elements that are being stressed are those ones, including the "premium," the "compensational nature" and the "independent right to make legal claims." In fact, those elements are the conditions for the establishment of the insurance contract or the reflection of its effectiveness. Insurance contract and mathematical techniques are all the indispensable elements of the insurance system, wherein the insurance contract is shown as the legal appearance of the insurance; while the mathematical techniques, as the tool used to realize its economic function, is a more inherent and essential element. In other words, an insurance contract is built based on the insurance-related mathematical techniques, where different constitutive elements of insurance are derived, which is to say that those

[418] See Yuan Qianzhi, *The General Part of Insurance Law*, (Beijing: China Financial Publishing House, Chinese translation edition, translated by Li Jinzhi, 1983), p.29.
[419] See George E. Rejda &Michael J. McNamara, *Principles of Risk Management and Insurance*, (New York: Pearson Education, 2014), p.5.
[420] See Yuan Zongwei: *Insurance Studies: Risk and Insurance*, (Taibei: San Min Book Co., Ltd., 1998), pp.51-52.
[421] See Jiang Chaoguo, *The Definition and Nature of Insurance*, 13 Taiwan Law Review, 57-58(1996).
[422] See Notes, *Variable Annuity: Security or Annuity,* 43 Va. L. Rev. 699, 793 (1957).

mentioned above different constitutive elements of insurance are merely the results of different emphases or different focuses of those scholars' understandings, but there is no fundamental divergence among them.

In addition, the obligation of telling the truth, the obligation to inform an increase in risk, insurable interests, etc. as the legal requirements put forward in the *Insurance Act* is intended to prevent an adverse selection and moral risk and are also the requirements raised by mathematical techniques represented by the law of large numbers. Otherwise, the sample-based speculation theory and the law of large numbers can't realize accurate speculation and the spread of risk.[423] Because of this point, mathematical techniques represented by the law of large numbers are indispensable constitutive elements of insurance, and also the elements that form the unique "characters" of insurance. It is also the essential connotation that explains why the transfer of risks and risk-sharing is repeatedly stressed in the aforementioned VALIC case and UBLIC case. Life insurance regards the life of the insured as the underwriting risk. In this sense, if the risk insured by an insurance contract is the death risk, and also the bearing of this risk is in conformity with mathematical techniques represented by the law of large numbers, then the product shall fall into the category of life insurance and also this can be considered as an element in determining the status of investment-linked insurance. On the other hand, elements, such as the "independent right to make legal claims" and the "compensational nature" are the critical points in or the legal effect of any insurance contract itself; hence they are not fundamentally different from the same of the investment contract and should not be considered as the elements in determining the legal attributes of investment-linked insurance.

3.2.2 Howey Test for the Determination of Securities

The use of the assumption of investment risk as the line of thought adopted in making judgments in UBLIC case and VALIC case has reflected the different institution functions between securities and insurance. That is, the life insurance mainly focuses on the provision of guarantee to its beneficiary and prevent it from running into any economic difficulties in case of the death of the insured, but the purpose of investment

[423] It is not sufficient from the information asymmetry or the weak position of the policyholder to explain the duty of the policyholder to inform and the duty of the insurer to explain, which are not grasp the nature of these obligations.

is to pursue a return on capital.[424]

The specific forms and types of securities are flexible and diversified. Whether investment-linked insurance or variable annuity can be included in the category of securities depends on our consideration of the determination of securities. Securities laws in various countries have different provisions on the scope of securities, and not all of them are provided the same way. Therefore, we need to analyze the essential definitions and determination standard of securities. In this respect, we have scholars who believe that securities are written vouchers prepared for the purpose of evidencing or setting up certain rights as it indicates that the holder of such securities has obtained the underlying rights and interests of those securities.[425] Following this approach, we would know that securities are a standard voucher for rights and interests and also with those characteristics, including "possessiveness," "formative," "profitability," and "negotiability." However, this definition has not conducted any further analysis concerning the general criteria used in determining securities. Comparing with the statutorily defined types of securities, a judgment on the essence of securities can fit the ever-changing development in the securities market. As for the essential definition of securities, the Howey test under US law is much more favored either in theory and practice.

The Howey test refers to a determination standard provided in *SEC v. W. J. Howey Co.* in order to determine whether an instrument belongs to an investment contract. The US Supreme Court, in *SEC v. W.J. Howey Co.*, defined "investment contract" as a "contract, transaction or scheme whereby a person invests his or her money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[426] Four elements are included in this determination standard, which is adopted by many courts after that and thus becomes an essential set of standards to be used to determine securities.[427] However, in subsequent cases, some amendments and further interpretations have been made on any of those four elements.

Firstly, the element, monetary investment, requires the capital contribution to the purchased investment contract is in monetary form. Nevertheless, in Teamsters v.

424 See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 196 (1971).
425 See Gu Gongyun, *Securities Law*, (Beijing: The People's Court Press, 1999), p.2.
426 See *SEC v. W.J. Howey Co.*, 66 S.Ct. 1100 (1946).
427 See Park McGinty, *What Is a Security*, 1993 Wis. L. Rev. 1033, 1052 (1993).

Daniel, the court did not confine it to monetary form. The purchaser gave up some tangible and definable consideration in exchange for substantial interests in the form of securities also complies with this element. However, if the labor is sold mainly to make a living, then it shall not be deemed as an investment.[428]

The second element is a common enterprise. The Federal Court of the US has not defined the "common enterprise" in this case, but this requirement mainly includes the "horizontal commonality" and the "vertical commonality" in the subsequent practice. The former generally requires the setup of a capital pool, and the investors will share the risk of the pooled capital.[429] In other words, this characteristic focuses on the relation among investors. The investment received from those investors shall form a "pool," the successful gaining of a return by each investor depends on the success of the whole business.[430] Vertical commonality also includes two determinations with different extents, namely the broad vertical commonality and strict vertical commonality. The former stresses the endeavor of the initiator, requiring that the wealth growth of all investors shall depend on the specialty of the initiator.[431] The latter stresses that the wealth of investors is not only mingled with the endeavor and achievement of a person or a third party seeking investment but also relies on the endeavors and achievements of those people.[432] Because there are certain defects for the application of the horizontal commonality and the broad vertical commonality standards,[433] therefore, there is a contention that as long as a certain kind of profit distribution is shown, this method will be able to apply "common enterprises" either in the form of horizontal commonality or vertical commonality.[434]

The third is "solely from the endeavors of other people." The word "solely" has been amended, meaning that we shall not understand it from its literal meaning, and all we need to do is to prove that endeavors of other people other than the investors are

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428 See *International Brotherhood of Teamsters v. Daniel*, 439 U. S. 551(1979).

429 "Three circuits require a form of common enterprise known as horizontal commonality, which focuses on the connection between the individual investor and other investors in the enterprise.This form of commonality requires that investors share the risk of the enterprise, usually through a pooling of funds. When horizontal commonality is present, multiple investors have interrelated interests in a common scheme and their fortunes are interwoven; they pool resources, share profits and share losses on a pro rata basis." See Miriam R. Albert, *The Howey Test Turns 64: Are the Courts Grading This Test on a Curve*, 2 Wm. & Mary Bus.L. Rev. 1, 16-17 (2011).

430 See Xing Huiqiang, *The Expansion and Boundary of the Concept of Securities in China's Securities Law*, 1 China Legal Science 244, 247(2019).

431 See *SEC v. Koscot Interplanetary, Inc*, 49 F.2d 478 (5th Cir. 1974).

432 See *SEC v. Glenn W. Turner Enterprises, Inc*., 474 F.2d 476 (9th Cir. 1973).

433 See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.205.

434 See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.205.

undeniable important elements.[435] For example, we have courts that explain this as "primarily," "substantially," or "predominantly" from the endeavors of other people.[436]

Fourthly, it needs the expectation for profit. This element includes two different concepts, namely whether or not a transaction involves any expected profit and whether or not this profit is the result of the endeavors of other people,[437] which is that it stresses the investors' expected profit shall be acquired with the investment endeavors of the commonality.[438] This characteristic mainly allows the distinction between investment-oriented and consumption-oriented nature for goods purchasing. The difference between them lies in that, in general, unlike goods or service purchasing, the expected return via investment does not care too much about the "transaction carrier," but focus on the profit generated from the investment.[439]

However, divergence exists in foreign countries as to whether or not the Howey above test can be deemed as the essential definition of securities. Some scholars believe that the conception of securities should be judged based on the Howey test and that the determination of investment contract by the US Federal Court in the Howey case was flexible, which was maintained to be consistent with the broad concept the Congress has been followed in determining securities.[440] We should explain the definition of securities as a determination of investment contract – the "Howey Test."[441] Based on the test, an investment contract exists whenever the reasonable expectation for profit we have for an economic warrant comes from the endeavors of other people.[442] There is also a view that the Howey test is only intended to test out whether a particular financial instrument falls into the category of investment contract rather than a test of the securities itself. The term "securities" does not have a universal or general standard.[443] Besides that, if the Howey test was to be applied in traditional stocks or other types of securities as may be defined by the Securities Act, then it would be

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[435] See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.208.
[436] See *SEC v. Koscot Interplanetary, Inc*., 497 F.2d 473(5th Cir. 1974).
[437] See *Warfield v. Alaniz*, 569 F.3d 1015 (9th Cir. 2009).
[438] See *SEC v. Infinity Group Co.*, 212 F. 3d 180(3d Cir. 2000).
[439] See Peng Bing, *How to Define Illegal Financing: A Critique of Legal Interpretation of Illegal Financing by Supreme Court*, 6 Jurist 38, 44(2011).
[440] See Miriam R. Albert, *The Howey Test Turns 64: Are the Courts Grading This Test on a Curve*, 2 Wm. & Mary Bus. L. Rev. 1, 1 (2011).
[441] See *International Brotherhood of Teamsters v. Danie*, 99 S. Ct. 790 (1979).
[442] See John J. Eklund, *What is a Security*, 36 Wash. & Lee L. Rev. 847, 861 (1979).
[443] See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.192.

unnecessary for the *Securities Act* to list a large quantity of securities instruments.[444] Thus, it can be seen that the divergence of views about Howey test lies in whether it should be applied in the essential definition of securities or be deemed as the definition of investment contract.

Judging from the legal expression of investment-linked insurance, it appears in the name of a life insurance contract, in which two contents, namely the traditional life insurance and the investment, are included. Regardless of either we first determine as whether or not the investment-linked insurance contract belongs to the investment contract, and then regress it to securities, or we first determine as to whether or not an investment-linked insurance contract is a security, and then classify it into the securities bearing the type of investment contract, all of which points out to whether or not an investment-linked insurance contract is an investment contract. Namely, the use of Howey test rules to determine the attributes of the investment-linked insurance contract will not be affected by divergence above. Hence, the Howey test can be considered as a factor in analyzing the legal attributes of investment-linked insurance.

3.3 The Analysis of the Legal Attributes of ILI and the Limits in Determining the Nature of Its "Dominant Factors"

3.3.1 Analysis of the Legal Attributes of ILI

As mentioned above, investment-linked insurance is a hybrid financial product. Although the product is considered as an insurance product by CIRC, its essential legal attributes attach more importance to the attributes of securities.

First of all, investment-linked insurance appears in the form of a contract. If we refer to the above analysis on the constitutive elements of insurance and securities, we may well be able to analyze the legal attributes of investment-linked insurance from its contract content.

In terms of the clauses of the contract, an investment-linked insurance contract includes two parts of provisions, provisions on insurance and provisions on investment, and also, it participates in investment activities through investment accounts. Generally speaking, the investment account, separately established beyond the guarantee account

[444] See *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1958).

of the insurance acts as the carrier and the realization tool of the investment and financial management functions of the investment-linked insurance rather than serves the role of insurance guarantee. Moreover, if we view it from the sales advertisement and product instructions about it, some investment-linked insurance contract has expressly indicated or particularly noted that the focus of this product is inclined to finance management, which implies a direct reflection of an investment-linked insurance product with strong investment nature. In the event where the design idea of investment-linked insurance has not been clearly expressed, the primary purpose of the buyers is to expect the returns received from investment and finance management, rather than the insurance guarantee brought by insurance. Because the major part of the premium is transferred into the investment account with the expectation for the return on "this portion of premium," investment risk concerning this part has also been fully assumed. It can be seen that though investment-linked insurance includes insurance, such insurance does not play a significant role in it.

Secondly, the essential element used to determine whether or not an uncommon warrant is security lies in the discovery of the actual traits and operation of this warrant.[445] For a new financial product, such as the investment-linked insurance, we should not limit to the analysis of the form of the contract, but should also carry out an essential discussion on its mode of operation.

The establishment of a traditional life insurance contract requires the payment of premium as the consideration, except for the similarities it shares with the monetary investment under investment contract, traditional life insurance does not care about those elements of the investment contract, including the "commonality", the "endeavors from other people" and the "expectation for profit". However, based on the foregoing discussion on the operation of investment-linked insurance, especially the establishment of a particular investment account is to meet the requirements raised by various elements in the Howey test. From the functionality perspective, the separate account is similar to fund, because individual investors are not only incapable of paying remuneration to any private financial manager but is also unable to provide professional management consultation. Fund and separate account, in this sense, have realized the diversified investment, which otherwise is hard, for those individual investors engaging

[445] See John G. Sobieski, *What is a Security*, 25 Mercer L. Rev. 381, 392-393 (1974).

indirect investment in stocks and bonds.[446] Therefore, despite the capital in the investment account has the name of "premium," it is not to use the premium as the consideration in exchange for compensation or a fixed amount payment by the insurer in case any risk transferred to insurer occurs under the agreed circumstances, but to expect the return on investment through the professional finance management carried out by the insurer. The Howey test requires that the purchaser's subjective expectation of gaining profit from the endeavors of other people must be a significant motivation rather than an incidental purpose.[447] The subjective purchasing purpose of the policyholder of the investment-linked insurance also complies with this point. Just as indicated in the UBLIC case, the economic incentive found in the variable annuity may cause the policyholder to overlook the guarantee provided by the traditional insurance contract, but to seek growth in the investment value of the separate account.[448] Therefore, despite "risk guarantee fee" has been collected by the investment-linked insurance, in fact, the death benefit available with investment-linked insurance almost depends on the value of the investment account, which though quite distinctive if compared with the operation mode of the traditional life insurance, it entirely complies with the Howey test.

Thirdly, we can take "Ping An Ying-ding Life Investment-linked Insurance Contract" as an example for our analysis. This product collects in a certain rate an initial fee in its initial premium (if no more than 200 thousand, the initial rate is 4%), this amount will be allocated and transferred into the investment account as per the agreements on the units of the investment, the cash value of this insurance equals to the total value of the investment units under the investment account, and for this insurance, the death benefit is 105% of the total value of the investment account. In addition, within the investment account of this insurance, there are "Ping An Development Investment Account," "Ping An Fund Investment Account," "Ping An Chosen Equity Investment Account," and "Ping An Currency Investment Account," with investment proportions set for each of them, e.g., 60%-100% for "Ping An Fund Investment Account," in this way, the investors' different acceptable risk can be satisfied.[449] Thus, it can be seen that the insurance guarantee value of this product is subject to the value

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[446] See Howell E. Jackson & Edward L. Symons, Jr., *Regulation of Financial Institutions*, (Beijing: China University of Political Science and Law Press, Chinese translation edition, translated by Wu Zhipan, 2003), p.812.

[447] See Miriam R. Albert, *The Howey Test Turns 64: Are the Courts Grading This Test on a Curve*, 2 Wm. & Mary Bus. L. Rev. 1, 19 (2011).

[448] See *Securities and Exchange Commission v. United Ben. Life Ins. Co.*, 387 U.S. 202 (1967).

[449] See "Ping An Ying-ding Life Investment-linked Insurance Contract", Ping An Life Insurance No. 023 [2012].

of the investment account, the premium, cash value of the insurance policy and the death benefit of this insurance will be shown and calculated directly as per the investment units under the investment account.

Likewise, the securities attributes of the investment-linked insurance can also be reflected by the corresponding impact the fluctuation of the capital market has on it. For example, judging from the Shanghai Securities Composite Index and the sales of investment-linked insurance, the sales volume of investment-linked insurance is roughly and positively related to the Shanghai Securities Composite Index (as shown in the below table). In those times, the capital market has excellent performance, and the investment performance of investment-linked insurance also makes the purchasers feel satisfied. Thus, they will increase their investment. On the contrary, if the capital market does not have an excellent performance, it is quite likely that the investment performance of investment-linked insurance will make the purchasers feel unsatisfied; thus, they will reduce their investment. The character that the return on investment fluctuates with the change of the performance of the capital market is just the reflection of the attributes of the securities. This fluctuation does not belong to the contents of traditional life insurance either, and can not achieve the purpose of ensuring a stable life.

Table：Shanghai Index and the sales of ILI (Unit: million yuan)[450]

Year	Shanghai Index		ILI	Year	Shanghai Index		ILI
	(Min)	(Max)			(Min)	(Max)	
2000	1,361.21	2,125.72	1,660	2010	2,319.74	3,306.75	552.23
2001	1,514.86	2,245.44	10,661	2011	2,134.02	3,067.46	454.24
2002	1,339.2	1,748.89	6,935	2012	1,949.46	2,478.38	436.33
2003	1,307.4	1,649.6	6,389	2013	1,849.65	2,444.8	8,317.51
2004	1,259.43	1,783.01	5,295	2014	1,974.38	3,239.36	28,949.79
2005	1,000.52	1,328.53	4,584	2015	2,850.71	5,178.19	67,788.33
2006	1,161.91	2,698.9	5,982	2016	2,668.76	3,301.21	93,897.44
2007	2,541.52	6,124.04	39,383	2017	3,016.53	3,450.49	47,041.76
2008	1,664.93	5,522.78	42,549.8	2018	2,449.2	3,587.03	33,285.30
2009	1,844.09	3,478.01	11,247.8	2019	2,440.91	3,288.45	37,600.00

In the end, the actuarial provisions enacted by the regulatory authority on investment-linked insurance also tend to attach more importance on the regulation of

[450] See Yearbook of China's Insurance (2000-2013), and CIRC website. http://bxjg.circ.gov.cn/web/site0/tab5203/; Shanghai Index< http://www.sse.com.cn/aboutus/publication/yearly/documents/c/tjnj_2019.pdf.pdf>.

investment account, as it is discussed previously, the risk guarantee is a factor that must be included in the CIRC's definition of investment-linked insurance. Also, it is required that the content disclosed by the insurer must consist of the "risk guarantee fee" which is confirmed using the actuarial method.[451] In 2003, the CIRC enacted the *Notice about the Issuance of Actuarial Provisions on New Personal Insurance Products* (No. [2003] 67), in which brief provisions have been stipulated on the risk premium of the investment-linked insurance. For example, risk premium should be collected through the deduction of the investment units in the investment account, for which the calculation method is to multiply the risk coverage by a certain percentage (this percentage should be no more than 100%) of the predetermined risk incidence. For the predetermined death rate, data from the *Experience Mortality Table* prepared by China's Life Insurance Industry should be adopted. For another example, for investment-linked insurance with premium paid per term, the basic premium for each policy year should be no more than 3000 *yuan* at the minimum and 5000 *yuan* at the maximum.[452] However, although this provision has covered the definition of the risk premium and the upper and lower limits of the termly paid premium, this document is mainly concentrated on formulating stipulations on the assessment of investment account and the pricing of investment units but has very brief provisions on the accurate calculation of risk premium. It can be seen that the actuarial provisions on investment-linked insurance, as made by the CIRC, also keep stressing the part of securities as found in the investment-linked insurance.

Therefore, despite the investment-linked insurance has the hybrid nature – involving both insurance and securities, the actual operation of this contract depends on the operation of the investment account, and the return received for this account becomes the death benefit upon the occurrence of an insurance accident. It indicates that the product has deviated from the risk pool of life insurance, as well as the mathematical techniques represented by the law of large numbers, its mode of operation is in full compliance with the Howey test for securities. Its primary purpose is no longer about the pursuit of the traditional insurance guarantee, but growth in the return on investment.

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[451] See Article 9 of *Interim Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (CIRC No. 6 [2001])

[452] See Article 6 of *Notice about the Issuance of Actuarial Provisions on New Personal Insurance Products* (CIRC No. [2003] 67).

3.3.2 Comparation and Analysis among Participating Insurance, Universal Insurance, and Variable Annuity

After we discuss the legal attributes of investment-linked insurance in the preceding paragraph, it is also necessary for us to compare the differences in legal attributes among participating insurance, universal insurance, and variable annuity, thus to specify the characteristics of ILI further.

First of all, in terms of the participating insurance, the actual allocated share of surplus by the insurer over a fiscal year should be no less than 70% of the whole surplus available for allocation for that year.[453] The distribution of this dividend is subject to the operational performance of the insurer for each year, that is, when the business performance is excellent, more dividends will be allocated. If the business performance of the insurer is on the average or even not so good, then fewer dividends or no dividends will be allocated. The policyholder and the insurer jointly assume this uncertain risk. The investment attribute reflected by the allocation of dividends is, in fact, the policyholder's enjoyment of a right, which is similar to the distribution of profits among shareholders by an insurance company, in the capacity of a creditor, with no direct participation in investment. However, the CIRC has requested that the amount of death benefit for participating insurance should be no less than 120% of the premium paid, also the way the insurance company has been followed in determining the premium should comply with the general actuarial principle.[454] In general, for participating insurance, the insurer follows a relatively conservative approach in the process of accurate calculation of premium by presuming "high" rates for relevant factors, i.e., higher death rate, higher surrender rate, higher operational cost or even lower interest rate. Furthermore, the profit generated by the use of the premium of this product for investment is allocated to policyholders in the form of distributing dividends. Therefore, though the participating insurance has an investment attribute, in fact, it still follows the practice of traditional insurance in its operation.

Taking "Ping An Zun-hong Life Endowment Insurance (Dividend)" as an example, this participating insurance has not established an investment account. Instead, all premium paid goes directly into the "guarantee account." For the survival benefit, 18% or 20% of the amount of primary insurance benefit will be paid; for the death benefit,

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453 See Article 13 of I*nterim Measures for the administration of participating insurance*.
454 See Article 4 and 5 of *Actuarial Provisions for participating Insurance.*

120% or 105% of the paid premium will be paid. Also, the policyholder has the right to enjoy the allocable surplus under the participating insurance of an insurance company.[455] However, the dividend enjoyed by the policyholder is not obtained by purchasing investment units, or by directing the insurance company to engage in a transaction with a third party according to its will on investment, thereby acquiring a return on investment. The sales of this insurance product follow the sales mode for traditional insurance, as most of its operating profit comes from the differences in mortality rates, interest rates, and other fee rates. Moreover, the payment of the insurance benefit for participating insurance is not built based on investment but is an accurate calculation based on the death risk pool, etc. rather than the main reliance on the investment performance of the insurer. If we take a look at the Howey test rules, we may know that all the premium paid by the policyholder to the insurer goes into the guarantee account rather than the investment account.[456] Not an expectation for growth in return in the future through the means of entrusted finance management, but merely participation in the share of dividends which is based on the actual operational performance of the insurance company, hence it is not in compliance with the Howey test.

Secondly, as for the universal insurance, the CIRC does not require it to establish a separate account for each policyholder. However, universal insurance, in general, does have an investment account for the convenience of increasing in either investment or risk coverage at any time in practice. Typical universal insurance includes additional expense and the premium collected based on the death risk of the insured. The rest of it goes into the investment account through which the money market rate can be obtained. Therefore, the premium of universal insurance goes into two destinations. One is for a guarantee account, and the other is for an investment account, in which the capital can be withdrawn at any time, something similar to the savings accounts with a bank, the return on investment for such capital is obtained based on the settlement interests rather than the investment units. The capital in the account participates in the securities market investment, and the investment performance of that account also determines the earnings of the policyholder.

The CIRC requires that the death risk coverage of universal insurance shall be no

455 See “Ping An Zun-hong Life Endowment Insurance (Dividend)”, Ping An Life Insurance No. 041 [2015].
456 See Article 13 of *Actuarial Provisions for Participating Insurance.*

less than 5% of the value of the account, and a minimum guaranteed interest rate should also be provided.[457] In practice, however, the weights given by various universal insurance to insurance attribute differs significantly, the risk premium for some of them is even zero, which complies with the Howey test for securities or is even developed into a financing tool. For example, the "An bang East Wind No. 5 Endowment Insurance (Universal Insurance)" has separately established a universal account for investment, whose portfolio and mode of operation should be determined by the insurer. The insurer collects 1% of the premium paid by the insurer as the initial fee, but will not further collect policy management fee and the risk premium for the first five policy years. In other words, for this insurance, the policy management fee and the risk premium for the first five policy years are zero, that is, the consideration for the transfer of risk has not been paid, so the account value expected by the policyholder directly depends on the investment performance of that account.[458] For this insurance, the minimum guaranteed interest rate is 3%, which is higher than the deposit interest rate of the bank over the same period. Thus, it can be seen that this promise on high return has raised an even higher demand on the capability of the insurer in utilizing its capital, risks, such as liabilities and mismatch may likely occur to the fund. We can see from this point that the actual operation of the investment account of this kind of universal insurance has deviated from the mathematical techniques represented by the law of large numbers, nor has it achieved the guarantee purpose of the insurance, but on the contrary, it complies with the Howey test and shows an apparent securities attribute.

Thirdly, in terms of a variable annuity, this product is personal insurance, whose policy-related interests are related to the price of investment units in the linked investment account, and which also has the minimal guaranteed policy-related interests as per the contractual agreement.[459] Comparing with that insurance for which the practice comes first and followed by the institutions in this regard, i.e., participating insurance and universal insurance and investment-linked insurance, variable annuity in China is the one being guided by an institution and followed by practice.[460] The first variable annuity in China was the "Bao De Ying" variable annuity plan launched by Jin Sheng Life Insurance in 2011. Compared with the traditional fixed annuity, the variable

[457] See Article 2 and 4 of *Actuarial Provisions for Universal Insurance.*
[458] See "An bang East Wind No. 5 Endowment Insurance (Universal Insurance)", An Bang Life Insurance No 13 [2017].
[459] See Article 1 of *Interim Measures for the Administration of Variable Annuity Insurance.*
[460] In 2011, the CIRC issued the *Notice on the Pilot of Variable Annuity Insurance* to encourage product innovation and carry out the pilot work of variable annuity insurance.

annuity adopts an investment account, provides minimal guaranteed policy-related interests, and follows an annualized payment.

Thus, it can be seen that in design, variable annuity shares the characteristics of investment-linked insurance, universal insurance, and traditional annuity. The rate of return for a variable annuity is not a fixed one because it is based on the rate of return on investment. The value of policy account equals to the price of the investment units (calculated by multiplying the number of investment units with the price of each investment unit) in the investment account linked to the specific policy; hence it has an evident investment attribute. The fee structure and upper limit of variable annuity insurance are consistent with that for investment-linked insurance.[461] However, the investment-linked insurance has no guaranteed minimal return, while the variable annuity has the clauses on guaranteed minimum return, and its investment attribute is stronger than universal insurance but weaker than investment-linked insurance.

Taking "ICBC An Sheng Life Insurance Bao De Ying Annuity Insurance (Variable)" as an example, this insurance is expressly confirmed as a finance management tool in its advertisement for sales.[462] After the less than 5% of the premium is deducted as the initial fee by the insurer of this insurance, the rest of the premium will be used to buy the investment units as per the buying rate of the next pricing day. The investment units bought will then be transferred into a personal account. The amount of death benefit also depends on the value of the individual account. The portfolio approach is adopted by the investment account of this insurance, wherein 0%-60% is allocated as equity assets, 30%-90% is allocated as a constant return asset, and 0%-20% is allocated as a liquid asset. Although this insurance undertakes that on the condition that there is no partial withdrawal or the insurance policy has never been canceled while ensuring the potential return, all premium paid shall be protected from all investment loss. However, this insurance has established a separate investment account for managing and measuring all investment activities. The profit and loss of investments, as generated by investment activities, will all be accrued in the investment account.[463] As it can be concluded, there is no difference between the investment account of the investment-linked insurance and this, the purpose of which

[461] See Article 4 of *Notice on the Pilot of Variable Annuity Insurance.*

[462] See the official website of the insurance, <https://www.icbc-axa.com/product/personal/personal4/wealth15/productdetail.jsp?CSRT=14423505239914468065>, Latest visited on March 17, 2019.

[463] See "ICBC An Sheng Life Insurance Bao De Ying Annuity Insurance (Variable)", No. 1-1, [2012].

is to engage in securities investment – a deviation from the mode of operation for traditional life insurance.

Therefore, it can be found that evident investment and finance management attributes are shown in participating insurance, universal insurance, investment-linked insurance, and variable annuity. However, the dividend allocation for participating insurance is different from the distribution of return in the investment account, which is under several insurances represented by the investment-linked insurance. Dividend under the participating insurance is acquired depending on the business performance of the insurer. No investment account has been established separately, and there is no direct involvement in investment operation and investment allocation, the return is also not being calculated according to the investment units, that is, the investment function of participating insurance is merely an investment in a broad meaning, not in a narrow way. In contrast, universal insurance, investment-linked insurance, and variable annuity realize their investment functions through a particular investment account; hence they are the investment in a narrow sense, with different forms of expression.

Table: Comparation of Investment Attribute in Some Products

Products	Traditional life insurance	Participating insurance	Universal insurance	Variable annuity	Investment-linked insurance
Investment Attribute	Cash value	Dividend distribution	Interest rate	Investment units	Investment units
The degree of investment	Weak ——————→ Strong				

3.3.3 Difficulties and Reflections in Determining Legal Attributes of the "Dominant Factors" of ILI

The above discussion of investment-linked insurance includes two elements, the insurance guarantee and investment and finance management. More often, the characteristics of investment and finance management are more significant. Under such a situation, if ILI is regarded as a whole, it becomes a debatable point for our theory studies as to how for us to determine the nature of it and how to apply laws to it.

Judging from the aforementioned VALIC case and UBLIC case, though only a few people with the opinion that "we realize that life insurance is an evolving institution. Common knowledge tells us that the forms have greatly changed even in a generation. And we would not undertake to freeze the concepts of 'insurance' or 'annuity' into the

mold they fitted when these Federal Acts were passed."[464] The opinion maintained by the majority of people as in both cases has all stressed the bearing of investment risk. Both cases have analyzed their elements, which conform with the insurance from the bearing of investment risk. The weighing of the investment part and the insurance part by the court is also included in such analysis – which dominating part should be referred to when inferring the legal attribute of it.[465] There is an opinion that refers to it as the predominant test.[466] Namely, as long as insurance protection and mortality considerations are dominant, principal, and central, and investment aspects are subordinate, secondary, and auxiliary, a product will not be a security.[467]

Conversely, if the investment attribute plays a significant role, then a variable annuity is securities rather than insurance. In VALIC, the Court, having identified what it found to be the product's insurance and investment features, measured them against each other and found the insurance features to be "ancillary and secondary" to the investment features.[468] However, it remains to be quite controversial as to the judgment on "dominant factors." For example, someone held the risk is distributed among all of the annuitants. Thus, as measured by the test of the risk-shifting and risk-distribution, the variable annuity is insurance.[469]

As for the primary and secondary judgments on two attributes of the investment-linked insurance, this thesis holds that irrespective of those factors, including "whether or not the investment risk is transferred," "product attractiveness", or the "subjective purpose of the purchaser," the dominant investment factor in investment-linked insurance can all be analyzed. However, it is still too hard for us to use this dominant factor to have an accurate measurement of the legal attributes of that product. A new divergence can be created as a result, and the problem has not been really solved. For example, an approach, in which a legal definition is made by making use of the predominant test and then applying corresponding *Insurance Act* and *Securities Act,* will ultimately make people overlook the "secondary part" under that approach, thus

[464] See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71 (1959).
[465] See *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 207 (1967).
[466] For example, "In VALIC, the Court, having identified what it found to be the product's insurance and investment features, measured them against each other and found the insurance features to be "ancillary and secondary" to the investment features. " See Milton P. Kroll & Gary O. Cohen, *Insurance—Security Identity Crisis*, 46 Geo. Wash. L. Rev. 790, 803 (1978).
[467] See Milton P. Kroll; Gary O. Cohen, *Insurance—Security Identity Crisis*, 46 Geo. Wash. L. Rev. 790, 794(1978).
[468] See Milton P. Kroll, Gary O. Cohen, *Insurance—Security Identity Crisis*, 46 George Washington Law Review 790, 803 (1978).
[469] See C. Lee Jr. Cook, *The Legal Barriers to the Variable Annuity*, 1958 U. Ill. L.F. 466, 469 (1958).

resulting in the lack of legal regulations on the "secondary part."

Admittedly, as to how to apply existing laws on a new matter, a general legal thought on this is to seek a determination of the legal nature of that new matter and then apply corresponding laws. However, the difficulties in applying this to investment-linked insurance lie in that this product has the dual nature of being an insurance and an investment concurrently, thus breaking the traditional financial system characterized by separated operation and separated supervision – neither insurance in the traditional sense nor a type of securities under current *Securities Act*. If it is an insurance, regressing it to a traditional insurance framework, would make the securities part remain unregulated. If it is a security, the investment account under investment-linked insurance attaches to the insurance attribute. Also, the characteristics, such as the failure to trade openly, all of them have made it far from a matter that can be solved simply by applying the *Securities Act*.[470] This line of thought has also been reflected in the country's judicial practice. For example, in the aforementioned judicial judgments, the reason their nature is ascertained as "disputes over personal insurance contracts" and hence they are confined to the application of the provisions in the *Insurance Act* is mainly because the investment-linked insurance is issued in the name of insurance.[471]

Besides, some courts acknowledge the investment attribute of that insurance and apply the logic of "caveat emptor," which is adopted in securities investment. Though the current line of thought as adopted in judicial judgment is easy to understand under China's existing written law system which features "separated operation and separated management for financial products," the problem lies in that investment-linked insurance, as a composite financial product, if we apply *Insurance Act* but ignores the application of several other laws, such as the *Securities Act, Law on Securities Investment Fund,* and *Trust Law.* It will lead to insufficient provision of information to policyholders, who buy this product, and their investment interests will not be able to get the protection from several systems targeted at the *Securities Act*, e.g., the information disclosure system. Hence, it is quite likely to have the occurrence of a large scale investment-linked insurance policy cancellation, just as what has happened in 2001 and 2008. The current approach is not only inevitable for the solution of this problem, but is also not the direction for the improvement of the protection of

[470] See *Notice on Strengthening and Standardizing the Execution of the Property Interests of the Life Insurance Products Owned by the Person Subjected to Execution,* Zhejiang High Court No.8 [2015].

[471] See Case No. 13591 [2007] of the Second Beijing Intermediate People's Court.

investment interests.

Therefore, it is not reasonable regardless of whether we determine the nature of investment-linked insurance as “securities” or “insurance” under China’s existing laws, or we can say both are acceptable. The crucial point lies in the law application after its nature is ascertained so that a reasonable logic can appropriately regulate it, thus to avoid supervision loopholes and the absence of investor protection. In a word, the determination of the formative nature of the investment-linked insurance is not the crucial point for our aim of seeking legal provision on this product, but the issue remains to be what kind of means of regulation, if adopted, can regress it back to the regulation under existing laws. Just as Judge Brennan has stressed in the VALIC case, “much bewilderment could be engendered by this case if the issue were whether the contracts in question were ‘really’ insurance or ‘really’ securities-one or the other. It is rather meaningless to view the problem as one of pigeonholing these contracts in one category or the other.”[472]

3.4 The ILI’s Regulation of the US, Japan, and Taiwan

3.4.1 The Change of the Approach of Regulation for the Variable Annuity in the US Law

In the determination of the legal attribute of the variable annuity in the US, the SEC has always been playing an important role, such as in the VALIC mentioned above and UBLIC cases. The standpoint of SEC is further reflected in the normative documents it has enacted, i.e., the SEC has noted in the *Release No. 33-5360* in 1973 that the variable annuity lacks the constitutive elements of insurance, the policyholder will assume the investment risk since it has a separate account.[473] In *Release No. 33-6051*, it has also been noted that death risk and investment risk should be valued, and multiple perspectives should be adopted in the analysis of variable annuities.[474] From the standpoints of SEC, though some insurance elements can be found in variable annuities, its essential characteristics can not thus be changed. Mainly, viewing from the features of the operation mode of variable annuities and many features it shares with the mutual fund, the variable annuity is thus determined as securities by the SEC.

[472] See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 80 (1959).
[473] See SEC No. 5360 (Jan. 31, 1973).
[474] See Release No. 33-6051.

The SEC's approach is that the weight or importance of the investment factor in the product in dispute is the main consideration in determining the legal status of the variable annuity. In other words, the degree of importance for investment factors is determined according to product specification, attractiveness, and the investment risk for the investor,[475] but the death risk in a variable annuity will not be used as a determinant for the legal attribute. For this, there is an opinion that the determination method used by the SEC can not be trusted because it is based on the "form over substance" and "appearance over economic reality."[476] This thesis also agrees on this critical viewpoint, because the practice that SEC measures this issue from just a certain characteristic of a variable annuity is not adequate. Variable annuities are hybrids of insurance and investment.[477] From the perspective of insurance, though the lifespan of the insured can not be predicted accurately in variable insurance, the insurer guarantees that it will continue to pay the annuity irrespective of the longevity of the insured. Variable annuity complies with the two elements, either it is tested by "risk-shifting" or "risk-distribution," thus should be considered as insurance.[478] The distinctive feature of a variable annuity is that the pensioners pay to purchase units of securities fund, which is quite like the case with an open investment company.[479] However, this is only one aspect of the legal attributes of a variable annuity. Many insurance products themselves also have specific investment characteristics; if we analyze this issue from the concept of the investment itself, we will know that any input or arrangement of a fund to obtain a return on it can all be called investment in a broad sense.[480] For example, contract clauses on cash value, fixed payment, savings function have reflected the broad sense of investment for traditional life insurance.

As for an insurance contract, Section 3(a)(8) of the *Securities Act of 1933* takes the expression "exempted securities", and uses the word "exempt", not "exclude". If it takes "exclude", that means an insurance contract is not within the scope of the

[475] "The SEC assesses the investment elements for their "importance" primarily in terms of the product's presentation, appeal, and investment risk to purchasers." See Milton P. Kroll , Gary O. Cohen, *Insurance—Security Identity Crisis,* 46 George Washington Law Review 790, 794 (1978).
[476] "Ironically, such a test smacks of the discredited approach based on form over substance, appearance over economic reality". See Milton P. Kroll , Gary O. Cohen, *Insurance—Security Identity Crisis,* 46 George Washington Law Review 790, 795 (1978).
[477] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts,* 51 B.U. L. Rev. 177, 186 (1971).
[478] See C. Lee Jr. Cook, *The Legal Barriers to the Variable Annuity*, 1958 U. Ill. L.F. 466, 469 (1958).
[479] See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.219.
[480] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 Boston University Law Review 177, 196 (1971).

securities law; If the Act takes "exemption", an insurance contract excuses or releases from compliance with securities law.[481] Furthermore, Section 3(a)(8) of the *Securities Act* seemingly forms a negative hint that the policy is a security with immunity from registration, but still should subject to the anti-fraud clause.[482] Therefore, if even the traditional insurance also bears specific investment characteristics, purely emphasizing the investment factor in the variable annuity without considering the insurance attribute is debatable under the SEC's regulation.

As it can be concluded from the above discussion, though the US Federal Court and SEC take different methods for the determination of the legal attributes of a variable annuity, both of them try to figure out whether it is the insurance characteristic that dominates or the securities attributes plays a significant role as far as the annuity in dispute is concerned, so that the line of thought featuring "the primary absorb the secondary" will then be used to determine the legal attributes of variable annuity. However, just as discussed above, this line of thought has difficulties in terms of its law application, i.e., it is hard for the law application of variable annuities to observe the provisions in Securities Act thoroughly. For this reason, to have better supervision on variable life insurance and also in light of the composite financial nature of the variable life insurance, the SEC has enacted several provisions, such as *Rule 151* and *Rule 151A,* which exempt the application of the *Securities Act* to any variable annuity that complies with the set conditions.

Rule 151 – the "Safe Harbor," which was enacted by the SEC in 1986. The rule provides some essential factors for variable annuity contracts to exempt securities law, such as "issued by a corporation (the insurer) subject to the supervision of the insurance commissioner," "the insurer assumes the investment risk," and "the contract is not marketed primarily as an investment."[483] Later on, in 2009, the SEC made amendments to it and enacted the Rule 151A, in which it stipulates under the following circumstance, insurance must be registered and disclosed pursuant to the *Securities Act*, (i) the paying

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[481] See Patrick S. Collins, *Regulation of Securities, Markets, and Transactions: A Guide to the New Environment*, John Wiley & Sons,Inc., 2011, pp.10-11.

[482] See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.218.

[483] (a) Any annuity contract or optional annuity contract (a contract) shall be deemed to be within the provisions of section 3(a)(8) of the Securities Act of 1933 (15 U.S.C. 77c(a)(8)), Provided, That (1) The annuity or optional annuity contract is issued by a corporation (the insurer) subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia; (2) The insurer assumes the investment risk under the contract as prescribed in paragraph (b) of this section; and (3) The contract is not marketed primarily as an investment. See 17 CFR 230.151: Safe harbor definition of certain "annuity contracts or optional annuity contracts" within the meaning of section 3(a)(8).

of insurance benefit by the insurer is related to the investment performance of security; (ii) the amount paid exceeds or is less likely to exceed the guaranteed amount.[484] Likewise, the SEC has also realized that it is rather difficult for the variable annuity to be subject to the provisions in the *Investment Company Act of 1940.* Unlike a fund, the variable annuity contract bears the dual characteristics of insurance and securities, the *Investment Company Act of 1940* does not apply to this annuity and its separate account.

Meanwhile, in order to regulate the scheduled premium variable life insurance and flexible premium life insurance and a better application of the *Investment Company Act of 1940*, the US has set forth the "6e-2" and the "6e-3(T)". The former, 6e-2, was enacted in 1976. The separate account was defined in 6e-2, including some immunity circumstances for the *Investment Company Act of 1940.*[485] The SEC enacted 6e-3(T) in 1987, wherein some temporal immunities were offered to separate account of flexible premium variable life insurance. It is stipulated that the capital of the separate account of variable annuity is limited to the sales of variable life insurance contract, the offering for sale of the scheduled premium variable life insurance, accrued dividend in relation to those contracts and the advance payments in relation to the operation of the separate account, that the fund in the separate account can not be used for variable annuity or in contractual liabilities involving no life or life contingencies. [486]

As it can be known from above, the provisions set forth by the SEC on the variable annuity and variable life insurance are only limited to disclosure, anti-fraud, and sale practice,[487] excluding supervisions on those aspects of the insurer, e.g., its solvency, which is to say it will not interfere with anything in the category of insurance which is traditionally under the supervision of the state government. The SEC in the US also realized afterward that those investment-featured insurances are not only investment contracts or insurance contracts only, but insurance and investment factors can also be divided precisely for the ease of management by the State Regulators and SEC, respectively.[488]

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[484] See Release No. 33-9152.

[485] For example, if a separate account meets the requirements of paragraph (a) of this section, then such separate account and the other persons described in paragraph (a) of this section shall be exempt from the provisions of the Act as follows:(1) Section 2(a)(35): Provided, however, That the term "sales load," as used in the Act and rules and regulations thereunder, shall have the meaning set forth in paragraph (c)(4) of this Rule. (2) Section 7. See 17 C.F.R. § 270.6e–2.

[486] See 17 CFR 270.6e-3(T), Subsection(a)(2), (a)(3).

[487] See SEC Release No. 33-9152; File No. S7-14-08.

[488] See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.220.

Apart from that, judging from the regulations in various states (see below table), despite most states still refers to the variable annuities as insurance, there have many states that have changed their traditional standpoint and expressly set forth in their *State Securities Act* that the variable annuity should be deemed as a form of securities. For example, in Hawaii, it is Blue Sky Law (*State Securities Act*), a law mainly stipulates provisions on the sales of financial products, including variable annuities, adopts the *Uniform Securities Act of 1956*. Also, the *Insurance Act* of the state follows the *Variable Annuity Model Regulation* enacted by NAIC, this Model Regulation set forth its regulations on the basis that the variable annuity is determined as insurance.

Thus it can be seen that in the law system of Hawaii, variable annuities are subject to the application of both the *Insurance Act* and the *Securities Act,* and also variable annuities are expressly included in the definition and enumeration of securities as made in the *Hawaii Revised Statutes* and Article 485A-102 of the *Uniform Securities Act (Modified).*[489] Despite no consensus has been made between the SEC at the Federal level and various states on the legal attributes of a variable annuity, the joint supervision on variable annuities have been formed. In other words, the state statutes attach importance to the supervision of solvency and reserve capital when it comes to insurance. In contrast, for the SEC, its importance is attached to the information disclosure.

Table: Variable Annuity in American state securities law [490]

Status of variable annuity	Adopting the NAIC Model Regulation	Non-adopting NAIC Model
Securities	Hawaii, Kentucky, Missouri, Montana, Nevada, North Dakota, Rhode Island, South Dakota, Vermont, Washington	Arizona, Florida, Massachusetts, New York
Insurance	Alabama, Alaska, Arkansas, California, Colorado, Connecticut, Delaware, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Mississippi, New Jersey, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, West Virginia, Wyoming	Georgia, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, Ohio, Texas, Virginia, Wisconsin

Therefore, as a hybrid financial product, a variable annuity is difficult to apply the traditional financial regulation system because its objective composite nature can not be adequately reflected regardless of whether it is defined as insurance or as a security.

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[489] See Hawaii Revised Statutes Section 485A-102: "Security" means a note; stock; treasury stock; security future…variable annuity contract….

[490] See Dean Sugano, *Variable Annuity Contracts Under State Statutes Regulating to Securities and to Insurance*, (Report No. 4, 2006), available at < http://www.state.hi.us/lrb/ >, pp.27-45.

The definition of variable annuities as securities is the primary standpoint adopted by the SEC. However, at the state level of the US, variable annuities are mainly defined as insurance. Yet, irrespective of whether it is defined as insurance or securities, the application of other relevant laws is not rejected, which has also reflected that the supervision of the US law on composite financial products, such as variable annuities, has turned from the definition of the nature of their legal forms to the essential regulation of those products.

3.4.2 Mutatis Mutandis Application of the *Financial Instruments and Exchange Act* in Japan

On October 1st, 1986, Nippon Life Insurance Company started to sell its variable insurance, and this product has the following characteristics: (1) it is separated from a general account to form special separate accounts for capital operation; (2) based on the actual performance of the operation, there are changes to several things, such as the value of the insurance benefit, the risk of which will be borne by the insurance company, whereas the policyholder shall bear the investment risk of the special account; (3) it mainly invests in negotiable securities, such as the stocks and bonds, whose business performances depend on the stock price and exchange rate, so it has the characteristics of having high risks and high returns; (4) minimal guarantee set to the insurance benefit.[491] Japan experienced in the economic bubble years from the late 1980s to the early 1990s; thus the variable insurance achieved relatively good sales performance, and the product was hotly pursued at that time.

However, three years after the launch of the variable insurance, at the end of the year 1989, Japanese economic bubble started to burst, with the crash of the stock market, the rate of return for the variable products declined, and the performance of the insurance company in the operation of its assets for the separate accounts declined even to such an extent that the cash value after the termination was far below the premium previously paid. Investors were suffering from a huge loss, and there was a high incidence of the disputes in which the insurance companies and the banks were the defendants.[492]

In 2006, Japan amended its *Securities Exchange Act* and renamed it as *Financial*

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[491] 参见[日]松井美知子：《変額保険の裁判例にみる融資者の責任》，《千葉大学社会文化科学研究（創刊号）》，第 128 页。

[492] 参见[日] 黒木松男：《変額保険の勧誘と説明義務》，《創価ロージャーナル第 2 号》，第 157 页。

Instruments and Exchange Act. The *Financial Instruments and Exchange Act of 2006* has realized the transformation from the traditional *Securities Exchange Act* to the "transitional" Financial Service Act – the comprehensive law. This law has, to the maximal extent, included its investment financial commodities and financial services into its applicable objects, and applies same regulations for the ones with identical economic functions, thus to construct a horizontal, all-around industry regulation, covering the sales, persuasion, assets management, and investment advice, as well as to build a basic framework for the conduct regulation.[493]

More specifically, the applicable objects provided by this law are investment commodities with "investment nature," and in terms of its scope of regulation, it has expanded the scope of traditional negotiable securities. The securities listed by Article 2 (1) of the *Financial Instruments and Exchange Act* includes 21 types, such as National bonds, local government bonds, enterprise bonds, stocks, investment trust, etc. Also, the law has stipulated in Article 2 (2) that the right of non-issued securities and warrant are deemed to be Securities – the "quasi- negotiable securities"; Article 2 (2) (v) further regards the collective investment scheme as the miscellaneous provisions for investment commodities, which includes three legal elements - "money invested or contributed by the equity holder", "business that is conducted using the money" and "distribution to investors dividends or profits arising from business."[494] The Howey Test in the US has been referred to when defining the meaning of a collective investment scheme.[495]

A traditional insurance contract is also a monetary contract agreed between parties concerned and belongs to financial instruments in a broad sense. However, this insurance contract is a contract with the insurance guarantee function, which is the pursuit of the transfer of risk to the insurer by the policyholder. Hence it is different from the investment commodities for which the investors proactively assume the risks. For products, such as the variable insurance and variable annuity, the cash value and insurance benefit, which "assume" the risks for the policyholder, are being affected by the exchange rate, and there is a likelihood that it may have large fluctuation.[496] Therefore, when formulating the *Financial Instruments and Exchange Act* in 2006,

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[493] See Yang Dong, *The Legislative Integration Theory of Financial Service*, (Beijng: Law Press, 2013), p.89.
[494] See Article 2 of the *Financial Instruments and Exchange Act.*
[495] 参见[日]黑沼悦郎：《金融商品取引法》，有斐閣 2016 年版，第 41 页。
[496] 参见[日]安居孝啓：《最新保険業法の解説》，大成出版社 2016 年版，第 1062 页。

Japan had also amended the *Bank Law* and *Insurance Business Law* and set forth the "mutatis mutandis application clauses." For bank or insurance products with strong investment nature, *Financial Instruments and Exchange Act* is quasi-applicable. The Law's failure to directly include "bank products with strong investment feature" and variable annuity into its scope of regulation can avoid the repeat application of relevant existing behavior rules.[497]

Article 300-2 of Japan's *Insurance Business Law*, as a mutatis mutandis application clauses, stipulates that the *Financial Instruments and Exchange Act* is allowed to be applied to "special insurance contract."[498] The so-called "special insurance contract" refers to an insurance contract that has the risk of loss (the total premium paid by the customer exceeds the total amount of insurance benefits, returns and other payments received by the customer as a result of signing this insurance contract) caused by fluctuations in interest rate, currency price, market exchange rate of financial instruments and other indexes.[499] Article 234-2 of Japan's *Regulation for Enforcement of the Insurance Business Act* has enumerated the special insurance contracts, including among others (1) special insurance contracts that link to the investment performance; (2) insurance contracts whose insurance benefits or cash value may be lower than the total premium paid due to the fluctuations in interest rate, currency price, market price or other market indexes for the financial instruments.[500]

Financial Instruments and Exchange Act includes the financial commodities with investment nature (including bank financial products and insurance financial products, both of which have investment nature) into its scope of regulation.[501] Also, based on the fact that in Japan, the causes for the filing of lawsuits relating to variable insurance are mainly those issues in relation to product persuasion and obligation to explain,[502] for insurance commodities with investment nature, e.g., the variable insurance, when it comes to the application of *Financial Instruments and Exchange Act,* it is mainly about the quasi-application of the provisions on the sales and sales persuasion of financial commodities (as shown in below chart). For example, By Article 300-2 of Japan's

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[497] 参见[日]安居孝啓：《最新保険業法の解説》，大成出版社 2016 年版，第 1061 页。
[498] See Article 300-2 of Japan's Insurance Business Law, < http://www.japaneselawtranslation.go.jp/law/detail/?ft=1&re=02&dn=1&x=18&y=9&co=01&ia=03&ky=%E4%BF%9D%E9%99%BA%E6%A5%AD%E6%B3%95&page=66 >, latest visited on July 30, 2019.
[499] See Article 300-2 of Japan's Insurance Business Law.
[500] 参见《保険業法施行規則》（平成 8 年 2 月 29 日大蔵省令第 5 号）第 234 条の 2（特定保険契約）.
[501] 参见[日]神田秀樹，神作裕之：《金融法講義》，岩波書店（东京）2017 年版，第 223-224 页。
[502] 参见[日] 黒木松男：《変額保険の勧誘と説明義務》，《創価ロージャーナル第 2 号》，第 157 页。

Insurance Business Law, variable life insurance can apply those provisions of the *Financial Instruments and Exchange Act,* including Article 37 (1), Article 37-2 (obligation to indicate the form of transaction in advance expressly), Article 37 -3(1)(ii), Article 37-3 (1) (vi), and Article 37-3 (3) (submission in writing before the conclusion of a contract), Article 37-5 to Article 37-7 (submission in writing relating to the receipt of the insurance benefit, termination in writing, the obligation to conclude a contract with the assigned agency for dispute settlement, etc.), Article 38 (prohibited acts), etc. When applying the abovementioned provisions, the "financial instruments trade contract" should be just replaced with a "special insurance contract."[503]

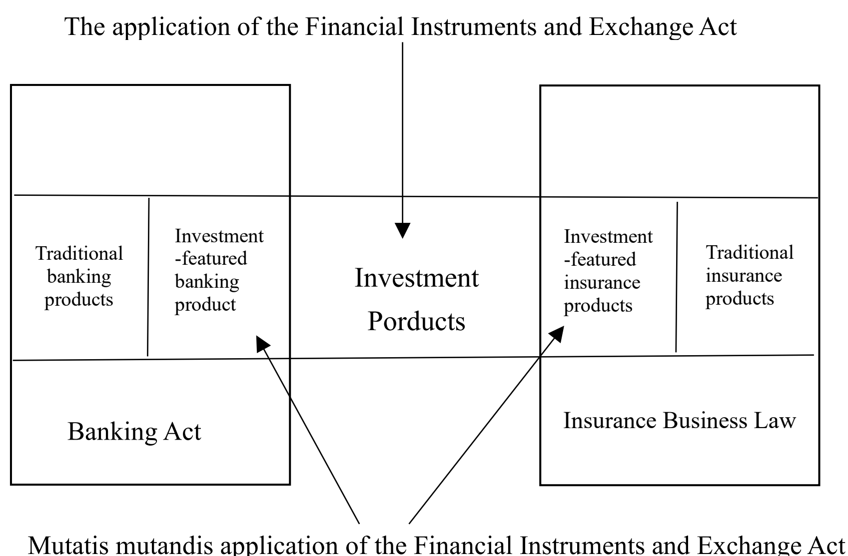


Figure. Rules for trading and persuasion of Japanese financial instruments industry [504]

Therefore, it can be known from above, in Japan, through the quasi-provisions in the *Financial Instruments and Exchange Act,* securities under the variable annuity are affirmed, and the focus of the regulations is on those stages of the product sales, including introduction and sales. *Financial Instruments and Exchange Act* has realized the horizontal regulation of the financial commodities, the core purpose of which is to protect investors, and this can be reflected in Article 1 of this law – the Regulation Purpose. Also, the investors are divided into "general investors" and "professional investors," wherein the latter is further divided into "qualified institutional investors" and "special investors," requiring regulations on the financial practitioners' adoption of different investment-related persuasive acts for different investors.[505] In a word, in

[503] See Article 300-2 of Japan's Insurance Business Law.
[504] 参见[日]神田秀樹，神作裕之：《金融法講義》，岩波書店（东京）2017 年版，第 224 页。
[505] 参见[日]川村正幸：《金融商品取引法》，中央経済社（东京）2014 年版，第 481-488 页。

Japan, the securities attribute of the variable insurance and the protection of its related investment interests have been affirmed and responded respectively by the law.

3.4.3 The *Financial Consumer Protection Act* in Taiwan

The “American Founded Manulife Life Insurance Company” in Taiwan issued the “Manulife Beautiful Life Deferred Annuity” in October 2000, which start the development of the investment-linked insurance.[506] The investment-linked insurance was introduced in the *Insurance Act* by Taiwan in 2002, and it is regarded as insurance for the protection of investment interests. Thus, it can be seen that for the variable life insurance, unlike the “securities definition” adopted by US law, both the Chinese mainland and Taiwan adopt the “insurance definition.” Also, the adoption of the “insurance definition” by both for investment-linked insurance indicates that they are all under the impact of the sales channel. For example, the “bank agency channel” is an essential ways used on the Chinese Mainland for the sales of investment-linked insurance.[507] In Taiwan, the sales of insurance mainly rely on the banks, and the reason behind this is that the banks have a substantial basis of credit and are deeply trusted by the public, which is easier for them to sell insurance products to the public. Therefore, “hot sellers available from the insurance companies in Taiwan, including the investment-linked insurance, variable annuity, short-annual-term savings insurance, etc. all regard the “bank” as their significant sales channel.”[508]

However, this means of sales has caused an impact on the determination of the legal attributes of investment-linked insurance. “The introduction of this product was in fact because the banks at that time were also experiencing some difficulties in terms of their capital, it was necessary to have more commodities being sold by the banks. Therefore it was not being supervised as security.”[509] If the investment-linked insurance is defined as securities, the role of the banks will be changed from the insurance sales agents to the securities underwriters and will be bound by the laws and regulations on securities transactions; hence they will assume more responsibilities and have more

[506] See Chun-Hsiung Cho &Ming-His Tang, *The Reexamination of Investment Essence of Variable Insurance-Focused on U.S. Law Experience*, 1 Chaoyang Business and Management Review 53, 55(2011).
[507] See Chang Ding & Hanxiong Li. *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), p.20.
[508] See Taiwan Insurance Institute, <https://www.tii.org.tw/opencms/bulletin/pressRelease/000226.html>, Lates t visited on December16 2018.
[509] See Lin Guoquan, *The Legislation of Taiwan's Financial Consumer Protection Law*, http://www.iolaw.org.cn/showNews.aspx?id=31238>, Latest visited on December 21, 2018.

difficulties in their sales.[510] Therefore, in Taiwan, investment-linked insurance is being regulated as an insurance product.

Just the same as it is on Chinese Mainland, where the investment-linked insurance is determined as insurance, the inadequate protection of investment interests can be found in Taiwan, which results in the endless occurrence of those cases in which the rights and interests of the policyholders are being damaged. For example, in the case of "improper sales by Shin Kong Life" in 2006, it was not only promised that the policyholders would surely earn 4% over a profitable year, and also the policyholders were encouraged to purchase investment-linked insurance with the mortgage loans on houses. Those customers eventually suffered from heavy losses due to the subsequent "financial tsunami" in 2008.[511]

After the year 2008, strengthening the protection of financial consumers has become an important orientation for the financial legislation in an era with the likelihood of a financial crisis. It is because the protection of financial consumers has a significant impact on the financial crisis and strengthening the protection of financial consumers can significantly reduce the incidence of the financial crisis.[512] This has been witnessed in Taiwan as well. Particularly, the structured notes issued by the Lehman Brothers led to the investors' failure to claim damages.

Moreover, in the process of signing a contract, financial consumers can't have an equal capacity as the insurer may have in negotiating due to reasons including their economic statuses, information asymmetry, etc. There has been a broad consensus that this disadvantageous contractual status requests inclined protection from the legislation. In the context above, the "*Financial Consumer Protection Act*" was enacted by Taiwan in June 2011.[513] The enforcement of this law has, to a great extent, filled up the inadequacies found in the original regulations on investment-linked insurance.

Table. Comparation of the investment interest between Mainland China and Taiwan

[510] See Lin Guoquan, *The Legislation of Taiwan's Financial Consumer Protection Law*, http://www.iolaw.org.cn/showNews.aspx?id=31238>, Latest visited on December 21, 2018.
[511] See Liu Yu-Chuan & Lin Po-Han, *The Development and Regulation of Investment Policy in Taiwan-The Application of Financial Consumer Protection Act and Fair Trade Act*, 1 Fair Trade Quarterly 109, 119-121(2013).
[512] See Dai Guoqiang & Chen Chen, *Financial Consumer Protection and Financial Crisis: Empirical Research Based on 142 Economies*, 3 Journal of Finance and Economics 100, 100(2015).
[513] There are some information for the legislative background of Taiwan's *Financial Consumer Protection Law*, <https://lci.ly.gov.tw/LyLCEW/agenda/02/pdf/07/07/01/LCEWA01_070701_00040.pdf>, Latest visited on December 22, 2018.

	Investment nature	The way to regulation	Financial consumer	Fiduciary duty	The suitability obligation	Civil relief
Taiwan	Stipulating in the basic law	Insurance Law and Financial Consumer Protection Act respond to ILI	Special legislation	Article 7 of FCPA	Article 9 of FCPA	Clear
Mainland	Stipulating in the administrative regulations	No laws to directly respond to ILI	The conception is not clear, is not clear, and the application of *Consumer Rights and Interests Protection Law* is controversial.	Limited to nominal trust	Stipulating in the administrative regulations	Obscure

First of all, the "*Financial Consumer Protection Act*" is legislation specially targeted at the group of "financial consumers." This law refers to the "protection of the rights and interests of financial consumers," the content of Article 1, as its primary value. More specifically, the disadvantageous statuses of financial consumers and the idea of offering inclined protection to them are explicitly specified, which is of vital significance to the correction of the actual unequal relationship a financial consumer in an investment-linked insurance contract. Article 4 of this law defines the "financial consumers" as those who receive the financial commodities or services provided by the financial service industry, while excluding those professional investment institutions or natural or legal persons with certain financial resources or professional capabilities, in doing so, it has included all the disadvantageous financial consumers and excluded those financial traders who do not require inclined protection. The "*Financial Consumer Protection Act*" does not respond to this issue from either the insurance or the securities attribute of those financial commodities represented by the investment-linked insurance, but to respond to it from the civil disputes arising out of the disadvantageous position those financial consumers are in. In case of dealing any contractual dispute in which investment-linked insurance is viewed as a whole, in terms of contract interpretation and judicial application, this benefits the consideration of both the relationship between the investment and the insurance parts and the favorable interpretation that should be made for an applicant of insurance in the event where there is any question about the insurance contract.

The inclined protection offered to financial consumers by the "*Financial Consumer Protection Act*" also means an increased amount of obligations imposed on the financial institutions. Before the enactment of that law, the "*Measures for the Investment Management of Investment-linked Insurance*" enacted by Taiwan distinguishes between a "fully entrusted" and a "non-fully entrusted" insurer based on

whether or not the said insurer is in its sole discretion (Article 20). The former requires a particular application for this fully entrusted business, which is filed in accordance with the *Securities Investment, Trust, and Adviser Act*, while the latter requires a declaration made to the competent authority by the insurer (Article 5). In addition, entirely entrusted insurers are vested with even higher obligatory demand and have to provide more considerate protection to the corresponding applicants of insurance. For example, for an entirely entrusted case, there are provisions including insurers prohibited from offering a guarantee to any asset under a specially established book or use it for a loan (Article 5), different scopes of investment for capital under the specially established book (Article 10 and Article 11), the qualifications for the insurer (Article 19), insurance contract and manual of the insurance commodity (Article 22), accounting principles for the specially established book (Article 25) and information disclosure (Article 27). However, irrespective of a "fully entrusted" or a "non-fully entrusted" case, the insurers of the investment-linked insurance are the asset managers of such assets under the specially established books, their roles all constitute the advisors for securities investment. Those specially established separate accounts have all adopted the trust structure, and a high basis of credit also exists.

Hence it is not different from the "fully entrusted" case, so there are doubts about the differentiated protection provided to investment-linked insurance and its related investment interests on this basis. For instance, we have scholars who have pointed out that it remains questionable as to why this practice that "whether or not an insurer in question is able to decide in its sole discretion on the subject matter insured" is deemed as the sole standard in determining whether or not there is any application of securities-related laws.[514] After the enactment of the "*Financial Consumer Protection Act*", Article 7 of this law has imposed the fiduciary duty in its highest standard to the financial service providers, and the original fiduciary duty in specific financial sectors has been expanded to cover all financial sectors, indicating that the inclined protection of financial consumers has been actually put into practice.

Secondly, in terms of the allocation of the burden of proof, the "*Financial Consumer Protection Act*" adopts an inversed burden of proof. In disputes over investment-linked insurance, the chief reason why an insurance applicant loses a

[514] See Kuan Chucheng, *A Review on the Laws and Regulations Regarding Separate Account on Investment-linked Insurance Products in Taiwan: Observations from the Perspectives of Theoretical and Comparative Law*, 109 Chengchi Law Review 177, 232 (2009).

lawsuit is being unable to produce a proof for the fact that the policyholder and its salespeople have failed to disclose risk adequately, and their sales are fraudulent. However, this burden of proof featuring the one that claims is the one that produces the evidence is quite demanding on the part of the insurance applicant. On the one hand, it is hard to produce evidence of the extent of the insurer's performance of the obligation to explain. On the other hand, "unless the insurance applicant has reserved the written materials given by the salespeople but to the contrary of the insurance contract, and must be able to prove that the salespeople provide the said material for the sake of signing the investment-linked insurance contract in dispute, otherwise it is quite hard for the insurance applicant to obtain any favorable result."[515]

However, after the enactment of the "*Financial Consumer Protection Act*," in Article 11 of that law, it stipulates as a proviso clause that "those circumstances in which financial service providers can prove that the damage is not caused by their failure to have a sufficient understanding of the appropriateness of the specific commodity or service provided to a specific financial consumer or by their failure to explain or explain truthfully or due to their wrongful or inadequate disclosure of risky matters are the exceptions." This clause has transferred the burden of proof for damages caused as a result of those matters, such as the failure to perform the obligation to explain to financial service providers represented by the insurer. If it is unable to produce evidence of its duly performance of the obligations to explain or to disclose risks adequately, then its failure to perform such obligation can thus be inferred. Under this mechanism of the inversed burden of proof, the insurance applicant of investment-linked insurance does not need to prove the deliberateness or the fault on the part of the insurer. Though this has imposed a relatively heavy burden of proof on the insurer, in turn, it has guaranteed the rights and interests of financial consumers represented by the insurance applicants.

Thirdly, in terms of the civil relieves, this law has also provided reliable regulations in this regard. Although Taiwan has particularly enacted the "*Securities Investors and Futures Traders Protection Act,*" including the establishment of a particular protection agency, as early as in 2002, to strengthen its protection of the rights and interests of the investors, more specifically, it stipulates that the investors can apply to the protection agency for the implementation of several relief rules, such as the

[515] See Lin Guobin, *Research on the Development, Supervision and Dispute of Investment-linked Insuranc e in Recent Years (2)*, 11 Taiwan Law Review 76, 78(2018).

mediation, filing of a lawsuit, or submission for an arbitration procedure, the definition of the investment-linked insurance allows no application of those civil relief rules. The dispute settlement mechanism for financial consumers (as in Chapter 3 of this law), as established by the "*Financial Consumer Protection Act,*" should not be restricted by the legal attributes of the investment-linked insurance if it is viewed from the macro perspective of financial consumption relation. This dispute settlement mechanism is not a traditional lawsuit procedure, but the Alternative Dispute Resolution (the "ADR").[516] Not only the result obtained by using this mechanism for the settlement of a dispute over financial consumption has the compulsory force, but also this mechanism "assumes" the responsibilities for the education, propaganda, and guidance offered to the financial consumers (Article 13).

Also, unlike the practice of attaching more importance to the administrative management relations by the "*Measures for the Investment Management of Investment-linked Insurance"*, this regulation defines the dispute over financial consumption as "civil dispute" (Article 5), thus making the private relieves more effective and also with more significance in reality. Despite both the "*Measures for the Investment Management of Investment-linked Insurance"* and the "*Law on the Protection of the Rights and Interests of Financial Consumers*" have provisions on several aspects, i.e., the anti-fraud and information disclosure on the party of the insurer, the latter makes the civil relief more readily available to insurance applicants, which allows the provision of more direct safeguarding if the private relieves, enforced by the insurance applicants based on their interests, are to be compared with the administrative regulations. Private persons can play positive roles, which is deemed as a complement to the role of the existing competent authority,[517] therefore the "*Financial Consumer Protection Act*" has supplemented the "*Measures for the Investment Management of Investment-linked Insurance"* by solving the latter's law application issue in which only administrative regulations apply to the securities part of the investment-linked insurance.

3.5 International Experience and Enlightenment

[516] See Lin Yuting, *Effective Settlement of New Financial Disputes: the Past, Present and Future of Alternative Financial Dispute Settlement Mechanism*, 199 Taiwan Law Review, 29(2011).

[517] See Shao Qingping, *Financial Regulation and Private Enforcement: Reflection on the Development of Regulation after the International Financial Crisis*, 40 Journal of Zhongzheng University, 98 (2013).

3.5.1 "All Roads Lead to Rome": Investors Protection

If we see from the preceding discussion on cases in the US, Japan, and Taiwan, products similar to investment-linked insurance have all undergone a long-term discussion. Regardless of the US's consideration of variable annuities as securities and thereby applies *Securities Act*, or the "insurance definition" in Japan and Taiwan (mutatis mutandis to *Financial Instruments and Exchange Act* or the particular legislation of the *Financial Consumer Protection Act*), they all reflect that the trend of turning from the definition of formative nature to the essential regulation for those kinds of financial products. That is to say, experience in comparative law serves the same purpose (investor protection), just as all roads lead to Rome. The line of thought represented by "substance over form" should be adopted, and the law applicable for those kinds of the product should be carried out in accordance with the normative logic the insurance and securities should have, thus achieving the purpose of the protection of the investment interests.

Except that the adoption of the line of thought represented by "substance over form" for the regulation of those kinds of financial products, serves the purpose of more effective regulation by the public power. More importantly, it is intended to strengthen regulations on the protection of investment interests. For example, in the US law, though divergence on the legal attributes of variable annuities still exists, the necessity in protecting the rights and interests of the investors are affirmed by Federal Supreme Court of the US, the SEC, various states and NAIC from the perspective of the protection of investors.

First of all, in the VALIC case, despite the investor protection issue was not mentioned in the Majority Opinion of the Federal Supreme Court of the US, Brennan, the Chief Justice of this case asserted in the Concurring Opinion that the need for a goal of investor protection is considered as the basis in determining variable life insurance is not insurance. In the view of the Chief Justice, Brennan, whether it is necessary to use the purpose for the regulation on the protection of investors as the basis to apply *Securities Act* to the annuity in dispute is critically dependent on whether or not the policyholder has directly involved in the allocation of the business profits made by the insurer. Based on the need for investor protection, he held that the variable annuity should be regressed to fall into the scope of application by the *Securities Act*, and he also had an excellent discussion on this point:

"This congressional division of regulatory functions is rational and purposeful in the case of a traditional life insurance or annuity policy, where the obligations of the company were measured in fixed-dollar terms and where the investor could not be said, in any meaningful sense, to be a sharer in the investment experience of the company. In fact, one of the basic premises of state regulation would appear to be that in one sense the investor in an annuity or life insurance company not become a direct sharer in the company's investment experience; that his investment in the policy or contract be sufficiently protected to prevent this. But the situation changes where the coin of the company's obligation is not money but is rather the present condition of its investment portfolio. To this extent, the historic functions of state insurance regulation become meaningless. Prescribed limitations on investment and examination of solvency and reserves become perfectly circular to the extent that there is no obligation to pay except in terms measured by one's portfolio. But beyond controlling corporate solvency and the adequacy of reserves, and maintaining observance of the legal list of investments, the state plans of regulation do not go in regulating investment policy. Where the nature of the obligation assumed is such, the federally protected interests in disclosure to the investor of the nature of the corporation to whom he is asked to entrust his money and the purposes for which it is to be used become obvious and real. The contract between the investor and the organization no longer squares with the sort of contract in regard to which Congress in 1933 thought its 'disclosure' statute was unnecessary." [518]

In the UBLIC case, there are also discussions on investor protection in the line of thought adopted by the court in its judgment. It seems eminently fair that a purchaser of such a plan be afforded the same advantages of disclosure, which inure to a mutual fund purchaser under § 5 of the Securities Act.[519]

"Contracts such as the 'Flexible Fund' offer important competition to mutual funds, see Johnson, The Variable Annuity—Insurance, Investment, or Both?, 48 Geo. L.J. 641, and are pitched to the same consumer interest in growth through professionally managed investment. It seems eminently fair that a purchaser of such a plan be afforded the same advantages of disclosure which inure to a mutual fund purchaser under s 5 of the Securities Act. 'At the state level the Uniform Securities Act makes *212 explicit what seems to be the view of the great majority of blue sky administrators to the effect that variable annuities are securities. 1 Loss, Securities Regulation 499. Given VALIC, we hold that for the purposes of the Securities Act these contracts are also to be considered nonexempt securities and cannot be offered to the public without conformity to the registration requirements of s 5." [520]

Regardless of the variable annuity in the VALIC case or the flexible fund in the UBLIC case, both of which have shown many characteristics relating to securities. If we regress this product bearing dual nature back to be under the traditional supervision of the state laws, then the rights and interests of the policyholder can not be fully protected. Therefore, the courts all hold that the product in dispute should not be exempted from the application of the *Securities Act*, especially for the information disclosure, it is necessary and fair to endow the policyholder of the annuity in dispute with the protection from the Securities Act, just like the same vested to the investor of

[518] *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959).
[519] *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 211 (1967).
[520] *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202 (1967).

mutual fund.

Secondly, the inclusion of variable annuity into the scope of securities by the SEC is also out of consideration for investor protection and the nature of the mutual fund, rather than publicly offered, is identified with this product.[521] Since the modern *Securities Act* is based on information disclosure, then the investment attribute in the variable annuity should be regulated in a way as it is for securities - the use of the logic about information disclosure for the protection of the investors.

Thirdly, States regulations and NAIC Model Regulation. Though the variable annuity is defined as in the category of insurance by the *Variable Annuity Model Regulation,* provisions similar to that for the mutual funds are adopted for the separate account in the variable annuity, hence to regulate the operation of that separate account essentially. The *Suitability in Annuity Transactions Model Regulation* has established the suitability principle for the sales of a variable annuity, requiring the recommendation of suitable products to appropriate customers. Although differences are found among the legal attributes of variable annuity defined by the Federal Court of the US, the SEC, NAIC, and various States of the US, there is no divergence in terms of the purpose of the regulations on strengthening investor protection.

The same case applies to Japan and Taiwan as well. The fiduciary duty is included in the clauses of Japan's adopted *Financial Instruments and Exchange Act,* i.e., the duty of good faith towards customers (Article 36), the duty of express notification in advance (Article 37), the duty of best performance and the suitability obligation (Article 40), all of them require the practitioners in the financial field to have goods understandings on the knowledge, experience, financial status of their customers. The *Financial Consumer Protection Act,* enacted by Taiwan, is a further direct reassurance of this point, that is, we shall have special legislation on financial consumers, and to expand the fiduciary duty to all financial service providers and set up a mechanism for the settlement of financial disputes, so as to strengthen our protection of financial consumers.

3.5.2 The Application of "Substance over Form" for the ILI

In view of the preceding discussion, we should not maintain a rigid thought on the multiple legal attributes owned by the investment-linked insurance, thereby confining

[521] See Allan F. Conwill, *Speech: Federal Regulation of Variable Annuity Issuers*, available at https://www.sec.gov/news/speech/1963/013063conwill.pdf , latest visit on Oct. 16, 2018.

ourselves to a determination between insurance and securities; otherwise, it will bring the issues of one-sided application of law and not being considered for the provisions under securities law. Moreover, based on the international experiences for the regulation of variable products, if the investment-linked insurance is to observe the existing logic for financial regulation, then it needs to follow the approach of securities law. That is, the legal regulation of investment-linked insurance should follow the idea, "substance over form," which initially is an important principle being followed in accounting and is also stipulated in Article 11 of the *Enterprise Accounting System,* enacted by China's Ministry of Finance in 2002. This article specifies that enterprises should carry out accounting in accordance with the economic essence of the transaction or matters, rather than merely referring to their legal forms as the basis for accounting.[522] "Substance over form" allows the tax authorities to ignore the legal form of an arrangement and to supervise its actual substance in order to prevent artificial structures form being used for tax avoidance purposes.[523]

The China Supreme People's Court pointed out in 1996 that "although the economic contract signed by the parties has a clear and standardized name, the content of the rights and obligations stipulated in the contract is inconsistent with the name, the nature of the contract should be determined by the content of the rights and obligations stipulated in the contract."[524] In particular, the application of "substance over form" in the judicial field is clearly provided in Article 2 of the *Notice of the Supreme People's Court on Issuing Several Opinions on Further Enhancing Financial Trials,* which was enacted in 2017. In other words, the line of thought in making judgments is quoted as "in relation to financial conduct contrary to regulations, which disguises financial risks, dodges financial regulation, or seeks profit by taking advantage of the system, with financial innovation, the effect of the conduct and the rights and obligations of each party shall be determined based on the legal relationship the conduct has constituted actually."[525] For those cases involving new types of financial transactions, i.e., entrusted finance management, the rights and obligations of the parties concerned should be ascertained in strict accordance with legal regulations, such as the *Contract*

[522] See Article 11 of *Business Enterprises and Accounting Systems*.
[523] See Organization for Economic Co-operation and Development, < http://www.oecd.org/ctp/glossaryoftaxterms.htm#S >, Latest visited on March 5, 2019.
[524] See *Reply on How to Determine Jurisdiction When the Name and Content of An Economic Contract Are Inconsistent*, No. 16[1996] of the China's Supreme Court.
[525] See Article 2 of *Several Opinions on Further Enhancing Financial Trial Work*, No. 22 [2017] of the China's Supreme Court.

Law, Company Law, Partnership Enterprise Law, and Trust Law.[526]

"Substance over form" fits the current difficulties we have for the application of laws to the investment-linked insurance, because it provides an effective solution that can allow the application of laws to investment-linked insurance by following the regulation logic of our existing financial system. That is, except for the application of the *Insurance Act*, investment-linked insurance has an evident investment characteristic, its investment account fits the essence of securities, so its investment account should also be treated in accordance with the regulation logic for securities. More specifically, it needs to register with the securities regulatory authority, disclose corresponding information, and comply with corresponding provisions from the *Securities Act*. This is also requested by the need to strengthen the protection of investment interests. It seems that two features in the investment contract give rise to the need for protection under the federal securities acts: control and management of the investment are in the hands of someone other than the investor; the investor bears the risk.[527] The capital in the investment account of the investment-linked insurance is managed and controlled by the insurer, but the policyholder assumes the investment risk. The "inadequacy" found in the judicial application, as discussed in chapter 2, is also a reflection of the necessity in strengthening the protection of the investment interests under the investment-linked insurance.[528] In addition, the judicial relief measures under the *Securities Act* are more favorable than the same under the *Insurance Act*; for example, in general, securities class action is provided explicitly in the *Securities Act*.

From the perspective of legal circumvention, financial composite products represented by investment-linked insurance have also reflected the current trend of mixed operation for the financial industry, despite it is still in the mode of "separate operation and classified supervision" under the existing basic laws. Notwithstanding the investment account adopts the true trust structure, it can only rely on trust companies for nominal trust business, and other financial companies can not share the dividends

[526] See Article 2 of *Several Opinions on Further Enhancing Financial Trial Work*, No. 22 [2017] of the China's Supreme Court.
[527] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts,* 51 B.U. L. Rev. 17 7, 214 (1971).
[528] Section 3 of the 1933 Act authorizes exemptions from section 5's registration requirements based on the nature of the security involved. Section 3(a)(2) exempts bank securities, insurance policies, and government securities because they are already regulated by some other agency more focused on the specific needs of the industry, and/or they are considered less risky to investors. See Thomas Lee Hazen, *Federal Securities Law*, Federal Judicial Center, 2003, p.38.

brought by this system. Many entrusted financial management agencies are wandering in a fuzzy zone between "attorney" and "entrust." Therefore, for investment-linked insurance, the name does not manifest the fact. That is a law-evasion act, in other words, a legal circumvention. In theory, the legal circumvention acts can be divided into the following three categories, namely, the change of subject for circumvention, the change of subject matter for circumvention, and the change of types of activities for circumvention. [529] Investment-linked insurance constitutes the changing activities among the three types. Under the insurance contract, it still has other financial assets management business. There is a separation between essential contents and expression forms of the contract. Under the existing model of regulation, the investment account of investment-linked insurance can not be effectively regulated, and the investment interests can not be guaranteed. Therefore, analyzing under the approach of "substance over form" is beneficial to the inclusion of the investment-linked insurance into the existing legal regulation system, hence to break the flaw of the traditional financial system that each regulator supervise their separate scope, and realize the conformity to the original regulation logic of the financial system on the part of the investment-linked insurance.

Nevertheless, what needs to be clarified is that the application - "substance over form" for investment-linked insurance appears to fall into specific conflicts with the "Rechtsschein Theorie" for commercial activities. Since the "Rechtsschein Theorie" for commercial activities is an important principle being followed by all commercial laws in identifying the effect of an act, whereas the "insurance act," as a typical commercial act, is also following the "Rechtsschein Theorie" for commercial activities. Therefore, it is necessary to clarify the relationship between the "substance over form" and the "Rechtsschein Theorie" for commercial activities.

There is also a view that the "Rechtsschein Theorie" attaches importance to the effect and order of private laws, while what has been highlighted by the "substance over form" is the effect and order of public laws, both of them can co-exist.[530] However, this explanation can not adequately clear the relation between the "substance over form" and the "Rechtsschein Theorie" for commercial activities, because the "substance over form" is not limited to the supervision by public power. For example,

[529] See Wang Jun, *The Legal Methods in the Judicial Decisions of Law-Evasion Transactions*, 3 Peking University Law Journal 628, 632(2015).

[530] See Ye Lin & Wu Ye, *On the "Look- through Supervision" of Financial Market*, 12 Law Science 12, 15(2017).

the application of "substance over form" in the judicial field is clearly provided in the *Notice of the Supreme People's Court on Issuing Several Opinions on Further Strengthening Financial Trials,* which was enacted in 2017. Based on this, we can see that the relation between the two is not merely a reflection of the difference between the fields of application for them.

In private laws, there are three kinds of expressions of "Rechtsschein Theorie" in the civil and commercial law system, namely the "bona-fide transfer" (agency by estoppel), "reservation in mind system," and "acquisitive prescription system."[531] Obviously, the "substance over form" as being followed in the case of investment-linked insurance has nothing to do with the "acquisitive prescription system". Therefore, we only need to discuss it under the two circumstances – "bona-fide transfer" and "reservation in mind system."

In terms of the bona-fide transfer, its general legal structure can be shown through the below figure. The significant difference between "bona-fide transfer" and "reservation in mind system" lies in that whether or not the person who handles and the principal are the same subjects, if not, it shall be the case of bona-fide transfer, but if so, it shall be the case of reservation in mind system.[532] To protect a transaction counterpart in good faith and maintain a safe transaction, under the circumstance of "bona-fide transfer" and "reservation in mind system," more often, the law endows the "Rechtsschein" acts (the acts of the person who handles and the acts of the transaction counterpart) with the priority in effect. The jurisprudence behind this is to stress the "Rechtsschein"-based legal impact of legal action from the perspective of commercial efficiency and seek a secured transaction.[533] In the commercial field, bona-fide transfer is mainly seen in those circumstances, i.e., the commercial notes, commercial registration, bona-fide acquisition that involves commercial transactions, etc. Thus, it can be seen that the bona-fide transfer focuses on the safety and effectiveness of transactions, but places the consideration of the real intentions of the real obligees in a secondary position.

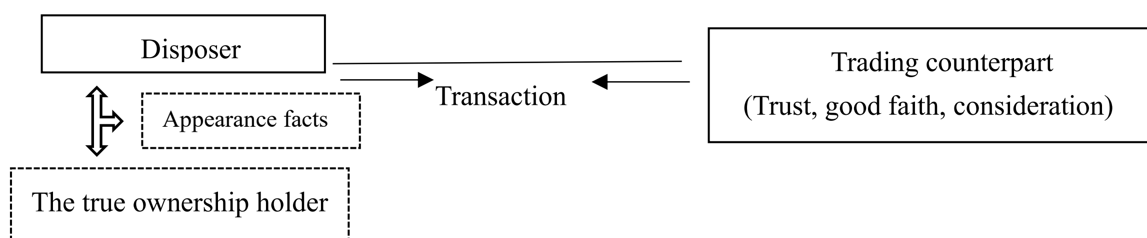
Consequently, the safeguarding of the rights and interests of the real obligees

[531] See Ding Nan, *the Rechtsschein Theorie in Civil and Commercial Law*, 5 Studies in Law and Business 32, 32(1997).
[532] As far as China's current law is concerned, the acquisitive prescription system has not been recognized by legislation.
[533] See Shi Tiantao, *Rediscovery of Commercial Relations and Mission of Current Commercial Law*, 6 Tsinghua University Law Journal 136, 150(2017).

resorts to the internal legal relations between the persons who handle and the real obliges for disposition and relief. This also means that when making safety judgment for commercial acts in the context of "Rechtsschein Theorie" for commercial activities. More often, it will involve the participation from the persons who handle, which is an apparent fact itself. As a result, what has been sacrificed are the interests of the real obliges. That is to say, the "Rechtsschein Theorie" only has the room for its application as far as the transaction security is concerned.

On the contrary, if it is only among specific parties concerned, the real intentions of those parties concerned should still be sought.[534] Only under circumstances that allow no other options, can it be deemed as the exceptions and supplements to principles including absolute ownership, seeking truth from facts, the autonomy of will, etc.[535] Among the legal relations of investment-linked insurance, both the persons who handle and the real obligees are the policyholders without any separation of their roles, and their transaction counterparts are insurers, so it involves no protection of a bona fide third party throughout the whole transaction. Therefore, what has been stressed by the "substance over form" principle, which is being followed in the investment-linked insurance, is to apply laws based on substantial legal relations, which does not conflict with the protection of the transaction safety under the circumstance of bona-fide transfer for "Rechtsschein Theorie" for commercial activities.

Figure. the legal structure of bona-fide transfer



Under the real intention reservation circumstance for "Rechtsschein Theorie" (see below figure), typically, the expressed intention rather than the real intention in mind is deemed as the basis for the assessment on the legal effects of a contract, which has reflected its valuable pursuit for transaction safety. Among the legal relations of investment-linked insurance, despite there exists a circumstance where the essential

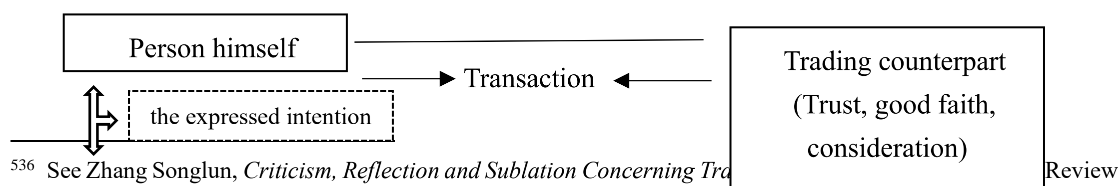
[534] See Chen Dun & Zhang Hang, *The Judicial Determination of the Trust Dispute over the Right of Return of Specific Assets-Review om Anxin Trust Case*, 4 Southeast Academic Research 153, 161 (2017).
[535] See Cui Jianyuan, *the Boundary of Rechtsschein Theorie*, 5 Tsinghua Law Review 5, 5(2019).

investment and finance management on the part of the policyholder is not consistent with the name of the insurance contract, in the contract of the investment-linked insurance, relevant contents, including the collection of the management fee for the investment account, investment unit, and the account operation, are included.

In addition, those contents are also under the strict supervision from and being confirmed by the regulatory authority, so the trust on the legality of the transaction acts, and the certainty of the effect of the acts can all be guaranteed, which is to say, the real intention under the policyholder's investment and finance management is also directly reflected in the contents of the contract, and the only difference is the existence of such issue where the contents of the contract have failed to be entirely summarized in the name of an insurance contract, so it can not deem as the circumstance of real intention reservation, nor does it involve any thoughts on the transaction safety of the contract.[536] Of course, in the process of selling investment-linked insurance, there are misleading or fraudulent sales behaviors; hence it will result in the difference between what has been understood by the policyholder and the content of the contract, which has caused the inconsistency between the real meaning and the expressed intention of the policyholder. In light of this situation, law applications are conducted according to the legal consequence in the event where a contract is canceled, which does not conflict with the line of thought - "substance over form," as adopted by the law applications for investment-linked insurance. The latter consists of breaking through the "name" of the contract, exploring the essential content of the contract, and confirming the real relation between rights and obligations.

Therefore, the "Rechtsschein Theorie" for commercial activities has not been violated if we analyze the application – "substance over form" that is adopted in the case of investment-linked insurance and this should also be an expected choice for the application of private laws in the investment-linked insurance and its supervision by public power.

Figure. the legal structure of the real intention reservation



[536] See Zhang Songlun, *Criticism, Reflection and Sublation Concerning Tra* Review 104, 104(2014).

the real intention

3.6 Chapter Summary

This chapter has mainly analyzed the legal attributes of ILI and the suggestion of it returning to the existing laws for law application. In the US law, after the two typical cases, VALIC and UBLIC, the variable annuity and variable life insurance are then defined at the federal law level as securities, the analysis over the judicial adjudication behind it is conducted from the perspective of the "investment risk-bearing" and the "protection of investors" and the differences between institutional connotations of the insurance and the securities are revealed. Based on this, between insurance and securities products, this thesis has carried out further analysis and discussion on their functional difference and judgment factors. The function and purpose of life insurance lie in that it provides insurance guarantee to ensure the stable lives of the beneficiaries. For its judgment, we mainly consider homogeneous risk pools and the application of mathematical techniques to spreading risk, whereas the function and purpose of securities lie in the pursuit of increase in the return on investment, and for its judgment factors, we mainly refer to the "Howey Test" for investment contracts. Based on the assessment of the abovementioned factors, ILI, participating insurance, universal insurance, and variable annuity all involve the contents of insurance and securities. Moreover, all of them have shown clear investment and financial management attributes. Participating insurance is only a kind of insurance in a broad sense, rather than an investment in a narrow sense, whereas for universal insurance, ILI, and variable annuity, they realize their investment function through special investment accounts; therefore those are an "investment" in a narrow sense. Among them, the investment attribute of ILI is the most obvious one.

Based on the transfer of investment risk, or the subjective intention of the purchaser, the leading role being played by the investment party of ILI can be analyzed. However, in terms of its law application, it is not appropriate to take the approach of applying corresponding statutory rules after the identification of "dominant factors," since it is hard to have a correct measurement of the legal attributes of the product even with the use of "dominant factors," also, it may result in a specific partial ignorance and

the absence of regulation in this regard. Given this point, the US law turns to take the approach of essential regulation on a variable annuity, the Japanese law takes the approach of "quasi-application of the *Financial Instruments and Exchange Act,*" and Taiwan uses the *Financial Consumers Protection Act* to strengthen the protection of those financial consumers, including the policyholders. Despite those laws taking different approaches, they arrive at the same end by different means – in fact, all of them have reflected the regulatory idea that "substance over form," applies, and have been applying laws to those products in accordance with the regulation's logic that ought to be set forth on insurance and securities, thus to achieve the purpose of regulating investment interests.

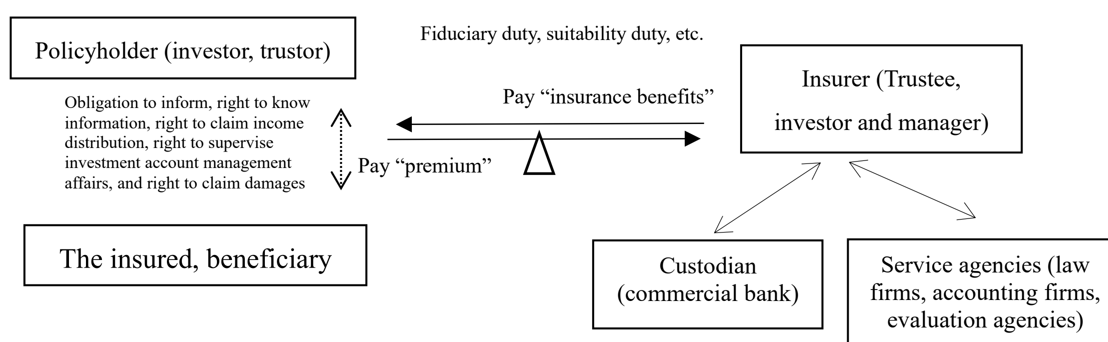
Current problems and key points with respect to law application for ILI are not in the definition of its attribute as "securities" or "insurance" under the existing laws of China. Instead, the "substance over form" approach should be adopted so that it can be returned to the regulation of existing laws and be subjected to corresponding regulations with rational logic, to thereby avoid supervision loopholes and the lack of protection of investors. "Substance over form" tallies with the difficulties being faced in the law application for ILI - a line of thought whose basis and evidence can be sought from the documents and files enacted by the Supreme Court in China; it is also not in conflict with the application of "Rechtsschein Theorie" for commercial activities. Therefore, we should stick to "substance over form" for the application of laws to ILI.

Based on the above analysis, for the application of "substance over form," which is followed in the law applications for ILI, in the following paragraph, we will refer to the essential regulations and the protection of investment interests as the principal clue. We will further carry out the analysis from two dimensions, the application of private laws and the supervision by public power. In terms of the application of private laws (not limited to the judicial application), we should establish the actual relation between the rights and obligations of the parties concerned according to the essential legal relations of the contract. In terms of the supervision by public power, while upholding the idea of functional and behavioral supervision, we should carry out the supervision over ILI based on the real structure and business nature of each specific product.

Chapter Four Private Law Relationship under the Investment Account and Its Interpretation

As aforementioned, in the private law relationship of ILI, the contractual relationship, and the risk allocation mechanism of it has changed. As a result, this has an impact on the allocation and balance of corresponding rights, obligations, and responsibilities. For example, the multiple roles played by policyholders and insurers, as discussed in Chapter 2, have also indicated that the actual demand for ILI can not be reflected by the rights and obligations of traditional life insurance, which are prescribed in the existing *Insurance Law*. In the legal structure for the de jure contractual rights and obligations of ILI, more stress should be given to the rights of the policyholders (the "investors" or the "principals") and the obligations of the insurer (the "trustee"), so that the idea of protecting financial consumers can be put into practice and corresponding rules can be applied analogically based on the existing normative logic. On this basis, this chapter is mainly concentrated on the private law relationship under the investment account.

Figure. the rights and obligations in the ILI



4.1 Entrusted Financial Management in the Investment Account and the Contract Nature of Investment-linked Insurance

4.1.1 Contractual Interpretation of the Relationship of Entrusted Financial Management

The investment account of ILI has shown the relationship between entrusted financial management. However, this entrusted financial management is not under any

nominate contract in China, including the *Civil Code* and the *Insurance Law.* In theory, there are mainly three different interpretations of this.[537]

First of all, some scholars hold that it is no doubt that the contract of entrusted financial management bears some characteristics of the "commission contract."[538] In practice, most of the entrusted financial management acts are more in conformity with the legal relationship between principal and agent, but are significantly different from the trust acts. Hence it is appropriate to identify them as an embodiment of principal-agent relationships.[539] Under this interpretation, the provisions on "commission contract," as in the *Civil Code*, apply to the contract of entrusted financial management. This viewpoint also can be verified by the attitude of the regulators. For example, the "China Banking Regulatory Commission" (CBRC) has once pointed out that personal financial management business is a bank service based on the "principal-agent" relationship and is a personalized and comprehensive service provided by the commercial banks to their customers.[540]

Secondly, since the deal structure of the entrusted financial management conforms to the constitutive elements of trust, some scholars who argue that among various financial management products, despite the forms of contracts are not all the same, all of them belong to trust as far as their legal structure is concerned. This fiduciary relationship does not vary with the change of trustees.[541] In both the "personal financial management" and "collective financial management," the "inner structure," as designed in those products, is that the principal (the beneficiary in general) transfers certain monetary property to a trustee - a bank or a securities trader, and the latter, for the interests of the beneficiary, shall manage the property independently and hand the return to the beneficiary, which is a typical trust structure.[542]

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[537] As for defining the common-law relationship between client and manager, there are "trust relationships" and "agency relationships". See Harvey E. Bines & Steve Thel, *Investment Management Law and Regualtion*, (New York: Aspen Publishers, 2004),pp.45-48.

[538] See Li Yongxiang, *Trial Gist of Entrusted Financial Cases*, (Beijing: The People's Court Press, 2005), p.50.

[539] See Gao Minshang, *Some Legal Issues in the Trial of Entrusted Financial Management Cases in the Securities, Futures, and Treasury Bond Markets*, 6 People's Judicature 27, 28(2006).

[540] "The relevant person in charge of the CBRC answered the reporter's questions on the issuance of the *Interim Measures for the Management of Personal Financial Services of Commercial Banks* and the *Guid elines for the Risk Management of Personal Financial Services of Commercial Banks*", < http://www.cbrc.gov.cn/chinese/home/docView/1617.html>, Latest visited on June 9, 2019.

[541] See Ji Kuiming, *On Unified Application of Legal Norms on Financial Planning Products*, 6 Global Law Review 93, 106 (2016).

[542] See Shi Tiantao and Zhou Qin, *Commercial Trust: System Characteristics, Function Realization, and Legislative Adjustment*, 2 Tsinghua Law Review 114, 117(2008).

Thirdly, being different from the abovementioned viewpoint, there is a contention that holds that the entrusted financial management represents an independent legal relationship and is a new kind of property management system.[543] The financial management only has the "out appearance" of the "principal-agent" relationship. The financing and management of funds are included by it. Because of having essential characteristics that are completely different from that of the commission contract or fiduciary contract in general, it is hard to be included in the list of typical contracts. Therefore, the use of the general "principal-agent" relationship in the corresponding analysis remains insufficient. The entrusted financial management business is now prevalent in those sectors, including securities, insurance, fund, and banking. From the capital market development and the protection of interests of the investors to the maximum extent, it is necessary to regard the entrusted financial management business as a kind of independent legal relation.[544]

The abovementioned viewpoint has dissected the basic legal relationship of the financial management products from different perspectives, which benefits the change of the fuzzy relationship between the rights and obligations of parties concerned in a contract of entrusted financial management. Nevertheless, the concept of modern commercial agency is now greatly different from the civil agency, if we use the "civil agency" as the "imputation theory" under the ordinary law for the regulation of the relation between end-users and manufacturers, then it does not conform to the essence of a business model and the cut of contractual responsibilities by merchants.[545] If the understanding of the relationship of entrusted financial management is limited to the understanding of traditional "principal-agent" relation only, and rules application is confined to those on commission contract, as found in the *Contract Law*, then in practice, we can not give an effective interpretation of the substantive relationship between rights and obligations involved in the entrusted financial management. Because the contract of entrusted financial management is different from a general commission contract in several aspects (see below Table), i.e., fault principle, the extent of the duty of care, etc. For example, Article 929 of the *Civil Code* stipulates that under a paid commission contract, the principal may claim damages for the loss incurred to it

543 See Li Yongxiang, *Trial Gist of Entrusted Financial Cases*, (Beijing: The People's Court Press, 2005), p.61.
544 See Huang Tao, *A Study on the Disputes over the Contract of Entrusted Financial Management*, 2 Beijing Arbitration 70, 72(2015).
545 See Zheng Yu, *Logic of Civil Law, Thinking of Commercial Law and Application of Law*, 4 Law Review 82, 91 (2018).

as a result of the fault on the part of the trustee. Some of the contracts of entrusted financial management have "warranty clause," which stipulates that the civil responsibilities bearable by a trustee is not conditional on the fault principle, but to assume all the risks arising out of the fiduciary acts. This is different from the fault principle on the part of the trustee as it is found in the typical commission contract under the civil law. Also, a general commission contract refers to the legal relationship between principal and trustee, whereas in a contract of entrusted financial management, there is no contractual relationship between the beneficiary and the trustee. In this sense, the obligation the trustee has for the beneficiary is a kind of lawful duty, whereas the obligation the entrusted agent has for the principal is a kind of contractual obligation.[546]

Furthermore, it is generally acknowledged that for the gratuitous civil contract, the parties concerned has the right to terminate the contract arbitrarily, while for the commercial non-gratuitous contract, the consideration relationship attaches more importance to the "trust relationship," the share of "interest" plays an increasingly more important role than the trust does, the parties concerned should not enjoy the right to terminate the contract arbitrarily.[547] The reason lies in that in order to complete the commercial trust, material resources and financial resources have to be input, sometimes, the trustee has to assume certain commercial risks, so the exercise of the right to terminate arbitrarily by the principal is easy to bring great loss to the trustee.[548] The "principal-agent" relationship, as found in the investment account, in the context of a commercial non-gratuitous contract, means that the policyholder has the right to terminate arbitrarily, but the insurer enjoys the right to terminate arbitrarily only under certain circumstance. Except for the idea of inclined protection of the policyholder in the legal principle, in fact, the policyholder's right to terminate an insurance contract arbitrarily is also of great consideration, because in the insurance contract, it is usually agreed that the insurer will deduct the certain fee in the event the policyholder exercises its right to terminate arbitrarily. Also, in general, the cash value of the insurance policy is far lower than the fee paid. In addition, the trustee does not invest in the name of the principal, but to invest under the name of a financial management product. This is not only different from the traditional civil law entrustment, in which the agent acts in the

[546] See Zhao Lei, *The Definition of Role of Trustee and the Achievement of Relevant Institutions*, 4 China Legal Science 74, 78(2013).
[547] See Liu Chengwei, *The Rescission of Performance Management Contract*, 4 Tsinghua University Law Journal 130, 136 (2019).
[548] See Cui Jianyuan, *Question and Explanation of Contract Rescission*, 9 Law Science 69, 77(2005).

name of the principal (the direct agency), but is also different from the brokerage contract, in which the agent acts in the name of the "trustee" (the indirect agency) – A reflection of the fact that a typical contract in the sense of traditional law can not include or explain a contract of entrusted financial management.

Table: Comparation between general and financial "principal-agent"

Items	General "principal-agent"	Financial "principal-agent"
Interested parties	Generally two parties in a contract	It involves more and more contract subjects, such as beneficiaries, management trustees, and custodians.
Consideration	Usually free	Usually paid
Power of principal	the right to terminate arbitrarily	Limited the right to terminate arbitrarily
Duty of agent	Standard of general contractual obligations	Higher contractual obligations, e.g., fiduciary obligations.

In terms of the viewpoints on "trust relationship in entrusted financial management", for financial products, such as the collective funds trust plan from the trust company, investment-linked insurance from the insurance company, asset management business from the securities company and RMB and foreign currency based financial products from the commercial bank, those products are not all in the name of "trust", but their essential legal structure is all in conformity with the constitutive elements of trust. This thesis does not oppose it as in chapter 2; it has also demonstrated that the investment account has adopted the trust structure. Nevertheless, the trust relationship as being reflected by those products is not sufficient to reflect the "complete picture" of the fundamental relation of those financial management products. The significant cause lies in that the essence of trust consists of the separation of rights from interests among the trust property.[549] The capital involved in the financial management product has not all realized the separation between rights and interest, especially for some typical financial products that are lack of the core elements for independent trust assets. For example, investment-linked insurance and universal insurance, which are developed by the insurance company, are typical financial management products. However, there are differences between them in terms of assets independence. The investment-linked insurance satisfies the independence requirement

[549] See Tang Yihu, *Research on Trust Property Rights*, (Beijing: China University of Political Science and Law Press, 2005), p.301.

for trust assets,[550] but the capital in investment account of universal insurance is not independent in accounting.

Consequently, it does not have the asset isolation effect and does not conform to the independence requirement for trust assets. [551] Therefore, the approach we take by analyzing the legal structure of trust can only reflect the essence of trust in some financial management products. [552] Moreover, from the "intention expression requirement" for legal acts, trust, as legal acts, its constitution requires the expression of the intention of the principal as to establish a trust,[553] and consider it as the main basis of a trust relationship.[554] However, in particular, contracts of entrusted financial management, the purchasers have not expressed the intention for fund trust. Despite the deal structure for some financial management products are similar to trust, to those financial management products which are not in the name of trust, the intention of trust can not be found in the contracts, which makes it hard for the application of the "fiduciary relationship of financial management products" in judicial practice.

There are various types of financial management products, and they are hard to use the legal relations prescribed in existing regulations to give a complete summary of the right-obligation relations shown in those financial products. This thesis tends to observe the financial management relation based on the "new independent relation." This because a large quantity of financial management business now exists in the market,[555] also it is for full exploitation of its uniqueness. Nevertheless, though the "new independent relation" stresses the particularity of the entrusted financial management, the rights and obligations have to be explained further since it is a new contractual relationship established beyond such laws as the "civil law on general commission contract." However, if only the investment account is concerned, there is no essential difference between the adoption of "trust relation theory" and the adoption of "new independent relation theory." The explanation of the relation of entrusted financial management (as found in the investment account) as a new relation or trust

[550] E.g., *Description of Investment-linked Insurance on Guangda Yongming,* etc.

[551] See Li You, *The Legal Effect of the "Minimum-Guaranteed Interest Rate Clause" for Universal Insurance*, 2 Insurance Studies 119, 119 (2018).

[552] It is of great significance to distinguish trust relationship and principal-agent contract relationship, because the core function of trust is bankruptcy isolation and cannot be replaced by principal-agent contract. See Shen Zhaohui, *The Fragility of the Legal Structure of Asset Securitization*, 6 Tsinghua University Law Journal 61, 64 (2017).

[553] See Jin Jinpin, *Research on Trust Act from the Perspective of Legal Act*, 1 Peking University Law Journal 166,169 (2016).

[554] See Shen Zhaohui, *The Fragility of the Legal Structure of Asset Securitization*, 6 Tsinghua University Law Journal 61, 66 (2017).

[555] Please refer to Chapter 2 for the development data of financial composite financial product statistics.

relation is, in fact, all providing the basis for the performance of the fiduciary duty by the trustee. In terms of the "trust theory," this theory is mainly based on the outstanding features of the trust, the rights, and obligations of the trustee in trust property management other than the historical background of the theory origin, and the transfer of trust property.[556] The definition of the fundamental relation of entrusted financial management as a "fiduciary relationship," the essence of it is aimed at vesting the issuer of the financial management product with fiduciary duty and providing a higher level protection to the purchasers of financial management product.[557]

On the other hand, there are quite a lot of differences between investment account based entrusted financial management and general entrusted agency, but the essential difference is still the difference in the principal's ability to control entrustment-related risk. For example, under the investment account, the policyholder, as the principal, invest the premium into the account, and ultimately assumes the investment risk of that account. Except through redemption, policyholder never involves into the management scope of "trustee" ("the insurer"), and hence has quite weak control of the entrustment-related risk. Besides, the cost of redemption the policyholder has over the first five years is quite high; they are by and large trapped. Therefore, the trustee should be vested with an even higher obligation standard – fiduciary duty.

4.1.2 The Entrusted Financial Management and Traditional Life Insurance

The "entrusted financial management relationship" found in the investment account of investment-linked insurance is not a nominate contract under existing law in China, and also the content of this contract has exceeded the regulatory framework of traditional life insurance. Therefore, it is necessary to make contractual interpretation for investment-linked insurance so that an applicable private law approach – a return to existing law, can be made available.

Theoretically, based on whether or not the law has established a norm and given a specific name as the standard, the contract can be divided into "typical contract" and "non-typical contract," [558] the so-called "nominate contract" and "innominate contract." Investment-linked insurance, as a financial innovation product, it is shown legally in

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[556] See John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 Yale L.J. 625, 627 (1995).
[557] See Liu Shen, *Legal Analysis And Supervision of Financial Products in China*, 1 Securities Law Review 219, 234(2009).
[558] See Cui Jianyuan, *General Theory of Contract Law (Volume I)*, (Beijing: Renmin University Press of China, 2008), p.53.

the form of a contract, and does not belong to a nominate contract under the *Insurance Law* or *Contract Law*, which is to say this contract is not a traditional life insurance contract, it can not be incorporated into the category of a typical contract, but a kind of non-typical contract. The non-typical contract includes purely non-typical contracts, simultaneous contracts, and mixed contracts. Purely non-typical contract means a contract whose content does not conform to any requirement for a nominate contract. Simultaneous contract means that all contracts have an interconnecting relationship, and the mixed contract means a contract that is consisted of parts of several typical (or non-typical) contracts.[559] For major puzzles of non-typical contract, it lies in how to apply laws when the intention of the parties concerned are not sufficiently expressed.[560] In general, there mainly have three approaches – "absorption theory," "combination theory," and "analogical theory."[561] When it comes to the investment-linked insurance contract, what is the relation between entrusted financial management conducted on the investment account and traditional life insurance? What theory can be adopted for its law application?

"Absorption theory" divides the "non-typical contract" into a major part and minor part of a contract, wherein the minor part is absorbed by the major part. The rules contained in the significant part of the contract should be followed in terms of the legal application for this mixed contract. The Roman Law does not acknowledge the free principle of contract, so the "absorption theory" should be adopted.[562] This viewpoint has quite an advantage in solving the legal application issue for a mixed contract enclosed with subordinated payment obligations. However, this theory has directly excluded the minor party of the contract. It compulsorily applies the intention of the minor party of the contract to legal rules in the major part of the mixed contract, which is not only suspected of failing to completely respect the expressed intention of the parties concerned in a contract, but also fails to apply legal rules effectively.

Also, it is not easy to judge on the major and minor parts of a contract. Different standards and discretions exist for the judgment of major and minor parts of various kinds of mixed contracts. For the investment-linked insurance, Chapter 3 of this thesis adopts the legal route-"substance over form" for it. Essentially, this is also intended to

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559 See Wang Zejian, *Principle of Debt Law*, (Beijing: Peking University Press, 2013), pp.139-140.
560 See Cui Jianyuan, *General Theory of Contract Law (Volume I)*, (Beijing: Renmin University Press of China, 2008), p.55.
561 See Wang Zejian, *Principle of Debt Law*, (Beijing: Peking University Press, 2013), p.140.
562 See Zeng Longxing, *Research on Modern Non-typical Contract*, (Taibei: Author Self Version, 1988), p.4.

get rid of the limitations brought by the "absorption theory." This is also an important reason as to why the legal application for ILI is restricted to the application of *Insurance Law* without the application of Securities Law. Moreover, there are differences in judging whether the insurance guarantee part or the investment part is the major part of the contract. For example, though the "investment part" of this insurance often accounts for the major part, the "investment part" also relies on the effectiveness of the "insurance content." Therefore, it is not suitable to adopt the "absorption theory" for the legal application of the contract for ILI.

"Combination theory" proposes to decompose provisions in a various typical contract to seek for its legal requirements, thus to find the "laws," and then reconcile and unify it to create a kind of compositional method for application.[563] Combination theory has quite an advantage when different contents of a non-typical contract all have corresponding nominate contracts for application – corresponding nominate contracts apply to different contents of the contract.

For example, if the multiple payment obligations assumed by one party concerned in a contract belong to different types of contract and all of them are in positions of identical value, whereas the adverse party only assumes single reciprocal payment obligation (paid contract) or does not bear any reciprocal payment obligation. For example, Party A and Party B come into an accommodation contract, in which Party A bears multiple payment obligations, i.e., respectively, the constitutive parts of typical contracts, including leasing, selling and buying, hiring contracts, whereas Party B pays certain consideration. In view of this circumstance, by principle, "combination theory" should be adopted, and make judgment based on the type of contract to which the "individual payment" belongs, i.e. for food supply, selling and buying rules should be applied, if one payment obligation is found to be defective, it shall be handled in accordance with corresponding rules (request to reduce the consideration payable or terminate the contract). However, if this has an impact on the unity in terms of the contractual economy, it should share the fate with it.[564]

There is a viewpoint that holds that decomposition based on this theory and then reconciliation based on the intention of the parties concerned, followed by a mechanical combination of the rules of all component parts so as to confirm its application, also has the defects of violating the intention of the parties concerned.[565] Nevertheless, the application of "combination theory" is not precise, how to decompose, and how to combine, both of which remain unclear when it comes to its application in non-typical contracts.

563 See Zeng Longxing, *Research on Modern Non-typical Contract,* (Taibei: Author Self Version, 1988), p.4.
564 See Wang Zejian, *Principle of Debt Law*, (Beijing: Peking University Press, 2013), p.141.
565 See Zeng Longxing, *Research on Modern Non-typical Contract*, (Taibei: Author Self Version, 1988), p.4.

Because the "absorption theory" violates the real intention of the parties concerned, and the "combination theory" has too much focus on forms, therefore they shall not be adopted by the law for mixed contracts.[566] Against mixed contract and quasi mixed contract, divergent opinion exists; there are "absorption," "combination," and "analogical application" theories, among which, the most rational one is the "analogical application."[567] In fact, among three law application approaches for a non-typical contract, the "analogical application" approach is still chiefly advocated.[568] This approach means to take out various elements from the contract first, and then analogically applies the provisions of each nominate contract.[569] According to Article 467 of China's *Civil Code*, for contracts that are not expressly provided in law, nominate contracts or most similar provisions in other laws may be referred to. Thus it can be seen that as a line of thought, China's *Contract Law* also adopts an analogical application for an innominate contract.[570]

As for the contract nature of investment-linked insurance, this product is placed under the name of insurance and has specific provisions on life insurance; hence it does not belong to a purely non-typical contract. Therefore, an investment-linked insurance contract belongs to a simultaneous contract or mixed contract type. The composition of a mixed contract is either a combination of more than two nominate contracts or the combination of nominate contract and innominate contract. A mixed contract is a single inseparable contract;[571] it is a mixture of the nature of more than two contracts, which are having an inseparable relation between them.[572] There is a viewpoint that points out that for "insurance financial management product," the key point that determines that its contract nature belongs to a simultaneous contract or mixed contract is whether the content of its insurance part has an inseparable relationship with the content of its investment part. Under this understanding, among insurance financial management products, though it is easy to tell from the provisions of participating insurance contracts, which part is insurance and which part is an investment, the two are closely

566 See Lin Chenger, *A General Introduction to the Debt Law of Civil*, (Beijing: Renmin University Press, 2003), p.25.

567 See Shi Shangkuan, *General Introduction of Debt Law*, (Beijing: China University of Political Science and Law Press, 2000), p.11.

568 See Wang Zejian, *Principle of Debt Law*, (Beijing: Peking University Press, 2013), p.141； See Zeng Longxing, *Research on Modern Non-typical Contract*, (Taibei: Author Self Version, 1988), p.19.

569 See Wang Zejian, *Principle of Debt Law*, (Beijing: Peking University Press, 2013), p.141.

570 See Article 124 of China's *Contract Law*.

571 See Liu Chengwei, *The Rescission of Performance Management Contract*, 4 Tsinghua University Law Journal 130, 133 (2019).

572 See Lin Chenger, *Research on the Debt Law of Civil Code (I)*, (Taibei: Ruixing Press, 2003), p.16.

related. Also, the profit-sharing of this insurance has not been realized by certain tools, and does not have independent financial management relation in law, which results in the inseparability for its contents. Therefore, it is no doubt that the participating insurance contract belongs to a mixed contract. This standpoint should also be maintained in judicial practice. For example, in *Wu Huafen v. Chongqing Company of China Life Insurance* concerning disputes over insurance contract, the Court held that the insurance premium, type of insured liabilities and profit sharing under the participating insurance contract are all based on the life condition of the insured, and the life condition of the insured has a direct impact on the assumption of all insured liabilities, provisions on insured liabilities have a reciprocal effect on that on profit sharing, and the content of the contract does not essentially have the separability.[573]

However, for universal insurance, investment-linked insurance, and variable annuity, those products are being managed by establishing a separate investment account and by calculating the return on investment separately, thereby its investment part shows certain independence. For this, if both the "premium" and "beneficiary amount" have to be calculated separately by a clear distinction between insurance and investment, then this investment-linked insurance should be understood under the simultaneous contract.[574] On the contrary, for an investment-linked contract, if there is a part, either in the insurance part or in part about the beneficiary amount, which is unable to be distinguished between insurance and investment, it is more appropriate to understand it as a mixed contract.[575] For this, there is also a responsive opinion that from the perspective of an investment-linked insurance contract, though its actual operation has the nature of different contracts, from the standpoint of policyholder and insurer, the parties concerned in a contract, they surely will not think what they have signed are two contracts;[576] hence, it is not necessary to explain it as the combination of two contracts when explaining it as a contract, it is more appropriate to explain it as a mixed contract.[577]

[573] See *Wu Huafen v. Chongqing Company of China Life Insurance*, Chongqing First Intermediate Court No. 06993 (2015).

[574] See Ye Qizhou, *Insurance Premium Repayment upon Voidable Investment-linked Insurance and Culpa in Contrahendo*, 6 Global Law Review 45, 49 (2014).

[575] See Ye Qizhou, *Insurance Premium Repayment upon Voidable Investment-linked Insurance and Culpa in Contrahendo*, 6 Global Law Review 45, 49 (2014).

[576] See Zhang Xiaomeng, *The Definition of Investment-type Insurance in Contract Law*, 9 Insurance Research 120, 123 (2017).

[577] See Zhang Xiaomeng, *The Definition of Investment-type Insurance in Contract Law*, 9 Insurance Research 120, 123 (2017).

As the mentioned two viewpoints, this thesis holds that the first one is more rational, because ILI can differentiate between the insurance provisions and financial management provisions in a contract, and then apply each of their own corresponding legal rules. For the latter viewpoint, the contract signed by the policyholder of ILI is one copy of the contract, in which two "payments" bearing two different natures are contained in the contract, but not the two independent contracts. To conclude this formally, for a combined contract, usually two circumstances are included, wherein the first is the purely literal combination, meaning that several independent contracts are combined due to the act of concluding a contract (e.g., enter into a written contract) without having any dependency relation between each other; the second is the combination that has certain dependency relation between them, in other words, the intention of the parties concerned, the effectiveness of one contract is subject to the effectiveness of another contract.[578] A purely literal combination is only a simple combination of several independent contracts, and as nothing but a packaged deal, they shall refer to their own independent contracts for the application of their corresponding laws. A combination of contracts that have dependency relation between them will then have more significance in legal interpretation. Theoretically, for this "dependency relationship," two different judgments, the "subjective meaning" and "objective elements" exist; however, the contract that legally comes with the investment-linked insurance should be deemed as the combined contract with "dependency relation."

Based on those mentioned above, the investment function of ILI is realized via investment account, and it has shown independence in its operation mode, purpose, product design. This is shown by the legal relation of entrusted financial management, which is different from the contractual relationship of insurance. Despite this, the establishment of the investment account, as well as its effectiveness and termination, also depends on the validity state of the insurance provisions.[579] Therefore, invest-linked insurance is neither a mixed contract nor a literally combined contract, but should be a combined contract with dependency relation and "analogical application" should be adopted for its law application. In other words, the insurance provisions of the contract are to be regulated by the *Insurance Law*, while the investment and

[578] See Wang Zejian, *Principle of Debt Law*, (Beijing: Peking University Press, 2013), p.139.
[579] Commercial relationship has its particularity and is different from civil law. See Shi Tiantao, *Rediscovery of Commercial Relations and Mission of Current Commercial Law*, 6 Tsinghua University Law Journal 136, 136 (2017); Wang Wenyu, *The Interpretation of Commercial Contract: Reasoning by Analogy and Economic Analysis*, 4 Peking University Law Journal 1270, 1280 (2014).

financial management provisions of the contract are to be regulated by rules such as the rules in Securities Law.

What needs to be expressly specified is that the way the investment-linked insurance, as a combined contract, adopts "analogical application," is not following the traditional and typical civil law thinking to return the right-obligation relationship in investment-linked insurance back to the rules on commission contract as found in the *Contract Law*. This practice of understanding commercial contracts (in which both the interest and risk allocation are extremely complicated) by comparing the preset right-obligation relationship in nominate contract with the agreed right-obligation relation between parties concerned can only make things worse.[580] Therefore, the "analogical application" for investment-linked insurance should be based on its characteristics and follow existing regulation logic, which is to say, for investment-linked insurance, as well as for the legal relation in the investment account, we should stick to the line of thought - the "substance over form" and refer to the essential right-obligation content for analogical application of existing laws, thus to realize the expected regulation of such product.

4.2 Legal Nature of the Investment Account and the Analogical Application of Rules for It

4.2.1 Legal Nature of the Investment Account: A Contract-type Securities Investment Fund

The legal nature shown by the investment account is now totally different from insurance. Then how to give a proper response and how to apply laws?

4.2.1.1 The nature of the investment account

Chapter 2 of this thesis has carried out a comparative analysis between an investment account and securities investment fund: the investment account is similar to the securities investment fund. What needs to be questioned further is that since those characteristics are similar to an investment fund, whether it tallies with the legal essence of the fund and its definition.

[580] See Wang Wenyu, *The Interpretation of Commercial Contract: Reasoning by Analogy and Economic Analysis*, 4 Peking University Law Journal 1270, 1280 (2014).

Article 2 of China's *Securities Investment Fund Law* stipulates that the present Law shall apply to the securities investment activities managed by fund managers and entrusted to fund trustees for the benefits of the fund shareholders, which is only a brief description of the operation mode of the fund. Hence one can not know from this Article the constitutive elements or judgment standard of the fund. However, the Draft version of the Law has once defined the investment fund as an investment organization where independent fund property is formed through a public offering of fund shares to raise fund, which is managed by fund managers and entrusted to fund trustees for securities investment activities conducted through the method of portfolio, while the fund shareholder shall enjoy the return and assume risk as per the shares held by them.[581] Also, different conclusions are made on an academic and theoretical basis. For example, an investment fund refers to a currency that is pooled based on the specific purpose of investment.[582] The term again can be boiled down to "investment method," "capital aggregate," "fund company or trust," "investment organization," "investment plan," "financial instrument or product" and "investment and financing system," different people may have a different opinion.[583]

In the foregoing paragraph, though we have "interpreted" the fund from different perspectives and have explored various characteristics of funds, we have not demonstrated the essential differences between fund and other financial products. For example, fund, as a kind of "investment method," there is no doubt to it, but stock, bond, etc., each of them is also a kind of financial investment tool. For another example, if we use "capital aggregate" to analyze funds, we will be able to explore the operational characteristics of the fund. If we analyze it from the perspective of traditional civil law, fund, as a pool of capital, belongs to financial group, a conception corresponding to a mass organization. The former stresses the pool of property, with the fund as its major representative, while the latter emphasized the gathering of members, with the company as its chief example. Because the bases on which the foundation and association are established have certain differences, so at legislation, there are differences between the two in terms of the requirements of establishment, organizational structure, etc. Nevertheless, there are many interconnections between them. For example, there are

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[581] See Li Yining, Notes on the Securities Investment Fund Law of the People's Republic of China (Draf t), <http://www.npc.gov.cn/wxzl/gongbao/2003-12/29/content_5326586.htm>, latest visivted on Nov. 7, 2019.

[582] See Zhang Lu, Luo Xu, and Guo Xiaojing, *Comparison and Practice of Fund Law between China, America and Britain*, (Beijing: Law Press, 2007), p.4.

[583] See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.13; Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.73.

many similarities between corporate type fund and company organization. In a company, the corporate capital pooled by shareholder contribution is the main factor for company operation. Also, both of them have the capacity as a subject of law and have organizational structures, such as the board of directors. In this sense, the use of "capital aggregate" for the dissection of a fund does not appear to have marked out the essential characteristics of fund. "Investment plan," "financial tool or product," and "investment and financing system" are also the same case without showing the uniqueness of fund.

We can tell from above if we only define fund from a single perspective, it is really hard to describe the legal characteristics of the fund. In spite of this, this thesis tends to describe the characteristics of funds from the subjectivity of funds. Because the fund, itself, has a clear systematism tendency, it is an investment organization with entity status. [584] The development of a fund to this day has constituted an important constitutive force of the market, which is especially the case when some of the funds have become institutional investors and major shareholders of listed companies, in this way, they participate in corporate governance. Though the contract-type fund does not have the capacity as a subject of law, its role in the market as the economic body can not be denied. Also, by being subjectivity oriented, it can let the fund types remain open and include more organizational forms of pooled capital, which tallies with the development need in reality. Therefore, this thesis tries to discuss the legal characteristics of fund from the perspective of "investment organization": Fund is (1) a pooled capital formed based on specific investment purpose; (2) raised from public investors or specific investors by professional institutions for securities investment activities conducted through the method of portfolio; (3) an investment organization where the investors enjoy the return and assume risk as per their capital contribution.

The purpose of the collection of fund capital is consisted of certain investment purposes – more specifically, to pursue growth in investment return. In terms of the investment account, the main purpose of paying the premium by the policyholder is to seek growth in account value, rather than an insurance guarantee. From the perspective of the trustee, the fund is professional financial management that relies on a professional institution for business operation and adopts a portfolio investment strategy. The insurer holds the post of account manager of the investment account, and is in charge of the operation of the account assets. The insurer may adopt different

[584] See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.14.

portfolio strategies with different risk based on the different risk categories of the investment account. Looking at the risk assumption, the policyholder of a traditional insurance product does not assume investment risk, nor shares the return on investment with the insurer, however, in the investment account, the policyholder, as the investor, completely assumes the risk it has for the capital input into the investment account.

In addition, the performance of investment account in other aspects, i.e., the option and conversion right policyholder has for an investment account, buying or selling the investment unit in the investment account on its own discretion, those characteristics in relation to actual operation, as well as the right of the policyholder, are in fact designed and operated in accordance with investment funds. In China, the types of funds are mainly the contract-type fund, which refers to the trust principle in terms of its operation mode and legal relationship.

Moreover, the fund adopts the legal structure of trust, which is a legal structure that differs from other general property management. Irrespective of the Anglo-American law system or the continental law system, parties (principal, trustee, and beneficiary) to trust and basic elements of trust (trust basis, trust property, and trust purpose) are identical.[585] In the legislation process of China's *Securities Investment Fund Law*, there has been a debate over the structure of fund trust, however, if viewing from asset independence of investment fund, Article 5, 6, 7 of this law stipulates that the fund assets are independent of the inherent assets of a fund manager and fund trustee, and fund assets can not be written off on the ground of the latter's having creditor's right against the fund shareholder. Apart from that, no compulsory enforcement should be carried out against the fund property unless it is a debt incurred to fund property. In addition, Article 2 of this law expressly stipulates that the *Trust Law* shall be applied for matters not covered, which further reflects the confirmation of trust relationships in securities investment fund by law.

Chapter 2 has given a brief demonstration of the trust structure of the investment account. Judging from the perspectives including assets isolation – essential elements of trust and the separation between rights and interests, by accounting, the capital pooled in the investment account is independent of the assets of the insurer; hence it achieves the state of assets isolation and bears the characteristics of asset independency.

[585] It should be noted that articles 6 and 7 of the trust law of China require the legality of the trust purpose and the trust property.

If the insurer goes bankrupt, the separate account does not participate in bankruptcy liquidation, which guarantees the safety of the assets of the policyholder. In addition, viewing from the rights and obligations between the policyholder and the insurer in practice, which are provided in the contract for investment-linked insurance, the policyholder enjoys the return on the investment units in the investment account and assumes risk in relation to it, whereas the fund in the investment account is in the custody of the insurer, who will engage in securities investment activities for the interests of the policyholder. To the policyholder, only the return and risk are shared, but not the ownership of the assets under the investment account. After the assets are transferred from the principal to the insurer, the insurer utilizes and manages the assets under the account, but is not actually in possession of the assets, and maintains accounting independence, therefore this transaction has reflected the "separation between the rights and interests concerning assets under the investment account", which tallies with the essential elements of trust. Despite the "principal-agent structure" of the investment account also conforms to the constitutive elements of a general commission contract, the investment account belongs to trust structure with asset isolation effect and the separation between ownership and returns, which is not a characteristic of commission or agency contract. This has further caused the evident differences between the rights and obligations of the two parties, i.e., the rights and obligations of the trustees. Therefore, it is more accurate if we explain the primary relationship in the investment account as the fiduciary relationship, which is also more in compliance with its actual operation.

4.2.1.2 Fund Types in An Investment Account and Analogical Application

In the division of fund types, investment account can be deemed as a contractual, open, publicly offered securities investment fund.

Based on various forms of organization, securities investment funds can be divided into "corporation-type fund" and "contractual-type fund." The former refers to a type of fund that pools the fund from investors through the issuance of stocks by a duly established independent fund company, the same fund collected is then entrusted to a fund manager by the fund company or assets trust company for securities investment, while the benefits are distributed to the investors in the form of a dividend on shares. The latter refers to another type of fund, where fund property is formed when the investors are subscribing fund shares pursuant to the agreement in the fund contract,

then the fund property is handed to the fund manager and fund trustee for an operation in accordance with trust principle.[586] The major sense for the division of the two lies in the different capacities as the subject of law, corporation –type fund qualifies as being a "legal person," which the contractual-type fund does not have. This has further caused the differences between the two in terms of the rights manifested by the fund shares, i.e., for the contractual-type fund, the fund share issued by it is a revenue voucher in which beneficial right is being reflected, while for the corporation-type fund, what has been issued by it is stock, by which stock right is manifested. The establishment of an investment account is based on the contract of investment-linked insurance, and the right and obligation between the policyholder, and such a contract mainly confirms the insurer. Also, China, currently, has not made any response to the subject body of the investment account. Though now the *Securities Investment Fund Law* in China allows the existence of the corporate-type fund,[587] in practice, the fund is mainly the contractual-type fund. Therefore, the investment account in China does not maintain the status as a legal subject, and should belong to contractual-type fund.

Based on whether or not the shares issued by fund can be redeemed, the fund can be divided into "open-end fund" and "closed-end fund." The former allows the investors to subscribe additional fund shares or redeem it, so the total fund shares and duration are not fixed, while for the latter, the total capital, number of shares, duration, etc have all been confirmed, and the investors are not allowed to subscribe additional fund shares or redeem it.[588] The major revenue channels for the closed-end fund are the bid-ask spread at the secondary market and the year-end dividend of the fund, whereas its investment risks are mainly the risk of the secondary market and the risk concerning the fund manager's ability in investment and financial management. The revenue of the open-end fund is mainly from the difference between the redemption price and subscription price. This price difference is again entirely dependent on the performance of the fund manager, so the fund shareholders of the open-end fund are mainly facing the risk concerning the capability of the fund manager without any risk from the secondary market.[589] For investment units in the investment account, an additional

[586] See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.14; Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.15.

[587] "This Law shall apply to the securities investment activities of a company or partnership formed through public or non-public capital raising for the purpose of engaging in securities investment activities, the assets of which are managed by a fund management institution or the general partners." See Article 153 of *Securities Investment Fund Law*.

[588] See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.15.

[589] See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), pp.18-

investment can be added, and the investment unit can be redeemed at any time. Besides, the revenue on the investment account is mainly subject to the investment performance of the insurer. Therefore, the investment account belongs to an open-end investment fund.

Based on the differences in fund collection, a fund can be divided into public offering fund and private placement fund. The former means that the investment fund is collected by issuing fund to the unspecific public in an open manner. The latter is a type of fund raised from a few institutional investors or individual investors in a private manner. The significance for this division lies in that public offering fund involves the unspecific public, which is under stringent supervision, i.e., there are significantly different regulatory rules for those aspects, including issuance requirement and information disclosure. When the insurer issues investment-linked insurance, basically it is aimed at unspecific policyholders, rather than specific institutional investors or individuals, which is to say, the policyholders of the investment account, are deemed as a kind of unspecific public. The characteristics in those aspects, as shown by the investment account, indicate that it belongs to the public offering fund.

It can be known from above that the investment account is, in fact, a securities investment fund. Based on this, further analysis is whether we can adapt the method of analogical application, and apply relevant laws on securities investment funds to the investment account. For the adoption of the method of analogical application, the judgment on the degree of importance of the constitutive elements, including the degrees of importance for identical points and different points, is the basis for the determination of similarity.[590] As we have discussed previously, the common points between investment account and investment fund are the independency in their legal status, the complete assumption of the investment risk by the investors, the trust nature of the operation mode, whereas for the differences between the two, the shares of public offering fund, among the securities investment funds, can apply for the listed transaction, differences in the rights of the members and the certain subordinative nature of the investment account. This thesis holds that the risk of the investment account, as assumed entirely by the policyholder, is already entirely different from the legal nature of traditional insurance, but is continuously getting “close” to investment

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[590] See Qu Maohui, *The Value of Private Law and Judicial Application of Analogy Application*, 1 Chinese Journal of Law 3, 15-16 (2005).

fund in terms of legal characteristics, such as the independency and trust nature, indicating that the investment account already has the essential features of an investment fund. Whether or not the “share” can be listed or the differences in a number of aspects, such as the rights of the members, are not the legal factors that exclude investment account from the investment fund, because investment funds can be further divided into various types of funds, i.e. “open-end investment fund” and “closed-end investment fund”, there are differences in whether or not all the fund shares can be listed and the rights of members. Therefore, in the legal sense, the investment account should be deemed as a securities investment fund, and the legal application to it should be based on the regulations prescribed for contractual, open-end, or public offering funds.

4.2.2 Legal Relationship between Relevant Subjects Involved in the Investment Account

The operation of a securities investment fund is based on the trust principle, so the relations between parties concerned in a fund contract are trust relations.[591] There are many different opinions concerning the legal relationships between parties in a contractual-type fund.

First, the fund share-holder is the principal and the beneficiary, whereas the fund manager and fund trustee are the “trustees”; second, the fund share-holder is the principal and the beneficiary, whereas the fund trustee is the “trustee” and the fund manager is the agent of the fund custodian; third, the fund share-holder is the principal and the beneficiary, whereas the fund manager is the “trustee” and the fund custodian is the agent of the fund manager; finally, the fund manager is the principal, the fund trustee is the trustee, and the fund share-holder is the beneficiary.[592] The reason for the differences between major legal relations of the above-mentioned fund lies in that various countries take different approaches towards the legal structure of funds. In other words, the funds have the difference between “unitary structure” and “dualistic structure”. The former case is found in a contractual-type fund in which there only exists a contractual relationship among the principal, the beneficiary, the manager, and the trustee. Fund manager and fund trustee perform the duties of trustee jointly, e.g., the “unitary structure” is adopted in the *Securities Investment Trust Act* enacted by Japan

[591] See Li Fei, *Interpretation of China’s Securities Investment Fund Law*, (Beijing: Law Press, 2013), p.9.
[592] See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.76.

in 1951; The latter case requires two fiduciary relations, namely the fiduciary relationship among the principal, the beneficiary and the manager and the fund trust relation between the manager and the trustee, e.g., the dualistic structure is adopted in the *Domestic Investment Company Act* enacted by Germany in 1956.[593] The abovementioned different trust structures have their own distinctive characteristics, "dual structure" is more able to reflect the transaction mode of trust, but does not benefit the protection of investors, because if the fund trustee has committed unlawful acts, the investor can not have the right of filing an action by a direct reference to the trust contract. However, in the "unitary trust structure," the investor, as a beneficiary, can exercise his or her rights in accordance with trust contract, including a direct exercise of the right of filing an action against the unlawful acts committed by the fund trustee, which can effectively protect the interests of the investors.[594]

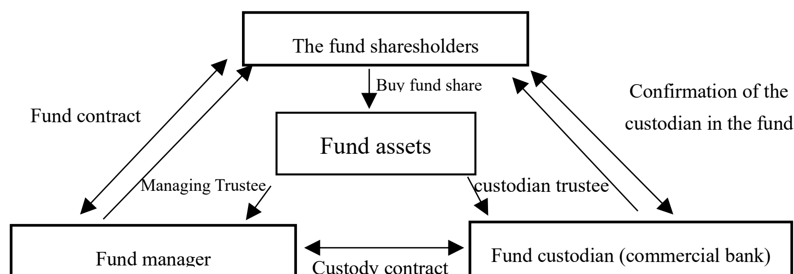
We may know from Article 3 of the *Securities Investment Fund Law* of China, which stipulates that the fund manager and fund trustee shall perform the trust duties in accordance with this law and the provisions in fund contract, China adopts the "unitary trust structure" for the legal relations between all subjects involved in a fund – only one fund contract exists between all subjects, wherein the fund shareholders are the "principal" and the "beneficiary," whereas the fund manager and fund trustee are joint trustees. Though fund managers and fund trustees are acting as the joint trustees, still different function orientations are set in the *Securities Investment Fund Law*. The major duties of the fund manager lie in the use of fund property for securities investment. Furthermore, it shall operate prudently and make scientific and yet rational investment strategies and carry out risk management, the purpose of which is to realize value preservation or appreciation for the fund assets.[595] The duties of fund trustee include the safe preservation of fund property, thus to secure the safety of fund assets.[596] Therefore, for fund manager and fund trustee, acting as the joint trustees, there are evident differences between their function orientations.

As it can be known from above, for the legal relationship between parties concerned in contractual-type fund, the fund shareholder and the fund manager establish the trust relationship through fund contract; through the confirmation of the

[593] See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), pp.17-18.
[594] See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.90.
[595] See Article 9 & 19 of China's *Securities Investment Fund Law*.
[596] See Article 36 of China's *Securities Investment Fund Law*.

trustee by the fund contract, the fund shareholder establish the trust relationship with the fund trustee; the fund manager and fund trustee are acting as the joint trustees, with the former mainly refers to the managerial trustee for fund assets, while the latter mainly refers to the custodial trustee (as shown in below figure).

Figure. the legal relationship between the parties of the contractual fund



Among the legal relationship between subjects involved in the investment account, the role of the policyholder has been changed to the role of “principal” or “investor”, and accordingly, the role of the insurer has been changed to “trustee” and “manager”. The legal relations of the parties involved in the investment account can be demonstrated from the following three aspects.

First of all, the legal relationship between the policyholder (“the investor”) and the insurer (the “managerial trustee for assets of investment account”). In form, the investment account is still represented by the insurance contract relation between the policyholder and the insurer, but substantially, the relation between the two has been transformed into the investment contract relationship between the investor and the managerial trustee for the assets of the investment account. Because the investment account is, in fact, the investment fund, this investment contract can be compared to the fund contract for comparative analysis. Investment account has not been separately established right from the start, but is established later by signing an investment-linked insurance contract. The premium paid by the policyholder has to be proportionally distributed to investment accounts bearing different risks – the purchase of the investment units of different investment accounts.

On the other hand, the insurer, as the trustee for capital management, determines the investment portfolio of the investment account and its mode of operation. Chapter 2 also starts its analysis from the definition of trust, which is in Article 2 of the *Trust Law*, the policyholder and the insurer as in an investment account, have also constituted the substantial trust relationship. In obedience to the approach taken in discussing the

"substance over form," the legal relationship between policyholder and insurer involved in an investment contract should also be analyzed in accordance with the legal relationship between investor and trustee for capital management, thus to specify the insurer's (trustee for capital management) major duties for value preservation and appreciation and the policyholder's (investor) beneficiary right, as well as the common benefit right, such as the supervision right, rather than understanding the legal relationship under the investment account as the insurance contract relationship and civil principal-agent relationship.

In the investment fund, the fund manager, as the trustee, is the actual operator of the fund assets, and has to minimize the investment risk of fund assets and guarantee that the fund holder shall have a maximized return on investment.[597] Likewise, insurer, as the trustee for the management of assets in an investment account, its duties are to realize the purpose of value preservation and appreciation for assets in the investment account, thereby maximizing the interest of the policyholder (the beneficiary). Apparently, if we observe the legal relationship between parties to a contract from the perspective of *Insurance Law*, it does not conform to the economic essence of a transaction, consequently resulting in the absence of the protection for investment interests.

The main purpose for the investor (policyholder) to buy investment units under the investment account is to acquire an increase in the return on investment and is thus subject to the corresponding right to receive return on investment, which is mainly in proportion to the number of investment units (under an investment account) possessed by the investor. Among all different rights, if by traditional civil law, they can be divided into property rights and personal rights. Take the rights covered by the property right as an example, Article 71 of the *General Principles of the Civil Law of China (2009 Amendment)*, property ownership right refers to the right enjoyed by the property owner as to own, use, dispose or benefit from such property. Article 39 of the *Property Law* also has such provision, and it is expressly provided in Article 65 of this law that the law shall protect the lawful private savings, investment, and the returns thereof.

Therefore, the policy holder's right to receive a return from the investment account, as a kind of property right, naturally, has the legitimacy. In fact, for the

[597] See Zhang Lu, Luo Xu, and Guo Xiaojing, *Comparison and Practice of Fund Law between China, America and Britain*, (Beijing: Law Press, 2007), p.13.

policyholder of investment-linked insurance, the main purpose of buying this kind of financial product is for investment and financial management with the expectation to acquire a return on investment. This also means that among various relevant rights entitled to the policyholder of investment-linked insurance, the right to receive return is the most concerning one.

Moreover, the policyholder enjoys the common benefit right over the investment account, particularly the right to supervise the trustee entrusted to manage the assets of the investment account. For example, in Chapter 4 of the *Securities Investment Fund Law*, it has specially stipulated the operation mode and organization of fund, including the supervision right owned by the fund shareholder, especially the supervision over the fund manager's investment operation by the fund shareholder conference. Nevertheless, for general collective financial management products, investors, more often, will not quite care about the common benefit right about the capital invested, such as the supervision right, the main reasons are: first, the policyholder does not act like a traditional shareholder, who, except for making a capital contribution, also cares about the corporate governance. The purchase of investment-linked insurance, as well the distribution of capital among investment accounts by the policyholder, the main purpose of which is to acquire a return on investment. The policyholder does not care anything about the specific operation and governance of all investment accounts, as well as the right to vote generated as a result of the participation in the investment in foreign countries. In other words, if the policyholder is not satisfied with the investment performance of investment accounts, it may realize its evasion of investment risks by redemption or reduction in investment.

Despite the total capital amount of all investment might be huge, this investment account represents a kind of collective financial management with numerous people involved, if those common benefit rights are distributed to each policyholder, then the common benefit right enjoyed by an individual appears to be too negligible to draw the attention from the policyholder. This applies to fund as well for it is a "pool" of a wide range of small to medium investors. Consequently, it is easier to get trapped into the "paradox of collective action", because every fund shareholder wants to hitch-hike and is unwilling to assume the cost of supervision.[598] Notwithstanding, the policyholder

[598] See Zhang Lu, Luo Xu, and Guo Xiaojing, *Comparison and Practice of Fund Law between China, America and Britain*, (Beijing: Law Press, 2007), p.322.

remains indifferent to the common benefit rights of the investment account; however, in law, we cannot deny the common benefit rights that ought to be enjoyed by it. The purpose of clarifying the common benefit rights entitled to the policyholder is to encourage the policyholder's exercise of the right to supervise the insurer's investment management in the investment account and reduce the implicit oppression of the policyholder by the insurer and its arbitrariness in making decisions on investment, as well as other law- or rule-breaching acts.

Secondly, the legal relationship between the insurer (the "managerial trustee") and the custodian of the assets in the account. Theoretically, based on two basic targets – the value preservation and appreciation for the assets in an investment account and asset security, the trustee for assets management and the custodian of the assets in the account are separated. The asset manager is mainly responsible for the duties about preservation and appreciation of the asset value, while the custodian of the assets in account is mainly responsible for the duties of asset security. However, in supervision rules enacted by China in early times, mandatory trusteeship was not required for capital in the investment account. Later on, In Article 7 of the *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insurance (No. 32 [2015] of the China Insurance Regulatory Commission),* it is expressly stipulated that the assets in the investment account should all be trusted. The market access, qualifications, service scope, etc. of the asset trust institution should conform to relevant regulatory rules, which indicates that in the legal relation of the investment account, there still exists the asset trust institution.

According to the mode of "unitary trust structure" as being adopted by funds in China, the managerial trustee and asset custodian of the investment account should be acting as the joint trustees. However, Article 31 of the *Trust Law* of China provides that it shall be referred to as the joint trustees in case there are two or more trustees for one trust and joint trustees should handle matters relating to trust jointly. Where the joint trustees are in debt to a third party in the process of handling matters relating to trust, they shall assume joint and several liabilities for repayment.[599] It can be seen that there are differences between the definition of joint trustees in the context of investment account where the insurer is acting as the asset management trustee and fund custodian,

[599] See Article 32 of China's *Trust Law.*

and the definition of the *Trust Law* on joint trustees.

The significance in distinguishing the differences in duties of the trustees of the investment account is to identify the existence of different bases of the claims clearly. In case the trustee (manager and custodian) of the capital in investment account violates the fiduciary duty, should the investor (policyholder) refer to the "other trustee shall assume the joint and several liabilities for compensation," as stipulated in Article 31 and 32 of the *Trust Law* or the different duties of the asset manager and custodian to an investment account, for the identification of responsibilities.

This thesis holds that under this circumstance, the relief basis of the investor (policyholder) should not be based on the provision of the *Trust Law* on joint and several liabilities. First, the investment account, as the substantial investment fund, rules of the fund should be analogically applied to it. The "basic legal relation of the contractual-type fund is the trust relationship" is something that has been confirmed in Article 2 of the *Securities Investment Fund Law.*[600] Based on this characteristic, the legal relation in fund trust can be deemed as a special trust relationship in which the fund shareholder is the trustee of the trust. By contrast, the fund is a special trust product; in other words, the relation between *Securities Investment Fund Law* and *Trust Law* is the relation between a special law and ordinary law.

Therefore, based on the principle that the special law is superior to ordinary law, the relief to the investor (policyholder) should be analogically applied to the *Securities Investment Fund Law*. Second, from the actual role played by the joint trustees, under the *Trust Law*, joint trustees have all participated in the management of trust property. On the contrary, when the *Securities Investment Fund Law* is analogically applied, though the joint trustees conduct the trust of an investment account, their duties do not cover the management and use of fund assets.[601] Under the circumstance where there is no joint handling of matters relating to trust, they have to assume the joint and several liabilities for the breaching of managerial responsibilities by the manager of the capital in an investment account. Apparently, this is not in compliance with the principle that the right shall be in line with the obligation. Some scholars point out that because of the functional separation between "trusteeship" and "management," "custodian" and

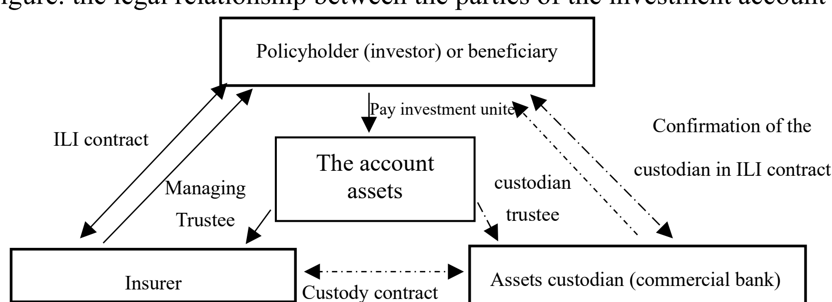
[600] Matters not included in *Securities Investment Fund Law* shall be governed by the Trust Law of the People's Republic of China. See Article 2 of China's *Securities Investment Fund Law*.

[601] It is also pointed out that fund managers and custodians are not co-trustees, but the only decomposition of trustees' function. See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.19.

"manager," both are the fund trustees, are not the joint trustees in the context of *Trust Law*, hence are not necessarily to assume the joint and several liabilities for compensation, but should based on the fault principle to determine whether they have fulfilled their duties in relation to the trust, thus to assume the responsibilities solely.[602]

In addition, in terms of the relation between the policyholder (the investor) and the custodian of the capital in an account, though the policyholder does not directly involve in the trust agreement signed between the insurer and the asset trust institution, based on the direct regulation from the law and by breaking through the relativity of contract, we can also regard the policyholder, the beneficiary, the insurer, and the asset trust institution, all of them relating to the investment account, as the subjects of the basic legal relationship. In other words, the "unitary trust structure" of the investment fund should be analogically applied. Policyholders, under the identity of the investor, can directly refer to the signed investment-linked insurance contract to exercise the contractual right it has against the insurer and the capital trustee of the investment account, including above-discussed supervision right.

Figure. the legal relationship between the parties of the investment account



4.3 The Regulation of the Investment Account: American Law Mode

The legal attributes of the investment accounts of a variable annuity and variable life insurance are quite clear as they define the nature of investment account as an "investment company" and apply the *Investment Company Act of 1940* to it.

4.3.1 Considering the Separated Account as An Investment Company

In the US law, the legal regulation on the investment companies adopts the mode of separate legislation – the enactment of *Investment Company Act of 1940* and

[602] See Hong Yanrong, *On the Governance Function and Independent Responsibility of Fund Custodians*, 6 China Legal Science 241, 241 (2019).

Investment Advisers Act of 1940 respectively, with the former mainly sets forth the rules concerning an investment company, including the registration of an investment company and its organizational structure; while the latter mainly formulates the rules on those aspects, including the establishment and the operation of fund by fund manager who is acting as the investment adviser, and this is different from the *Securities Investment Fund Law* in China, which adopts a unified legislation mode covering the rules on the establishment, operation and management of fund companies, as well as the rules on rights and obligations of fund managers, and many others.

America's definition of "company" in the *Investment Company Act of 1940* is relatively broad, including not only the corporation, but also partnership, association, joint-stock company, trust, fund, any organized group of persons, whether incorporated or not, receiver and trustee covered by Chapter 11 of the US Code, or any official or liquidating agent having similar functions.[603] For those types of investment companies, in Article 4 of the *Investment Company Act of 1940,* the US further divides the investment companies into three types, including face-amount certificate company, unit investment trust, and management company,[604] among which the one that plays a dominating role is the management company.[605] As it can be known from above, the objects being regulated by the *Investment Company Act of 1940* are quite broad and the forms in which those investment companies are organized are also various, with flexibility and openness, and are not confined to certain one or some forms. We have scholars who point out that the investment companies being regulated by the *Investment Company Act of 1940,* in fact, refer to an investment aggregation.[606] Nevertheless, although the objects being regulated by the *Investment Company Act of 1940* is broad, the insurance companies were excluded from its regulation. The reason is that the State

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603 "Company" means a corporation, a partnership, an association, a joint-stock company, a trust, a fund, or any organized group of persons whether incorporated or not; or any receiver, trustee in a case under Title 11 of the United States Code or similar official or any liquidating agent for any of the foregoing, in his capacity as such. See Section 2 (a)(8) of Investment Company of 1940).

604 (1) "Face-amount certificate company" means an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding. (2) "Unit investment trust" means an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities, but does not include a voting trust. (3) "Management company" means any investment company other than a face-amount certificate company or a unit investment trust. See Section 4 of Investment Company of 1940).

605 See Hazen Thomas Lee, *The Law of Securities Regulation*, (Beijing: China University of Political Science and Law Press, Chinese translation edition, translated by Zhang Xuean, 2003), p.832.

606 See Huang Hui, *Jurisprudential Basis and Operational Models of Asset Management: the US Experience and Its Implications for China*, 5 Global Law Review 128, 130 (2019).

laws have made concentrated regulations of those companies of the US.[607] Therefore, in terms of the "carrier" of assets management, compared with the diversity shown by the American investment companies, only a single type is defined by laws in China, which is mainly the investment fund being regulated by the *Securities Investment Fund Law.* Also, in terms of the types of investment funds, a contractual-type investment fund is the most common one in China. Though Article 153 of the existing *Securities Investment Fund Law* has stipulated forms, such as the company and limited partnership, they are roughly stipulated forms in the absence of corresponding rules. Consequently, China's *Securities Investment Fund Law* has a limited scope of adjustment, but the "old" is discarded and the "new" are brought forth, an objective law found in the commercial transactions, in practice, has resulted in the emergence of various transaction or forms of organization, e.g., the investment account of the investment-linked insurance and various kinds of assets management plans, which have caused the apparent disconnection between commercial practice and existing laws.

Since the US has diversity in terms of the objects being regulated by the *Investment Company Act of 1940,* there has been a heated debate over whether or not the investment account (separate account) is a kind of investment company.[608] The regulations on variable annuity have all required the establishment of a separate account and the independence from an insurance company in accounting so as to achieve the requirements for assets isolation and capital independence. In this regard, the establishment of a separate account for a variable annuity is similar to that for a mutual fund. In *Prudential Ins. Co. of America v. SEC of 1964*, the US Federal Court defined this separated account as an investment company. The major dispute, in this case, is whether or not the separated account of the variable insurance issued by the Prudential Company belongs to an investment company, rather than whether or not Prudential Company is an investment company. Prudential Company claimed that only a specific business organization can be the object being regulated by the *Investment Company Act of 1940,* since a separated account is not in an organizational structure, it should not be

[607] See Wendell M. Faria, *Status of Insurance Companies and Insurance Company Separate Accounts Under the Investment Company Act*, Variable annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3-2.

[608] "The application of the Investment Company Act of 1940 to variable life insurance raises three questions: first, whether separate accounts which fund variable life insurance policies are investment companies within the meaning of the Investment Company Act of 1940; second, whether state insurance laws conflict with the provisions of the 1940 Act; and third, whether the McCarran-Ferguson Insurance Regulation Act, which prohibits federal statutes from impairing state laws regulating the business of insurance, limits the applicability of the 1940 Act." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law. 1017, 1031 (1973).

identified as the investment company stipulated in the *Investment Company Act of 1940*. For this case, the court held that the value of the investment account of this product sold by Prudential Company is based on the investment units in that account, the profit or loss is then shared based on investment performance, plus the purpose of the capital in this account is for securities investment. No guarantee has been provided to the value of such investment account, so this account is, in fact, a "fund" and shall be regulated by the *Investment Company Act*.[609]

After the Prudential case, the question remains: how to define separated account and how to apply it under the *Investment Company Act of 1940*, SEC initially held that the separated account belongs to the periodic payment plan,[610] however, afterward, SEC realized that variable annuity and variable life insurance are a kind of unique financial products, which are different from the periodic payment plan, thus, for this reason, rules especially aimed at the separated account, including Rule 6c-6, 6c-7, 6c-8, 11a-2, 14a-2, 15a-3, 16a-1 and 22c-1, were enacted by SEC.[611] "Article 27(i) on the separated account" was added when the *Investment Company Act* was amended in 1996, since then relevant requirements for the periodic payment plan no longer applies.[612] This provision requires that what has been issued by the separated account must be redeemable securities, whereas in the *Investment Company Act of 1940,* only open-end management company or unit investment trust are allowed to issue redeemable securities, therefore in early times, the separated account was classified as the open-end management company under the *Investment Company Act of 1940.*[613]

Thus it can be seen that law application for the separated accounts of variable

[609] See *Prudential Ins. Co. of America v. SEC*, 326 F.2d 383 (1964).

[610] "Periodic payment plan certificate" means (A) any certificate, investment contract, or other security providing for a series of periodic payments by the holder, and representing an undivided interest in certain specified securities or in a unit or fund of securities purchased wholly or partly with the proceeds of such payments and (B) any security the issuer of which is also issuing securities of the character described in clause (A) and the holder of which has substantially the same rights and privileges as those which holders of securities of the character described in clause (A) have upon completing the periodic payments for which such securities provide." See Section (a) (27) of Investment Company Act.

[611] See Wendell M. Faria, *Status of Insurance Companies and Insurance Company Separate Accounts Under the Investment Company Act*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3-20.

[612] "(1) This section does not apply to any registered separate account funding variable insurance contracts, or to the sponsoring insurance company and principal underwriter of such account, except as provided in paragraph (2). (2) It shall be unlawful for any registered separate account funding variable insurance contracts, or for the sponsoring insurance company of such account, to sell any such contract unless— (A) such contract is a redeemable security; and (B) the insurance company complies with section 26(f) and any rules or regulations issued by the Commission under section 26(f)." See Section 27 (i) of Investment Company Act.

[613] See Wendell M. Faria, *Status of Insurance Companies and Insurance Company Separate Accounts Under the Investment Company Act*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3-22.

annuity and variable life insurance is conducted in the context of an investment company.[614] In the *Investment Company Act of 1940*, the one that plays an important role in the establishment and operation of an investment company is the investment adviser. Nearly 60% of the American fund and trust initiators are independent investment advisers.[615] During the incubation period, the investment adviser participates in the process of establishing an investment company, after it comes into the actual operation stage, an investment adviser is then responsible for investment management.[616] Moreover, among all types of investment companies, mutual fund accounts for the majority of them and becomes the leader in the capital markets of the US.[617] Nevertheless, a mutual fund is not a legal term under the *Investment Company Act of 1940,* but an expression which is widely used in commercial practice.[618] It is a collective investment tool that raises capital from public investors to form a capital pool, which is then handed to professional institutions for investments in different securities products.[619] Thus it can be seen that in fact, a mutual fund is an open-end fund in company type.[620] Take the mutual fund as an example, investment adviser plays a vital role throughout the operation of an investment company (as shown in the below figure). SEC in America has also expressly provided in Rule 6e-2 that suggestions or consultation are offered to the separated account by an investment adviser and that the separated account should be registered according to the *Investment Company Act of 1940.*[621]

The "general definition + exclusion" is adopted by the US for the definition of "investment adviser" in Article 202 (a) (11) of the *Investment Adviser Act of 1940* – "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning

[614] "If separate accounts are open-end investment companies, they are subject to regulation by state insurance laws and by the 1940 Act." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law. 1017, 1041 (1973).
[615] See Zhang Lu, Luo Xu, and Guo Xiaojing, *Comparison and Practice of Fund Law between China, America and Britain*, (Beijing: Law Press, 2007), p.36.
[616] See Huang Hui, *Jurisprudential Basis and Operational Models of Asset Management: the US Experience and Its Implications for China*, 5 Global Law Review 128, 133 (2019).
[617] See Peter Lückoff, *Mutual Fund Performance and Performance Persistence*, Gabler, 2011, p.1.
[618] See Huang Hui, *Jurisprudential Basis and Operational Models of Asset Management: the US Experience and Its Implications for China*, 5 Global Law Review 128, 130 (2019).
[619] See Wallace Wen Yeu Wang, *Corporate Versus Contractual Mutual Funds: An Evaluation of Structure and Governance*, 69 Wash. L. Rev. 927, at 930 (1994).
[620] See Guo Feng and Chen Xia, *Introduction of Securities Investment Fund Law*, (Beijing: Law Press, 2008), p.136.
[621] See 17 CFR § 270.6e-2.

securities."[622] Also, this provision has excluded some specific banks,[623] eight subjects, such as lawyers, accountants, and engineers, from the category of investment adviser.[624] Thus it can be seen that the definition of investment adviser in the *Investment Company Act of 1940* remains relatively broad. In *Lowe v. SEC of 1985*, the US Federal Court established the use of trust relationship as the critical factor in determining investment adviser.[625] In the US, investment advisors mainly provide services in two aspects. First, it is to provide customers with customized or non-customized investment suggestions; second, it is to provide customers with services including investment decisions, account management, the appointment of qualified custodians, and instruction on managerial activities.[626]

In light of the abovementioned, in dealing with the legal relationship among investor, investment company, and investment adviser, the *Investment Adviser Act of 1940* focuses on formulating provisions on the following two aspects. First, vesting investment adviser with fiduciary duty and preventing the conflict of interests. For example, in Article 206 of the *Investment Adviser Act of 1940,* the US has explicitly prohibited the investment adviser from committing some acts: investment advisers are prohibited from cheating any customer or potential customer through any means, plans or measures; forbidden to engage in any transaction, practice or business through which to swindle or cheat any customer; acting as the agent of its own account, selling securities to or purchasing securities from customer deliberately, among others.[627] The

[622] "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. See Section 202 (a)(11) of *Investment Advisers Act of 1940*.

[623] It does not include (A) a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956, which is not an investment company, except that the term "investment adviser" includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if, in the case of a bank, such services or actions are performed through a separately identifiable department or division, the department or division, and not the bank itself, shall be deemed to be the investment adviser." See Section 202 (a)(11) of *Investment Advisers Act of 1940.*

[624] See Section 202 (a)(11) of *Investment Advisers Act of 1940.*

[625] "As long as the communications between petitioners and their subscribers remain entirely impersonal and do not develop into the kind of fiduciary, person-to-person relationships that were discussed at length in the legislative history of the Act and that are characteristic of investment adviser-client relationships, we believe the publications are, at least presumptively, within the exclusion and thus not subject to registration under the Act." See *Lowe v. SEC,*472 U.S.181(1985).

[626] See Huang Hui, *Jurisprudential Basis and Operational Models of Asset Management: the US Experience and Its Implications for China*, 5 Global Law Review 128, 132 (2019).

[627] See Section 206. (80b–6) of Investment Advisers Act of 1940. It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly— (1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; (3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which

core of the *Investment Company Act of 1940* is, in fact, a special anti-fraud rule, requiring that the investment adviser should observe the trust standard, and also this standard is highlighted throughout the whole actions conducted by the investment adviser.[628] Second, strengthening the governance structure within the investment company and enhancing the supervision over investment adviser and maintaining the check and balance on its rights. In the *Investment Company Act of 1940*, for an investment company, its general governance structure consists of shareholder (the investor), board of directors, and investment adviser. According to the governance rules for a company in general, the shareholder has the right to choose and appoint board members and investment adviser, and the contract with the investment adviser should be signed by the board of directors, which again votes to make decisions on some important events of the investment company.

Nevertheless, in this process, the board of directors is not a general execution body in corporate governance as prescribed in the company act. In the *Investment Company Act*, the board of directors mainly serves the role of supervision. The chief duty of the board of directors is to evaluate all relevant information and approve the Investment Adviser Contract, thus to maximize shareholder interests.[629] The important matters that are decided through the votes cast by shareholders are not the operational decisions of the investment company, but mainly are such matters, including the fund management fee paid to an investment adviser. The execution body is the investment adviser, and the investment decisions of the investment company are also made by it. So in the *Investment Company Act of 1940,* the investment adviser, for one thing, enjoys major business authority in the operation of the investment company, for another thing, is being supervised by the board of directors and shareholders (investors). For example, in Article 10 (a) of the *Investment Company Act*, it stipulates that the number of directors who have stakes in the investment adviser should be no more than 60% of all board members.[630] Shareholders meeting has the right to limit the investment adviser's

he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction; or (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

[628] See Lou Xiao, T*he Way to Build Corporate Fund Governance Structure in China -- From the Perspective of American Mutual Fund Governance Structure*, 6 Law Review 86, 89 (2013).

[629] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-31.

[630] "(a) No registered investment company shall have a board of directors more than 60 per centum of the members

scope of power, increase or decrease the number of investment advisers, demote or even replace the original investment adviser or alternatively, select an investment adviser who is adapted to the shareholders' expected return on investment and risk-bearing capacities, of course, "voting by feet" is also allowed, meaning that fund shares in their possession can be redeemed or transferred.[631]

Table: differences in the organizational functions/power

Function	*Investment Company Act of 1940*	General company law
Operation and management power	Investment adviser	Board of directors, officer
Supervisory power	Shareholders; board of directors	Shareholder; Independent Director / Special Committee of the board of directors; board of supervisors

4.3.2 Registration of the "Type of Investment Company": Change to Unit Investment Trust in Practice

At present, very few separated accounts in the US have been registered at SEC as open-end management companies (mutual fund). In practice, those separated accounts are mainly the unit investment trust.[632] Possibly, the reasons that the US now adopts mostly the practice of registering the separated accounts as unit investment trust are following. First, the company-type fund itself has a high operating cost. The governance structure of the company-type fund leads to the occurrence of extremely high transaction costs, i.e., the cost of centralized decision-making and the cost of intervention, especially when the board of directors is negotiating or performing relevant matters.[633] Second, the open-end management company is organized in the form of a company and is subject to statutory company restrictions imposed by each State of the US, as well as even more stringent regulations enacted by SEC on a mutual fund. Consequently, the common practice adopted by the US is to maintain a "dual-layer structure" mode, which is to register the separated account at SEC as a unit investment trust, then the capital in many different separated accounts is again invested in the one registered as open-end management investment company.[634] This "dual-layer

of which are persons who are interested persons of such registered company." See 15 U.S.C. 80a-10.

631 See Huang Hui, Jurisprudential Basis and Operational Models of Asset Management: the US Experience and Its Implications for China, 5 Global Law Review 128, 135-136 (2019).

632 See Wendell M. Faria, *Status of Insurance Companies and Insurance Company Separate Accounts Under the Investment Company Act*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3-22.

633 See Lou Xiao, *The Way to Build Corporate Fund Governance Structure in China -- From the Perspective of American Mutual Fund Governance Structure*, 6 Law Review 86, 90 (2013).

634 See Wendell M. Faria, *Status of Insurance Companies and Insurance Company Separate Accounts Under the*

structure" mode is established mainly based on Article 12 (d) (1) (E) of the *Investment Company Act of 1940,*[635] and the application of Article 12 (d) (1) (A) of the law to "fund of fund" is further exempted.

In other words, in order to prevent "pyramiding" effect and potential repeating expense, Article 12 (d) (1) (A) of the *Investment Company Act* stipulates that the following 3 circumstances are illegal, one investment company purchases more than 3% of the voting rights (or 5% of the total assets) of another investment company or invests less than 10% of its own assets into another investment company.[636] However, in Article 12 (d) (1) (E) of this law, three circumstances, for which Article 12 (d) (1) (A) can not be applied, are provided, including the one that this security is the only investment securities possessed by that investment company registered as a unit investment trust.[637] For this reason, for the separated account, the choice to invest in only a mutual fund and registered itself as unit investment securities at the SEC can avoid the application of Article 12 (d) (1) (A).

This "dual-layer structure" mode is similar to the mode of operation for "master-feeder fund."[638] Those open-end management companies raise capital from and distribute stocks to ordinary investors mainly through separate accounts, which resemble the retail mutual funds.[639] Those open-end management companies are also

Investment Company Act, Variable Annuities and Variable Life Insurance Regulation. ed. by Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3-22.

[635] The provisions of this paragraph shall not apply to a security (or securities) purchased or acquired by an investment company if—
(i) the depositor of, or principal underwriter for, such investment company is a broker or dealer registered under the Securities Exchange Act of 1934, or a person controlled by such a broker or dealer;
(ii) such security is the only investment security held by such investment company (or such securities are the only investment securities held by such investment company, if such investment company is a registered unit investment trust that issues two or more classes or series of securities, each of which provides for the accumulation of shares of a different investment company); and
(iii) the purchase or acquisition is made pursuant to an arrangement with the issuer of, or principal underwriter for the issuer of, the security whereby such investment company is obligated—
(aa) either to seek instructions from its security holders with regard to the voting of all proxies with respect to such security and to vote such proxies only in accordance with such instructions, or to vote the shares held by it in the same proportion as the vote of all other holders of such security, and
(bb) in the event that such investment company is not a registered investment company, to refrain from substituting such security unless the Commission shall have approved such substitution in the manner provided in section 26 of this Act. See Section 12(d)(1)(E) of Investment Company Act.

[636] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-14.

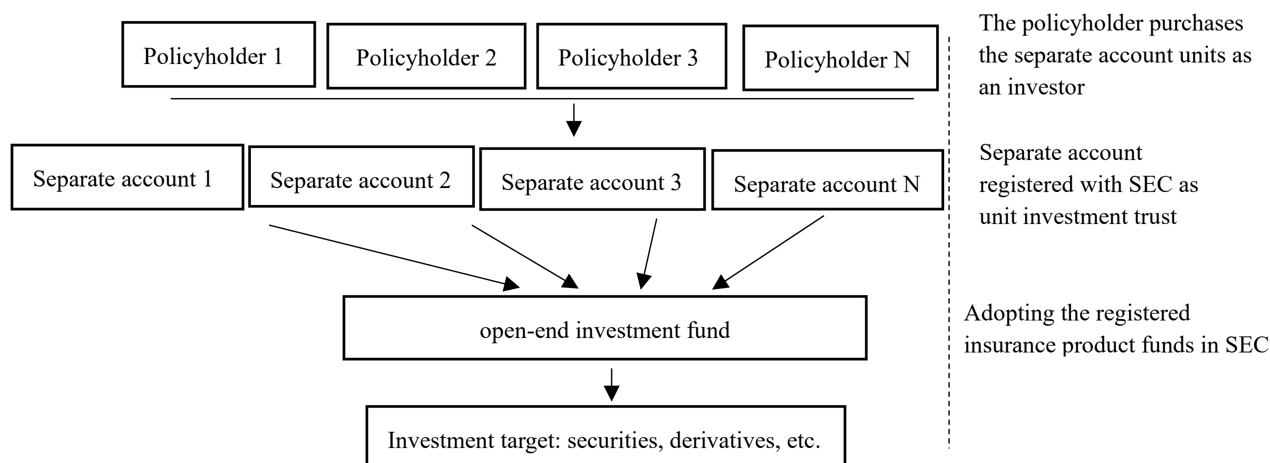
[637] "such security is the only investment security held by such investment company (or such securities are the only investment securities held by such investment company, if such investment company is a registered unit investment trust that issues two or more classes or series of securities, each of which provides for the accumulation of shares of a different investment company)". See 15 U.S.C. 80a-12(d)(1)(E).

[638] See C. Christopher Spragua, *The Funding Vehicle*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.7-2.

[639] This corresponds to institutional funds.

referred to as "underlying funds," which in turn are also referred to as "insurance dedicated funds", because those funds almost only serve for separated accounts and are usually not accessible by the public.[640] Therefore, in practice those open-end management companies are not new and specially established, but established by cloning or duplicating existing insurance funds since they all have the same investment objective, investment strategy, and investment adviser, thereby it is beneficial to the improvement of administrative efficiency, the reduction of the scrutiny from the SEC, and the possible presentation of the previous investment performance of the open-end management company to investors.[641] Also, this operation mode makes it possible for an insurance company to accumulate the growth in the economic scale of the assets while under a single entity – one mutual fund.[642]

Figure. Separate account registered as unit investment trust



However, irrespective of whether the separated account is registered as an open-end management company or unit investment trust at the SEC, all of them are objects being regulated by the *Investment Company Act of 1940.* The main difference of the two is the organization structure, with the former bearing legal subject status and having organizations, including shareholders meeting and board of directors, while the latter is based on trust and the establishment of contract with no capacity as a subject of law

[640] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable annuities and variable life Insurance regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-58.
[641] See C. Christopher Spragua, *The Funding Vehicle*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.7-2.
[642] See Wendell M. Faria, *Status of Insurance Companies and Insurance Company Separate Accounts Under the Investment Company Act*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3-22.

and also in absence of organizations, such as the board of directors.[643] Therefore, if the separated account of variable annuity or variable life insurance is registered as unit investment trust at the SEC rather than an open-end management company, consequently, organizational governance rules on open-end management companies, such as director election and approval of investment adviser, can not be directly applied to it. For example, the "provisions on election," which is not applicable to directors – Article 16 (a) of the *Investment Company Act of 1940*, which stipulates that any director of a registered investment company should be appointed according to the votes at an annual or special meeting. If at least more than two-thirds of all directors are elected and duly appointed, then in the event there is any vacancy on the position of director, it may be filled up through other means.[644] For another instance, Article 15 of the *Investment Company Act of 1940,* the provisions on investment adviser, does not apply to separated accounts registered as a unit investment trust. This provision stipulates that a majority must approve investment advisers of votes, and there has to be an accurate description of some matters in the *Investment Adviser Contract*, including all the remunerations payable.[645] Again there is another example, Article 16 (a) of the *Investment Company Act* of 1940, requiring the board members to be elected by the shareholders of the investment company at an annual or special meeting, does not apply to separated accounts registered as unit investment trust at the SEC.[646]

Nevertheless, it is worth noting that even though the separated account is registered as a unit investment trust, some provisions in the *Investment Company Act of 1940* on organization governance still apply to it.[647] For example, Article 9 (a) of the *Investment Company Act of 1940*, the provision on the qualifications for affiliated persons, applies to all investment companies, including open-end management

643 See Huang Hui, J*urisprudential Basis and Operational Models of Asset Management: the US Experience and Its Implications for China*, 5 Global Law Review 128, 131 (2019).

644 "(a) No person shall serve as a director of a registered investment company unless elected to that office by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for that purpose; except that vacancies occurring between such meetings may be filled in any otherwise legal manner if immediately after filling any such vacancy at least two-thirds of the directors then holding office shall have been elected to such office by the holders of the outstanding voting securities of the company at such an annual or special meeting." See 15 U.S.C. 80a-16(a).

645 See 15 U.S.C. 80a-15.

646 "No person shall serve as a director of a registered investment company unless elected to that office by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for that purpose……" See Section 16 (a) of Investment Advisers Act of 1940.

647 See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-25.

company, unit investment trust, etc.[648] For another example, for the requirements on initial capital, Article 14 (a) has stipulated the size requirement for the registration of an investment company, according to it, the initial capital should be at least a net value of 100 thousand US dollars.[649] This requirement has not differentiated between the types of investment companies, which also means that the initial capital in the case of separated account has to comply with this requirement as well. However, the SEC has enacted Rule 14a-2 – if the insurance company that initializes the establishment of a separated account complies with the requirement that its combined capital and surplus is no less than 100 million US dollars, then the separated account can be exempted from the application of Article 14 (a) of the *Investment Company Act*.[650] Take another case as an example, for the requirements on capital trust, Article 17 (f) of the *Investment Company Act* requires that the capital raised through the issuance of securities by an investment company that is registered as a management company should be trusted in a qualified agency (banks, securities dealer in a National Securities Exchange or investment company that satisfies the requirements of SEC).[651] Despite that the object of this regulation are investment companies registered as management companies, it does not mean that the unit investment trust does not in need of a trust. For example, Article 16 (a) of the *Investment Company Act* requires that the capital, surplus, and undistributed profit of the bank custodian of the unit investment trust, in total, should, at any time, be no less than 500 thousand US dollars even at the minimum level.[652] However, in Sub-article (f) of this Article, it is expressly exempted from the application of Article 16 (a) of the *Investment Company Act* to the one registered as separated

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[648] "It shall be unlawful for any of the following persons to serve or act in the capacity of employee, officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company." See Section 9 (a) of *Investment Advisers Act of 1940.*

[649] "such company has a net worth of at least $100,000". See 15 U.S.C. 80a-14.

[650] "the insurance company establishing and maintaining such separate account shall have (1) a combined capital and surplus, if a stock company, or (2) an unassigned surplus, if a mutual company, of not less than $1,000,000 as set forth in the balance sheet of such insurance company contained in the registration statement or any amendment thereto relating to such contracts filed pursuant to the Securities Act of 1933." See SEC Rule 14a-2.

[651] "Every registered management company shall place and maintain its securities and similar investments in the custody of: (A) a bank or banks having the qualifications prescribed in paragraph (1) of section 26(a) for the trustees of unit investment trusts; or (B) a company which is a member of a national securities exchange as defined in the Securities Exchange Act of 1934, subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investors; or (C) such registered company, but only in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investors." See 15 U.S.C. 80a-17(f).

[652] "designates one or more trustees or custodians, each of which is a bank, and provides that each such trustee or custodian shall have at all times an aggregate capital, surplus, and undivided profits of a specified minimum amount, which shall not be less than $500,000". See 15 U.S.C. 80a-26(a).

accounts or insurance company and underwriter with such accounts.[653]

4.3.3 Comparative Analysis: Difference and Enlightenment

Through above analysis on the management mode for the separated account in the US, it can be known that regardless of whether the separated account is registered as open-end management company or unit investment trust at SEC, the idea of shareholder democracy has all been reflected in the rules on internal governance, and the basic concept of mutual restrictions on rights have been implemented and put into practice. The basis for the establishment of open-end management companies is mainly the Company Acts in each State. There are special boards of directors established to carry out the function of supervision, and also there are investment advisers to perform the operational duties. Though the unit investment trust is established mainly based on trust or fund contract and there is no special board of directors established to carry out the function of supervision, it is being operated based on trust principle. The fund shareholder input capital to form fund capital, and there is an organization for it (unit investment trust) - the fund shareholder conference. The fund manager performs the duties relating to operation and investment, whereas the fund trustee is responsible for the preservation of and supervision overfund. The principle of check and balance on rights is still being reflected from the inside. Except for the application of the abovementioned rules from the *Investment Company Act of 1940* to separated accounts of a variable annuity and variable life insurance, the *Model Law* enacted by NAIC has also reflected those key points of the rules. For example, in *Variable Life Insurance Model Regulation (1996)*, Article 6 requires that for the variable life insurance issued by the insurer, at least one separated account should be established and that the account assets should all be trusted and should receive supervision and scrutiny from the State insurance supervision officers.

Also, in the US, the asset manager of the separated account has an explicit fiduciary duty. If the separated account is registered as an open-end management company, then the rules from the *Investment Company Act of 1940* on fiduciary duty can be applied directly. For example, in Article 36 (b) of the *Investment Company Act of 1940,* it stipulates that the investment adviser shall assume fiduciary duty upon its

[653] "(f) Exemption. - (1) In General- Subsection (a) does not apply to any registered separate account funding variable insurance contracts, or to the sponsoring insurance company and principal underwriter of such account." See 15 U.S.C. 80a-26(f).

collection of service remuneration.[654] If the separated account is registered as a unit investment trust, the fiduciary duty of the fund manager directly originates from the trust contract or fund contract signed. If the manager breaches the fiduciary duty, he or she shall assume corresponding civil liabilities.

As for the relation between open-end management company (mutual fund) and unit investment trust in the context of the US Laws, it can be understood based on the company-type funds and contract-type funds. Returning to the analysis in the context of the laws in China, despite of the fact that the scope of adjustment by China's *Securities Investment Fund Law* covers the organizational forms including contractual-type funds, company-type funds and partnership enterprises, the main objects being regulated by this law are the contractual-type funds. The latter two are added in the 2012 amendment of the law and just show in an Article being contained in the *Supplementary Provisions* to this law without too many details.[655]

Table. The Comparation between American mutual fund and China's contractual fund

Items	American mutual fund	China's contractual fund
Organization	corporation-type fund	contractual-type fund
Governance	Shareholders - Board of directors - Investment adviser	Fund shareholders-Fund management company-Fund custodian
Management	Investment adviser (outsider operation under mutual fund)	Fund management company
supervision	Board of directors, shareholders	Fund Custodian, Fund shareholders

In comparation to the abovementioned mode of rules on the separated account in the US, we can analyze from below aspects, among others, the regulations on the internal governance of the investment account in China, as well as the fiduciary duty of the insurer.

First, from the "appearance" of the investment account, it seems that the policyholder (the investors) and the custodian are able to supervise the insurer. However, in fact, the insurer is the initiator and the actual manager of the investment account, whereas the policyholder basically has no real power for the supervision over the investment account, but has to adopt the method of "voting by feet." Also, the

[654] "For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services……" See Section 36 (b) of *Investment Advisers Act of 1940.*

[655] See Article 153 of China's *Securities Investment Fund Law.*

insurer has the right to choose the custodian of the assets of the investment account, and also the custodian is only following the investment instruction from the insurer without being independent in performing its supervision duty. Besides, the common benefit right enjoyed by the policyholder against the investment account has not been explicitly specified in the regulations enacted by the CIRC on the ILI and on its investment account. Therefore, for the rules on the governance of the investment account, essential supervision over insurer's assets management and operation is missing. Consequently, this results in a serious imbalance between rights and obligations relating to an investment account. Comparing with the model adopted by US laws, on the basis that the investment account is substantively deemed as the investment fund, relevant provisions in the *Investment Fund Law* can be analogically applied so as to compensate the loss in this aspect. For example, Article 46 of the *Securities Investment Fund Law* has provided a number of rights, including the voting right for the matters to be reviewed at the fund shareholder conference.

Table. Comparation of investor rights rules

Investment account	Securities Investment Fund Law（Article 46）
No rues	(1) Sharing income from fund assets. (2) Participating in the distribution of the residual fund assets upon liquidation. (3) Transferring or requesting redemption of the fund shares respectively held by them in accordance with law. (4) Requiring that the fund shareholders' meeting be convened or convening the fund shareholders' meeting according to the relevant provisions. (5) Exercising their voting rights regarding matters deliberated at the fund share holders' meeting. (6) Instituting an action against the fund management institution, fund custodian or fund service institution for its conduct that infringes upon their lawful rights and interests. (7) Other rights as agreed upon in the fund contract. The fund share holders of a publicly offered fund shall have the right to consult or copy the publicly disclosed information and data regarding the fund; and the fund share holders of a non-publicly offered fund shall have the right to consult the financial accounting books and other financial data of the fund where their personal interests are involved.

Second, it is the conflict of interests relating to an investment account. Currently, the obligations of the insurer are still the general obligations contained in the *Insurance Law,* but the fiduciary duty of the insurer has not been specified. Between the

policyholder and the insurer to an investment account, naturally, there is conflict of interests and moral risk. This is because that in the assets management relationship found in the investment account, the insurer, as the manager or the trustee, assumes the duty of care on the part of a bona fide manager. However, in the assets management process carried out by the insurer, the goal of value preservation and appreciation for assets in the account may not always in line with or tend to identify with the goal of the growth in its own insurance property, especially when it must realize the maximized interests for both the company and its shareholders. Based on the assumption of rational economic man, when dealing with the two kinds of conflicts of interests found in the account, namely “policyholder - insurer” and “insurance company - its shareholder”, it is likely that the trustee will sacrifice the interests of the policyholder to an investment account – the conflict between the maximized interests of the investors and the growth in the economic benefits of the insurance company itself, as found in the investment account, which is especially the case when the insurer does not directly enjoy the distributed income arising out the management of the assets in the account, but to receive a fixed assets management fee based on the contract. This leads to a higher probability of sacrificing the interests of the investors in case the insurer is facing a conflict of interest.

Therefore, comparing with the practice of the US laws that define the separated account of the variable life insurance as the investment company and hence apply laws, such as the *Investment Company Act of 1940* and the *Investment Adviser Act*, China lacks corresponding rules (including basic laws and departmental rules or regulations) on the internal governance of the investment account of investment-linked insurance and the fiduciary duty of the assets manager. Apparently, special legislation on an investment account is unpractical, the comparatively feasible approach is to define the investment account as an investment fund, and apply existing *Securities Investment Fund Law*, and further clearly specify the corresponding obligations of the insurer and the application of the rules on the insurer.

4.4 The Obligations of the Insurer

4.4.1 The Transaction Structure for “Caveat Venditor and Caveat Emptor”

At present, the idea of “giving inclined protection to financial consumers” is rising up in most countries and regions, which is a realization of the pursuit of the law for

substantial fair value. If the idea of protecting financial consumers is reflected in the private law relationships as found in the investment account, it then requires the transformation of the transaction structure, "caveat emptor" to "caveat venditor and caveat emptor," in this way, the insurer's performance of the obligations is stressed, thus to realize the goal of protecting investment interests. Otherwise, it is likely to have the wrong application of "caveat emptor" in the judicial application relating to ILI as shown in Chapter 2 and cause inconsiderate protection of investment interests. Based on this, in the foregoing paragraph, the logic used in applying "caveat emptor" is analyzed in an effort to clarify the importance of "caveat venditor" and the transaction structure in the investment account.

Though "caveat emptor" is an ancient maxim in the Anglo-American law system,[656] it has not become a rule in the British and American cases until the *Chandelor v. Lopus* of 1603[657] and the *Parkinson v. Lee* of 1802.[658] In *Barnard v. Kellogg,* Davis, the Grand Justice of the US Federal Court, pointed out that "caveat emptor principle is thought to be the one that most fits to the demand of commercial transaction since it requires the seller to care about its own interests and this requirement is also not difficult to realize, because if he does not believe his own judgment, he can request the seller to guarantee that the commodity purchased by him is consistent with the sample. If the buyer is satisfied with the commodity and gives up the opportunity to check the commodity under the circumstance where there isn't any guarantee from the seller, thereby, the buyer should assume the quality risk for the commodity he has purchased".[659] Thus it can be seen that the formation of the transaction rule, "caveat emptor", was based on the simple commodity transaction structure found in early times, the understanding of the transaction object did not need to depend on the obligation of the seller as to disclose corresponding information, there was no evident information asymmetry between the two parties.

However, when it came to late 19th and early 20th century, the centralization of

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[656] See Walton H. Hamilton, *The Ancient Maxim Caveat Emptor*, 8 Yale Law Journal 1133, 1136(1931).

[657] In the case, the defendant Chandler, as a goldsmith, sold his alleged bezar stone to the plaintiff, Lopus, for £ 100. Later, the plaintiff found that what he bought was fake, so he sued the court for fraud. In the court's opinion, the defendant merely claimed that the disputed goods were bezoar, did not expressly warrant, and did not constitute fraud. Because everyone always claims to be good when selling goods, the risk of whether it's bezoar is borne by the plaintiff. See Smith, John William, *A Selection of Leading Cases on Various Branches of the Law: With Notes (Vol.1)*, Charles H Edson and Co., 1888, pp. 319–353.

[658] In the case of Parkinson V Lee in 1802, the court also ruled that the plaintiff was defeated on the principle of caveat emptor that the seller did not guarantee clearly and did not constitute fraud. See Parkinson v Lee, 102 ER 389 (K. B. 1802).

[659] *Barnard v. Kellogg*, 77 U.S. 383 (1869).

production and capital appeared in a commodity economy, which had broken the market structure characterized by free competition. The formation of monopolies, such as the trust, have caused the originally simple market transaction structure to change, which makes the inequality feature of the two transaction parties become evident, thus shaking the assumption about the economic basis on which the "caveat emptor" is established and the unconditional application of "caveat emptor" is mitigated and the attention is now drawn to "caveat venditor." For instance, in *Perry v. Sharon Dev. Co.,* the Court held that the purchaser did not have the capability to check and find the quality of the disputed house; also the seller has implicitly guaranteed in the contract that the "caveat emptor" has not been used as the basis in making the judgment.[660] Particularly, with the rising and developing of the idea of "consumer protection," the relation between purchaser and seller is no longer deemed as an equal civil trading relation, the legislation has stressed the responsibilities of the seller in that corresponding laws have been specially enacted to offer more inclined protection to consumers. Therefore, for contract-based transactions, noticeable changes have been made to the traditional internal logic, which is contract-based with strict obedience to "caveat emptor." It is not appropriate for us to give one-sided emphasis on "caveat emptor," but ignore the change of trading basis.

The change from "caveat emptor" to "caveat venditor and caveat emptor" has also been witnessed in the financial field. Since the founding of the Amsterdam Stock Exchange in 1602, the development of securities was keeping pace with the evolution of "caveat emptor." Under securities transaction, the "bearing of risks by investors themselves" is no doubt a deep imprint left by the connotation and logic of "caveat emptor." In the securities transaction field, the investors are not dealing with the seller (the issuer and service agency of the securities) directly in a face to face manner. The securities shown in front of the buyers have undergone "professional processing or packaging" done by many securities service agencies, including underwriters, accounting firms, and law firms. The buyer can not easily check the entity information behind those securities as it may be the case for general commodities, hence evident information asymmetry can be found between the buyer and seller engaging in securities transaction. Despite this, the "bearing of risks by investors themselves" had been observed unconditionally in the early *Securities Act,* which was oriented by

[660] See *Perry v. Sharon Dev. Co.*, 4 All E.R. 390, 395-96 (C.A. 1937). Also see Alan M. Weinberger, L*et the Buyer Be Well Informed? - Doubting the Demise of Caveat Emptor*, 55 Maryland Law Review 387, 397(1996).

liberalism and individual rationality. This had resulted in massive fraud and illegal acts found in the securities transactions. It was not until 1697 when the UK enacted a law to limit the quantity of the brokers and stock brokers and their bad practice. However, fraudulent acts were not effectively contained by this *Act*; shortly afterward, the South Sea Bubble burst.[661]

After that, a number of laws were enacted by the UK and the US to allow the compulsory disclosure of certain information, i.e., registration, the disclosure of prospectus, etc. to reduce information asymmetry. This has reflected that while upholding the "caveat emptor" in the securities transaction field, the seller of securities should be imposed with certain disclosure obligations. After the economic crisis in 1929, the US President, Roosevelt announced that the Securities Act should be changed from "caveat emptor" to "caveat venditor" and regard information disclosure as the legislative philosophy for the securities.[662] In other words, openness – "this dazzling lamp," as the basis of the *Securities Act*, disclosure itself will prevent fraudulent transactions that otherwise may not be known to the public. The ones who indeed can understand that information, their judgment can be reflected in the "market price" and infiltrated into the investors through the investors' advisers.[663]

Therefore, for the private law relationships in the investment account, we must change from one-sided emphasis on "caveat emptor" to the law application logic of "caveat venditor and caveat emptor,"[664] thus to realize the fair protection of the policyholder. As for the content of "caveat venditor," Modern law mainly imposes the insurer with many different obligations and requires the insurer to perform those obligations so as to achieve the equality for the transaction of financial commodities. The "caveat venditor" mainly includes those obligations, including the fiduciary duty, information provision obligation, the obligation to explain, the suitability obligation, etc., which will be discussed separately in the following paragraphs.

4.4.2 The Management of Assets in the Account and the Fiduciary Duty of the Insurer

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661 See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.1.

662 See Franklin D. Roosevelt: *"Statement on Signing the Securities Bill*," May 27, 1933. http://www.presidency.ucsb.edu/ws/index.php?pid=14654, latest visited on September 10, 2018.

663 See Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation*, (Beijing: Law Press, Chinese translation edition, translated by Zhang Lu, 2008), p.27-28.

664 See Li You, *The Applicable Logic of Caveat Emptor and the Inequality Found in Financial Consumption Relationship*, 7 Social Sciences of Beijing 38, 38 (2019).

China's *Insurance Law* has not expressly specified the obligations of the insurer as the fiduciary duty. As it has been discussed previously, ILI includes the legal relation of entrusted financial management, and the investment account exists in the form of a substantial trust structure. According to the line of thought, "substance over form," which is adopted for law application in this regard, the insurer, as the assets manager, should assume the fiduciary duty rather than identifying its obligations only based on the *Insurance Law.* However, the role played by the insurance company in the issuance and operation of the investment-linked insurance is indispensable, which is not only the reflection of the role played by the insurer in the entrust financial management for the investment account, but also a reflection of the trust the policyholder has shown to the insurer acting as a financial management company, because once the investment-linked insurance is to be sold, services including the management over its issuance and operation all have to be provided or completed by the insurance company. This entrusted financial management relation is consistent with trust basis of the fiduciary duty.

Under the Anglo-American law system, the obligation assumed by the trustee is the fiduciary duty – the trust relationship the principal has with the trustee,[665] and a legal relationship formed based on the trust one party has on the other party. The Anglo-American law system made the fiduciary obligation for equity law. Traditionally speaking, fiduciary duty was initially confined to the fiduciary relation. However, by the time the Common Law under the Anglo-American law system was developed into the 13th century, a diversified social trust relation required fiduciary duty with the higher performance standards. Under this background, based on some maxims, with the conception of abstract, fair, justice, etc., equity law allows the Judge to give full play to discretion, hence to compensate for the rigidity of the common law. Equity law grants relief to many those circumstances where one party abuses the trust the other party has on it.

Along with the development of equity law, the basis of fiduciary duty is established on trust and confidence – a replacement of the too abstractive expression made in early times.[666] The fiduciary duty is thus extended and applied to other fields.[667] For example, if a customer shows trust and confidence to the banker who is

[665] See Tamar Frankel, *Fiduciary Law*, (Oxford University Press, 2011), p.106.
[666] See LS Sealy, *Fiduciary Relationships*, 20 Cambridge Law Journal 69, 70-71(1962).
[667] Such as the agency relationship between shareholders and management in the company law, the medical

acting for or on behalf of the customer, then a trust relationship is established.[668] In *Kurth v. Van Horn,* it is ascertained by this method that there is the fiduciary relationship between the bank and the customer, and the bank bears the fiduciary duty. This case has made a definition of fiduciary relation.

"a very broad term embracing both technical fiduciary relations and those informal relations which exist wherever one man trusts in or relies upon another. One founded on trust or confidence reposed by one person in the integrity and fidelity of another. A "fiduciary relation" arises whenever confidence is reposed on one side, and domination and influence result on the other; the relation can be legal, social, domestic, or merely personal. Such relationship exists when there is a reposing of faith, confidence and trust, and the placing of reliance by one upon the judgment and advice of the other."[669]

The definition as to whether a legal relationship is a fiduciary relationship has to be prudent, because the determination of fiduciary relation means the assumption of the most stringent fiduciary duty thereafter. The "trust" the principal has on the trustee is more abstractive. To what extent the trust relationship should be ascertained as a fiduciary relationship? The core of fiduciary relation lies in the trust, the control of facts, and the dominant position.[670] In other words, this trust is a decision made based on the professional basis of the trustee. Even if it is for a smart beneficiary, it still needs the protection from fiduciary duty, because the nature of a fiduciary relationship will bring the jeopardy that the trustee may abuse its rights.[671] In *United States v. Robert Chestman*, the Court held that the fiduciary relation involves discretion and dependency – one person relies on another person (the trustee) for the service to the benefit of its interests. While relying on the trustee to act to the benefit of its interests, the beneficiary of this relation can entrust the trustee to manage this or that kind of property. Because the trustee has obtained the use right for this property to serve the fiduciary relation, so he is obliged not to use the property for any of its own purposes.[672]

Nevertheless, it is worth noting that the "dual ownership" exists in the Anglo-American law system, which has certain difference from the trust in the continental law system, especially when the traditional theory holds that for trust property, the dual ownership found in the Anglo-American law system does not conform to "one property,

relationship between doctors and patients, as well as custody, partnership and other fields. See Scott T. Fitzgibbon, *Fiduciary Relationships Are Not Contracts*, 82 Marquette Law Review 303, 306 (1999).

[668] See M.H. Ogilvie, *Banks, Advice-Giving And Fiduciary Obligation*, 17 Ottawa Law Review 263, 274 (1985).

[669] *Kurth v. Van Horn*, 380 N.W.2d 693, 695-696 (1986).

[670] See *United States v. Margiotta*, 688 F.2d 108 (2d Cir. 1982).

[671] See Frankel, *Fiduciary Law*, 71 California Law Review 795, 810 (1983).

[672] See *United States v. Robert Chestman,* 947 F.2d 551 (2d Cir. 1991).

one ownership", the structure of rights in the continental law system. Based on this, there is a difference in terms of the ownership of the trust property. In fact, in the Anglo-American law system, the so-called "due ownership" is not completely corresponding to the "ownership" in the Continental Law System. In the trust in the Anglo-American law system, the ownership entitled to the beneficiary is only ownership in the context of the equity law, rather than ownership in the context of the common law. The ownership enjoyed by the beneficiary against the trust property in the sense of the equity law is merely a right to relief. Unlike the ownership in the Continental Law System, it shall not have the powers and functions, including possession, usage, revenue, and disposal.[673] In this sense, the ownership enjoyed by the trustee against the trust property is the "explicit ownership," which shares the same "appearance" and powers with the ownership in the property law in the continental law system; The ownership enjoyed by the beneficiary against the trust property is the "implicit ownership," which does not have the legal meaning of the ownership in the property law.[674] Therefore, the "dual ownership" in the Anglo-American law system is not the obstacle factor in establishing the trust relationship and in identifying its rights and obligations in the context of the continental law system.

Expressions, such as "trust" and "entrusted to" are adopted in the definition of trust in Article 2 of the *Trust Law* of China. Also, legislation organ in China persists that trust should be deemed as a kind of financial management system or referred to as a property management system, whose core content is "being trusted to manage property on behalf of other people." This entrustment is based on trust, where there is a trust, there is an entrustment.[675] It can be seen that in China, the trust relationship is also "positioned" as the trust basis between parties concerned. As discussed previously, the entrusted financial management relationship between the policyholder and the insurer to an investment account is the same with the "entrust-being entrusted," the basic legal structure of the trust in China, and also the basis of trust for the two are the same. The essence of both two lies in assets management, and they are all the basic legal relations formed based on trust, and expect to realize the appreciation of their funds in accounts via the experts' financial management, so they rely on the investment

[673] See Zhao Lei, *The Definition of Role of Trustee and the Achievement of Relevant Institutions*, 4 China Legal Science 74, 75 (2013).
[674] See Zhao Lei, *The Definition of Role of Trustee and the Achievement of Relevant Institutions*, 4 China Legal Science 74, 75 (2013).
[675] See Interpretation of Trust Law of the People's Republic of China，<http://www.npc.gov.cn/npc/flsyywd/jingji/2003-11/14/content_324178.htm>, Latest visited on July 18, 2019.

advice from the trustee for making investment decisions; therefore, the theoretical basis of the fiduciary duty assumed by the insurer of the investment-linked insurance can be sought from the trust basis of the policyholder.

Moreover, if we view it from foreign legislations, fiduciary duties are vested to financial institutions in many jurisdictions. For example, in the US, the *Dodd-Frank Act* has extended the fiduciary duty to financial institutions. In 913 (g) of this Act, it stipulates that all securities dealers and brokers shall have the fiduciary duty against their customers.[676] Japan's *Financial Instruments and Exchange Act of 2006* has also stipulated the fiduciary duty, i.e., the duty of good faith to customers (Article 36), etc. Article 21 of the *Markets in Financial Instruments Directive* has expressly specified the best execution obligation on the part of the trustee, who shall take all reasonable steps to secure the best possible result for its customers.[677] Article 7 and Article 9 of the *Law on the Protection of Financial Consumers*, enacted by Taiwan, have all stipulated the fiduciary duty. Thus it can be seen that fiduciary duty is formed in the equity law in the Anglo-American law system and traditionally speaking, the fiduciary duty is confined initially to the trust relation. This obligation is universally applied to financial institutions, regardless of securities dealers, securities investment advisers or banks and their customers. Therefore, the assumption of fiduciary duty without distinguishing between specific types of financial institutions is a general trend.

In the law of China, the application of fiduciary duty is now confined to financial products with clearly identified trust relationship, in other words, except for the product with nominal existence of trust, it remains unclear as to how to apply fiduciary duty in financial products that essentially have the trust or dependency relations. Just as it was discussed previously, the analogical application should be adopted for the legal relations in an investment account, but what kind of explanation approach should be taken to realize this - a question remains to be discussed further in Chapter 6.

4.4.3 Suitability Obligation, Information Provision Obligation, and the Obligation to Explain

Fiduciary duty on the part of the insurer is the most important reflection of the

[676] See *Dodd-Frank Wall Street Reform and Consumer Protection Act*, available at https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf.
[677] See *Directive 2004/39/Ec Of The European Parliament And Of The Council Of 21 April 2004*, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32004L0039.

"caveat venditor," but not all the obligations bearable by the insurer. The duly obligations to be performed by the insurer also include the information provision obligation, the obligation to explain, and the suitability obligation. Those obligations are not limited by contract agreements and are shown in the form of statutory obligations. For example, in China, the Supreme People's Court has also made it clear in its Judgment that the fiduciary duty, as a statutory duty, is not limited by the contract agreements, and its automatic application in the trustee's performance of its obligations benefits the protection of the interests of both the principal and the beneficiary.[678] However, certain overlaps can be found among those obligations of the insurer. For example, fiduciary obligation is mainly shown by the duty of care and the duty of loyalty, requiring that the trustee shall handle matters relating to the trust, and perform obligations, including being honest, credible, prudent and effective management, etc., (More detailed discussion on their applications will be discussed in the following paragraph) for the maximized benefit of the beneficiary. Thus it can be seen that fiduciary duty is broad in scope and abstract in content. It can be understood from a certain level that the information provision obligation, the obligation to explain, and the suitability obligation can be deemed as a kind of concrete expression of the fiduciary duty of the insurer. For example, in the assets management carried out by the insurer for the maximized benefit of the beneficiary, it is an inevitable obligation that information and report need to be provided to the principal. However, though overlaps can be found among those obligations, all of them have independent institutional value and can not be substituted for each other as those are having different emphases and jointly constitute the obligations of the insurer.

For the insurer's obligation to explain, Article 17 of the *Insurance Law* has explicitly specified it and is also deemed as the pre-contract obligation of the insurer. The traditional theoretical basis of the obligation to explain is that the disadvantageous position of the policyholder and the principle of good faith in the context of the insurance law. Therefore, this obligation to explain and the information provision obligation are coherent with each other in terms of their regulative purposes. They are all set forth to ensure that the choice of the purchaser can be built on adequate information exposure, thus to make rational decisions.

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[678] See Disputes over contracts between *Ganzi Rural Credit Union* and *International Trust Co., Ltd*, the Case No. 880 of Civil [2017] of the Chinese Supreme Court.

In terms of the insurer's information provision obligation, this obligation is corresponding to the policyholder's right to know. The insurer's information provision obligation is specified to highlight the policyholder's right to know, because the policyholder, as the consumer of the insurance, shall enjoy the right to know the information about the product. Insurance consumers, as a group of people who actually exist, their consumer behavior is based on access to adequate market information, sufficient market information is a guarantee to rational consumer behaviors.[679] For the policyholder (the purchaser), knowing certain information concerning the investment-linked insurance is the precondition for such acts, including the choice to purchase and making investment decisions. An investment-linked insurance contract is a fixed format contract, for a number of reasons, i.e., the lack of necessary professional knowledge, has put the policyholder into a disadvantageous position due to the information asymmetry.[680] Also, in practice, the insurer and its agents, more often, emphasize too much on the income of the account, but evade the investment risk that may be faced.[681] Therefore, the insurer's information provision obligation is in direct relation with the policyholder's right to know, which plays an important role in reducing contractual fraud.

As to whether there is any difference between the obligation to explain and information provision obligation, there are scholars who point out that the interchangeable use of the two terms in law, as a fact, indicates that there is no essential difference between the two.[682] In terms of whether the consumer has understood, the performance of the obligation to explain must be based on the understanding of the financial consumers; whereas the focus of information disclosure obligation is the establishment of an environment with adequate information so that the consumer can be in an environment with readily accessible information and in principle, it does not care about whether the consumer can comprehend it.[683] Furthermore, from the time the obligation to explain is to be performed, it is often considered as a pre-contract obligation, which has to be performed before the conclusion of a contract. As for the

[679] See Tuo Guozhu & Zhu Junsheng, *Rethinking the New Products of Personal Insurance*, 8 China Insurance, 18 (2003).
[680] See Notes, *Federal and State Regulation of the Variable Annuity,* 44 Minn. L. Rev. 289, 291 (1959).
[681] For example, *Zhao Yun vs. Zhong-hong Life Insurance Company*, the Civil Case No. 439 [2014] of Guangzhou Court.
[682] See Yu Haichun, *Research on the Protection System of Insurance Consumers' Rights and Interests: Focusing on the Regulation of Insurer's Explanation Obligation*, (Beijing: University of International Business and Economics Press, 2015), p.152.
[683] See Liu Yuan, *A Comparative Study on the Legal Protection Mechanism of Financial Consumers*, (Beijing: Law Press, 2012), p.174.

disclosure of information about investment account, which ought to be done, in general, we have the requirement for a continuous disclosure before, during or after an event. For example, in prior event information disclosure, information, such as risk reminders, interests demonstration, and basic features of the product, should be included in the product description of the investment-linked insurance. During the information disclosure conducted during or after an event, the insurer should disclose investment strategy in relation to the investment account, the unit price of the investment, information on returns, etc. to the policyholder, as well as the provision of a report on the policy status regularly. Therefore, despite the obligation to explain and information disclosure are all information provision systems that are set forth to make it possible that the choice made by the purchaser is based on sufficient information and that they can thus make reasonable decisions, such a wide range of information concerning the investment account can not be covered by the obligation to explain.

In terms of the insurer's suitability obligation, judging from the development of modern law, in the process of selling financial products, the sales staffs are required to assume suitability obligation – the identification of the appropriateness of the product to a specific purchaser is an important reflection of being responsible and the evaluation basis on the part of the seller. This obligation requires that the sales staff of financial products should carry out evaluations on the risk-bearing capacities of the investors. The insurers are required to know products and customers well and introduce only suitable products. The consideration of the risk thresholds of customers when recommending or selling securities to them and let them decide by themselves whether it is suitable to buy,[684] because it is extremely likely that the seller, driven by the profit-seeking nature of any merchant, will infringe upon the rights and interests of the consumer.[685] The sales of financial products have the typical profit-making nature, generally speaking, the more the product is sold, the more like profit will be made out of it, also more likely it will infringe the rights and interests of the policyholder, therefore in early times, the suitability obligation on the part of the sales staffs, was mainly a moral obligation, which had not been uplifted to a statutory obligation. In the transformation of the judicial application from "caveat emptor" to "caveat venditor and caveat emptor," the suitability management against the investors has become a statutory

[684] See Robert H. Mundheim, *Professional Responsibilities of Broker-Dealers: The Suitability Doctrine*, 1965 Duke Law Journal 445, 449(1965).
[685] See Zhang Bin, *Research on the Theory and Cases of Financial Consumer Protection*, (Beijing: Law Press, 2015), p.5.

obligation to be assumed by the sellers of financial products (see Article 98 of China's *Securities Investment Fund Law*).[686]

In terms of the differences between the obligation to explain and the suitability obligation, the obligation to explain focuses on whether the traders of financial commodities have disclosed information to investors, whereas the suitability obligation puts particular emphasis on whether or not the financial commodities introduced or sold fit to the investment goals and risk-bearing capacities of the customers.[687] Because for one thing, the new financial products and services have enriched the options of the financial consumer, for another thing, it has exposed the limitations the consumers have in those aspects including the level of expertise and cognitive abilities, especially in the context that the sales staffs will use all means to attain their ends, more often, misleading sales acts, including being exaggerating about the level of return, arbitrary judgment and the hiding of risks, are committed by them.[688] Therefore, from the perspective of the protection of financial consumers, the suitability obligation has supplemented the defects of the information provision obligation and the obligation to explain, hence have reduced the risk of fraudulent sales. As to the application of those obligations, the suitability obligation is normally deemed as the advance procedure for the obligation to explain, which is only applied after the suitability obligation is performed.[689] In actual condition, from the introduction made before the transaction to the completion of the transaction, the confirmation of suitability and the performance of the obligation to explain take place alternatively.[690]

4.5 Chapter Summary

The securities attributes mainly show the legal attributes of ILI, and its investment attributes are shown by the investment account. The "carrier" of such attributes, consequently, has also caused conflict under the existing laws. In view of this, this chapter is mainly intended to discuss the relation between the rights and obligations of

[686] See Li You, *The Applicable Logic of Caveat Emptor and the Inequality Found in Financial Consumption Relationship*, 7 Social Sciences of Beijing 38, 38 (2019).
[687] See Huang Aixue, *Research on the Anti-fraud System of Financial Commodity Transaction*, (Beijing: Law Press, 2012), p. 174.
[688] See Zhang Bin, *Research on the Theory and Cases of Financial Consumer Protection*, (Beijing: Law Press, 2015), p.6.
[689] See Zhang Xiaomeng, *Research on the Obligation of Suitability of Insurance Contract*, (2018 Doctoral Dissertation of Zhongnan University of Economics and Law), p.18.
[690] See Huang Aixue, *Research on the Anti-fraud System of Financial Commodity Transaction*, (Beijing: Law Press, 2012), p. 173.

the parties concerned in ILI, from the perspective of private laws.

In theory, there are different understandings of the entrusted financial management in the investment account, such as “commission contract relationship,” “trust relationship,” “new legal relationship,” etc. The stipulations on “commission contract” as found in the contract law cannot tally with the “ought to be relation” between rights and obligations involved in the investment account, and there are many differences between the two in aspects including the authorities, obligations, and imputation of the trustee. More specifically, in the analysis of the relationship in the investment account, there is no essential difference between “trust relationship” and “new legal relationship,” both of them are intended to strengthen the obligation of the insurer and to provide the basis for the performance of the fiduciary duty by the insurer. Also, in ILI contract, there exists the “entrusted financial management” in the investment account, and the nature and content of its related provisions are different from that set forth in the traditional life insurance. It is not appropriate to interpret the contents of the two parts using the “absorption theory” and the “combination theory,” but we should explain the relation of the two as a simultaneous contract with dependency relation, and thereby adopt “analogical theory” for their law application.

The legal attributes of the investment account are different from the “nature” and “function” of the traditional life insurance. Viewed from those aspects, including the characteristics and operation mode of the investment account, this account conforms to the legal attributes of the securities investment fund, so it is the securities investment fund in real sense. The legal relationship between the parties and an investment account should also be dealt with according to the corresponding rules of the fund. The policyholder, as the investor, enjoys the rights under private laws, such as the beneficiary right against the account and the supervision right, while the insurer, as the trustee, should also assume the fiduciary duty in their role as the assets manager. The analysis in this aspect can also be verified from US law, which defines the nature of the investment account as an investment company and applies the *Investment Company Act*. Though, in practice, the US tends to register the investment account as unit investment trust at the SEC, this move results in a certain different law application if compared with the registration of the same as an open-ended management company. All of them have reflected the basic idea of mutual restriction on rights in the rules of internal governance; especially, the fiduciary duty to be assumed by the insurer in their

role of assets manager has been explicitly specified.

In private law relation, for the investment account of ILI, we should give more emphasis on the obligation of the insurer. Moreover, in terms of the private law application, we should advocate the idea of giving inclined protection to financial consumers, and carry out the analysis of private law relation based on the law application logic of "caveat venditor" and "caveat emptor." The responsibilities of the insurer, as the "seller," are mainly shown by their performance of the obligations, including fiduciary duty, the obligation to explain, information provision obligation, and the suitability obligation. Though some of the contents of those obligations are overlapping, each of them has independent institutional value and focus, and jointly they constitute the obligations of the insurer.

Chapter Five The Regulatory Relationship under the Application of Public Law and Its Clarification

In Chapter Three, we have discussed the fact that we should not confine ourselves to the discussion of its legal attributes when it comes to the legal debate on ILI. "Substance over form" should be adopted as the approach for its law application. In terms of the supervision by public power, it comes down to the question as to how for the public power to carry out adequate supervision of ILI under a substantial regulation approach of this kind.

5.1 The Formation of the Power of the Supervision Authority of ILI and the Analysis of Its Supervision

5.1.1 The Background and Causes for the CIRC's Regulation to ILI

For the supervision over ILI by the public power, CIRC took the lead in enacting *Interim Measures for the Management of Investment-linked Insurance* in 2000. After that, the ILI was incorporated into the regulatory framework of the CIRC. However, according to aforementioned analysis, because of the legal attributes of ILI, especially the evident securities attributes it has, it is necessary to raise a further question, which is that since the China Securities Regulatory Commission (CSRC) was established in 1992, while the CIRC was established in 1998, in this sense, why this financial product with evident investment nature was not included into the scope of supervision by the CSRC in the first place, but to be supervised by the CIRC.

First of all, from the perspective of the CSRC, as far as the regulation of the securities market is concerned, the formation of a centralized and unified nationwide regulatory authority by the CSRC was not completed at the time when it was established. The establishment of the CSRC was a response to the demand for economic development at that time. Just as the first Chairman of the CSRC has once said, "since the reform and opening-up, along with the deepened reform on the joint-stock system and the issuance of various kinds of negotiable securities, especially in the context of the rapid development of the stock market, China is quite in need of a centralized and

unified regulatory authority with unified laws, regulations, as well as unified systems in place for the implementation of unified supervision.[691] Moreover, in 1992, the "810" mass unexpected incident occurred in Shenzhen, shocked the top leaders from the centralized national government, which has also further induced and speeded the construction of a unique regulatory authority for the securities market.

In October 1992, two commissions, namely the Securities Commission of the State Council and CSRC, were established. The former is intended to carry out unified macro-management over the securities market, while the latter is the enforcement body of the former's regulation on the securities market. By 1998, the Securities Commission of the State Council had been incorporated into the CSRC, the "incorporated CSRC" thus became a ministry-level institution which was directly affiliated to the State Council, and until then, a centralized and unified nationwide securities regulatory system was basically formed. This well suggests that though the CSRC was founded in 1992, it did not exist as a supervisory authority with centralized and unified nationwide regulatory power over a few years since then. Even though the CSRC did become the centralized supervisory authority for the securities market in 1998, it still needed to integrate many things between the former two commissions, i.e., affairs, personnel, and management, etc. Apart from that, at the time when there was a unified regulation system run by the CSRC, it was also the time when the stock market was at low tide. The primary mission of the CSRC at that time was also concentrated on how to activate the market and was also busy handling the financial frauds of many companies, including the DAQING LIANYI PETRO-CHEMICAL CO., LTD. This also led to the CSRC's being too busy to attend to supervision over ILI. The facts above have indicated that the fact the time the CSRC was founded is earlier than the time the CIRC was founded does not mean that the CSRC has a temporal advantage in terms of the supervision over ILI.

Secondly, from the perspective of the CIRC, ILI, as a new type of personal insurance product, was advocated and introduced by the CIRC. In the 1990s, the bank interest rate in China had undergone a relatively large adjustment (As shown by the below chart – The annual interest rate for one year fixed term deposit for 1990-1999). However, the risk brought by the change in interest rate had not been identified by the

[691] See Liu Hongru & Nan Yan, *The Background for the Birth of the Securities Regulatory Commission*, 38 China Economic Weekly, 64 (2009).

insurance companies at that time, which had also resulted in a difficult situation being faced by the development of the insurance. In order to reduce the risk of the loss from the difference of interest rate, the regulators also maintained an evident attitude towards the development of new products. For example, Ma Yongwei (the first Chairman of CIRC, serving for the period between November 1998 to October 2002) demanded to speed up the research and development of new products to satisfy the need for the development insurance market.[692] "Developing ILI product is an effective means for China's insurance industry, especially the life insurance industry, to prevent and eliminate operational risks, and is also a good "cure" for the reduction of the impact of fluctuating bank interest rate on the life insurance industry, thus gradually adapting our life insurance product to the international trend."[693] Wu Xiaoping, the then Vice-Chairman of the CIRC had also expressly conveyed that all insurance companies were encouraged to spare great efforts in developing investment-linked and participating life insurance products, and further asserted that "life insurance in China has now stepped into a critical period in which the traditional life insurances change into non-traditional life insurances." This change will turn China, the most significant potential market for life insurance, into a market in reality.[694]

Table. The adjustment of China's one-year deposit rate (APR %), 1990-1999.[695]

Date	one-year deposit rate	Date	one-year deposit rate
15 Apr. 1990.	10.08%	23 Aug. 1996	7.47%
21 Aug. 1990	8.64%	23 Oct. 1997	5.67%
21 Apr. 1991	7.56%	25 Mar. 1998	5.22%
15 May 1993	9.18%	1 July 1998	4.77%
11 July 1993	10.98%	7 Dec. 1998	3.78%
1 May 1996	9.18%	10 June 1999	2.25%

Thirdly, the economic environment at that time also required an urgent introduction of products represented by the ILI to promote the development of the insurance industry. There is a view that for the life insurance industry which suffers significantly from the reduction in interest rate, investment-oriented insurance, such as the ILI serves just like an invigorator, which not only can solve the pressing issue of

[692] See Yu Yan, *Insurance Supervision for 20 Years: Three Presidents, Three Lives*, 6 Caijing Magazine, 57-60(2018).
[693] See Yuan Keming, *the Investment in Insurance Companies,* People's Daily Online< http://people.com.cn/GB/channel3/22/20001218/353801.html>, Latest visited on May 14, 2019.
[694] See Yuan Keming, *the Investment in Insurance Companies*, People's Daily Online< http://people.com.cn/GB/channel3/22/20001218/353801.html>, Latest visited on May 14, 2019.
[695] The data comes from the official website of the People's Bank of China, <http://www.pbc.gov.cn/zhengcehuobisi/125207/125213/125440/125838/125888/17094/index2.html>, Latest visited on April 20, 2019.

"loss from the difference of interest rate," but can also increase the scale of the assets under management over a short period of time.[696] Under this background, Ping An had hired Travor, a well-known actuary, for the development of ILI. Travor had stated in the new product presentation that the development route for the world's insurance products was to improve from the guarantee type to the investment type. In this sense, ILI not only has the guarantee function but also has the investment function. Ping An also believed at that time that the return on the investment made via the new products could offset the loss from the difference of the interest rate, which was brought by a reduction in interest rate. Therefore, on January 26th, 1998, the Ping An established a research project for ILC, titled as the "Phoenix Plan."[697] Also, Ping An Insurance Company formally launched China's first "ILI" – "Century Finance Management & Investment-linked insurance" on October 23rd, 1999.

At that time, Ping An announced in the marketing event that this was considered as a milestone throughout the history of development for Ping An and also marked China's life insurance industry's entry into a new period where the traditional and non-traditional products were being developed simultaneously.[698] Likewise, "China Life Insurance and China Tai Ping Life Insurance Company" had also chosen their own ILI products as a move to shake off the difficult situation faced in their development. On October 1st, 2000, the Tai Ping Life Insurance launched China's first Universal Life Insurance – "Tai Ping Sheng Shi & Chang Fa Endowment Insurance." In 2000, China Life Insurance developed China's first participating insurance – "Millennium Finance Management."

The development of those products had won much favor from the market, and also they were the smash hits in the market at that time. Among them, the sale of ILI was quite amazing. For example, since 2000, there were more than 10 thousand people who bought ILI in each month in Shanghai. On April 7th of that very year, Ping An expanded its scope of trial sale from Shanghai to Beijing.[699] With such an excellent sales performance for ILI, the market share of Ping An Life Insurance was expanding rapidly. From 1999, the market share of Ping An (42% in Shanghai) had exceeded that of China Life Insurance (37%). By the year 2001, the market share of China Ping An Life

696 See Chen Ken, *Chinese Insurance History: 1978-2014*, (Hangzhou: Zhejiang University Press, 2014), p.58.
697 See Wang Hesheng, T*he History of Ping An,* (Beijing: China Citic Press, 2008), p.122-123.
698 See Wang Hesheng, *The History of Ping An*, (Beijing: China Citic Press, 2008), p.126.
699 See Yuan Keming, *the Investment in Insurance Companies*, People's Daily Online< http://people.com.cn/GB/channel3/22/20001218/353801.html>, Latest visited on May 14, 2019.

Insurance had already increased to 51%.[700]

Thus, it can be seen that once the ILI was launched into the market, they soon became the new favorites of the market, developed rapidly, and then gave rise to a dramatic change in the pattern of China's life insurance industry. We have scholars who remark jokingly that this insurance, upon its launch into the market, thrived vigorously and broke the situation that market shares of China's life insurance had long been completely occupied by five "golden flowers," namely the children insurance, endowment insurance, regular return insurance, critical illness insurance, and general life insurance.[701]Thus, it can be known from above that the new types of insurances, e.g., the ILI, were introduced as a new type of personal insurance under the encouragement and advocation from the former CIRC.

Furthermore, those products were all introduced chiefly by the insurance companies in China and then issued in the name of personal insurance. Despite the ILI has evident investment attributes, its securities attributes were not clearly understood at the very beginning since its formation, so the investment-related problems in it were not exposed to us either. Besides, a financial system featuring "separate management and classified management" had also been established at that time, even though the CSRC had the intention to get involved. Still, it could not break through the classified supervision provided in the fundamental law. Those factors have resulted in a fact that it was the former CIRC that has formed its power for the comprehensive regulation of the ILI.

Therefore, just as "the swift-footed arrive first," CIRC enacted a series of normative and regulative documents (See below Table). It is reasonable and expectable to include the ILI into the regulatory framework for insurance. From the supervision carried out by the CIRC on the ILI, it can be roughly divided into four stages. Stage one, the period from 2000 to 2007, was the stage for the establishment of the system of regulatory rules on the ILI. The regulations enacted during this stage were mainly intended to fill up the vacancy we had for the regulation of the ILI; the contents of those regulations were quite broad and also in a general sense. For example, the *Interim Measures for the Management of Investment-linked Insurance* (No. [2000]26]) was mainly intended to provide basic rules for the development of ILI. Stage two, the period

700 See Chen Ken, *Chinese Insurance History: 1978-2014*, (Hangzhou: Zhejiang University Press, 2014), p.60.
701 See Guo Li, *Investment-linked Insurance and Its Legal Issues*, 4 Financial Law Forum, 73(2001).

from 2007 to 2012, was the stage in which sales risks were under strict control. In this period, several large scale ILI surrender incidents occurred, the regulations on the ILI, as enacted by the CSRC, were mainly intended to have strict control over the sales risks. Stage Three, from 2012 to 2015, was the stage in which there was a loose control over the scope of investment for insurance. It was mainly intended to expand the scope of investment for insurance, including the supervision by public power, which also kept loosening its control over the ILI. Stage four, the period from 2015 till now, was a supervision period in which the ILI was regressed to be insurance. Several regulations on the ILI were enacted by the CIRC in this period with the main focus on the insurance guarantee function of the personal insurance product, hence to return to the very essence of insurance. For example, in the *Notice from the China Insurance Regulatory Commission about Regulating the Product Development and Design of Personal Insurance Companies* (No. 134 [2017]), insurance companies are required to design and develop their products in a way that can truly bring the insurance guarantee function of the personal insurance product into a play.

Table. Main Regulations on ILI, Universal Insurance, and Participating Insurance

No.	Name of Regulation	Note
1	The Interim Measures for the Administration of Investment-Based Insurance (CIRC No. 26[2000])	Expired
2	Interim Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products (CIRC No. 6 [2001])	Expired
3	Notice on Issuing the Actuarial Rules for New Types of Personal Insurance Products (CIRC No. 67 [2003])	Expired
4	Notice about Entrusting the Banks for the sale of the ILI and the Universal Products (CIRC No.22 [2004])	Expired
5	Actuarial Provisions for Individual Investment-Linked Insurance (CIRC No. 335 [2007])	Revised
6	Notice about Relevant Matters Relating to the Strengthening of the Management of the Sale of the Investment-linked Insurance (CIRC No.76 [2007])	Expired
7	Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products (CIRC No.3 [2009])	Effective
8	Notice on Further Strengthening the Management of Investment-Linked Insurance Sales (CIRC No. 10 [2009])	Effective
9	Guideline on the Identification of Misleading Sales of Personal Insurance (CIRC No.87 [2012])	Effective
10	Guiding Opinions on Ascertaining Personal Insurance Companies' Liability for Misleading Sales (CIRC No.99 [2012])	Effective
11	Measures for the Management of the Business Operations of Personal Insurance in Beijing Area (CIRC No. 213[2014])	Expired
12	Notice on promoting the reform of participating life insurance premium rate (CIRC No. 93 [2015])	Effective
13	Notice on Standardizing Investment-Linked Insurance Investment Accounts (CIRC No. 32 [2015])	Effective
14	Notice on Matters Relevant to Standardized Life Insurance Products with Short and Medium Duration (CIRC No. 22 [2016])	Effective
15	Concerning Further Improving the Actuarial System of Personal Insurance (CIRC No. 76 [2016])	Effective

16	Notice on Strengthening the Supervision of Personal Insurance Products (CIRC No. 199 [2016])	Effective
17	Notice on Further Strengthening the Supervision of Personal Insurance (CIRC No. 113 [2016])	Effective
18	Notice on Standardizing the Behavior of Product Development and Design of Personal Insurance Company (CIRC No. 134 [2017])	Effective
19	Notice on Further Strengthening sales management of life insurance company (CIRC No. 136 [2017])	Effective

5.1.2 The Main Approaches for the Supervision Carried out by the CIRC

The ILI has a development history of nearly 30 years in China, and the CIRC, as the regulatory authority, mainly adopts the following means of supervision.

5.1.2.1 The adoption of a line of thought: similar to the information disclosure being observed by the securities investment fund

The *Interim Measures for the Management of Investment-linked Insurance* enacted by the CIRC in February 2000 is the first normative document exclusively formulated for the ILI by China. Significant contents of this *Interim Measures* are shown in three aspects. First of all, this *Measures* has explicit provisions on those things concerning the ILI, including its definition, operation, product launch requirements, and primary conditions of the salespeople.[702] Secondly, *this Measures* also has made demands on those aspects, including the characteristics of the investment account, the bearing of risk, management requirements, requirements on the fund of the investment account, the scope of investment, etc.[703] Thirdly, it has expressly stipulated the information disclosure system for the ILI.[704] It can be concluded that the *Interim Measures for the Management of Investment-linked Insurance* has established the basic framework for the supervision of the ILI, and has further adopted a form of regulation which is different from that for the traditional life insurance. More specifically, the risk assumption subject for the investment account and the information disclosure is expressly provided. However, the line of thought used in those regulations appears quite ambiguous as far as specific contents are concerned, especially for the information disclosure, which is quite rough with low requirements on disclosure standard. For example, this *Measures* only requires the disclosure of those aspects of contents, including information on the financial situation of the investment account, rate of return on investment, management fee, etc. The interval between disclosures should be six months, at least, and the disclosure should be made through a designated newspaper.

[702] See Article 2, 5, 6, 7, 8, 9, 10, 14 and 16 of *Interim Measures for the Management of Investment-linked Insurance.*
[703] See Article 3, 4, 11, 12 and 13 of *Interim Measures for the Management of Investment-linked Insurance.*
[704] See Article 15, 16, 21 and 22 of *Interim Measures for the Management of Investment-linked Insurance.*

However, the *Measures* did not meet the demand at that time for the regulation of the ILI.

For example, after the entrance into the 21st century, the stock market in China showed a prosperous look, especially in July 2001, the Shanghai Securities Composite Index reached the point 2245, creating up a historical new height. However, within several years after that, it encountered a bear market, the stock index kept decreasing. The investment performance of the investment account of the ILI was also not so good with severe loss, which had caused the dissatisfaction among policyholders. Furthermore, in the sale of the ILI, there were fraudulent practices, including misleading consumption and concealing the fact of loss. Eventually, they had triggered the large scale Ping An ILI surrender incident. There is an analysis that has pointed out that this large scale ILI surrender incident was related to the less general and less detailed requirements found in the *Interim Measures for the Management of Investment-linked Insurance* enacted by the CIRC.[705]

In order to supplement what has been missing in the information disclosure system of those new financial products represented by the ILI, the CIRC specifically enacted the *Interim Management Measures for the Disclosure of the Information on New Personal Insurance Products* in December 2001. Comparing with the previous regulations on information disclosure, this *Measures* has added multiple means of information disclosure, e.g., Product Description, Calculation of the Insured Interests, Announcement, Customer Report, Recommendation, pictorial poster, and leaflet.[706] Also, in Chapter 2 of this *Measures,* there are special provisions on the disclosure of information on the ILI. In terms of the contents to be disclosed, it requires that the Product Manual should include risk reminder, basic features, the condition of the investment account, hesitation period.[707] However, this *Measures* still has no detailed provisions on the information contents to be disclosed but to have different information disclosure requirements for ILI, universal insurance, and participating insurance-based mainly on the differences between those new type personal insurance. In 2009, the CIRC enacted the *Management Measures for the Disclosure of the Information on New Personal Insurance Products,* in which there are further improvements and detailed

[705] See Yu Yan, *Insurance Supervision for 20 Years: Three Presidents, Three Lives*, 6 Caijing Magazine, 57-60(2018).
[706] See Article 2 of *Interim Management Measures for the Disclosure of the Information on New Personal Insurance Products,* (CIRC No. 6[2002]).
[707] See Article 8 of *Interim Management Measures for the Disclosure of the Information on New Personal Insurance Products,* (CIRC No. 6[2002]).

provisions on the information above disclosure. For example, for the means of information disclosure, the return visits paid to customers by customer service staff and the reports sent regularly are included.[708]

As can be known from the above analysis, though the CIRC has defined the ILI as an insurance product, essentially, it does have realized the securities attributes the ILI bears, and thus have adopted a kind of information disclosure, which is similar to that for the securities investment fund.

Nevertheless, although the CIRC has adopted a practice similar to the practice for a fund for this kind of information disclosure, it again clearly specified that "the insurance company and its agent, when disclosing information on new types of products, shall not use ratio index to make a simple comparation with other insurance products or bank savings, fund, national debt, etc."[709] It can be seen that the means of information disclosure as adopted by the CIRC for the ILI is one-sided, incomplete, and less thorough.

5.1.2.2 The strict supervision over sales & the suitability principle to purchasers

As mentioned above, upon its introduction, the ILI has soon become a star product in our market. Ping An Insurance even managed to break away from the problematic situation being faced by the insurance industry in the 1990s with the help of this insurance product. However, the "extensive" promotion and development of the ILI also resulted in two large scale ILI surrender incidents in 2001 and 2008. For this reason, the CIRC implements strict supervision over sales and manages the "suitability" to purchasers.

The first large scale ILI surrender incident occurred in 2001. On June 6th, 2001, the State Council enacted the *Interim Measures of the State Council on the Management of Reducing Held State-owned Shares and Raising Social Security Funds,* in which it stipulates that the held State-owned shares shall be reduced mainly by the secondary offering of the state-owned share. Any of the joint-stock limited companies (including companies listed outside the territory of China) with its shares owned by the State shall, when issuing shares to the public investors for the first time or for increasing the

708 See Article 3 of *Management Measures for the Disclosure of the Information on New Personal Insurance Products,* (CIRC No. 3[2009]).
709 See Article 8 of *Management Measures for the Disclosure of the Information on New Personal Insurance Products,* (CIRC No. 3[2009]).

quantity of shares issued to the public investors, shall sell the State-owned shares at 10% of the financing amount.[710] In the context of equity division, these "secondary offering" and "market-set prices," as the means of reducing held State-owned shares, were unfair, and the government's contest with people for profits made a wide range of investors feel bitterly disappointed. It seriously cracked down on their confidence in the investment.[711] The stock market had been deeply affected by it as the Shanghai Securities Composite Index decreased from point 2245.43 on June 14th, 2001 to point 1348.79 on January 22nd, 2002, and the percentage of the drop is 39.93%. This sharp fall trend in the stock market was also quickly reflected by the investment performance of the investment account under the ILI. For example, the investment account under the ILI experienced various extents of losses in 2001, wherein the development account had lost 4.54 million, in which 3.05 million was the loss in fund investment; the fund account had lost 66.55 million, in which 19.72 million was the loss in fund investment.[712] Many media reported such a tremendous loss to the ILI.[713] For example, Southern Weekend, the country's influential magazine, published an article titled "*Ping An 'Century Finance Management': A Hidden Truth of Loss*" in December 2001. In this thesis, it was pointed out that the ones who earn money only account for about 0.67% of the sales, whereas people who still "can not make ends meet" account more than 99% even to this day.[714] Those reports had drawn full attention from the market. Eventually, a local Ping An ILI surrender incident in Fujian was found to have spread to a significant nationwide scale surrender incident.

The second "surrender storm" took place in 2008. Driven by the recovery of the stock market in 2006, ILI also showed explosive growth in 2007. In 2007, the premium income for the ILI was 39.383 billion, with a year-on-year growth of more than 558.37%, accounting for 7.96% of all the premium income of the insurance company, with a year-on-year growth of 6.48%.[715] However, this did not last long. Under the dual impacts characterized by tight monetary policy and the 2008 financial crisis, China's

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[710] See Article 5 of *Interim Measures for the Administration of Reducing State-Owned Shares to Raise Social Security Funds,* (No. 22 [2001] of the State Council).
[711] See Gan Peizhong, *The Government and the Market in the Reduction of state-Owned Shares*, 4 Jurists Review87, 87-90(2002).
[712] See Chen Ken, *Chinese Insurance History: 1978-2014*, (Hangzhou: Zhejiang University Press, 2014), p.83.
[713] For example, the paper, "After the Peak Sales of Investment-linked Insurance: who stole customers' cheese?", was published in the21st Century China Business Herald and other media in China.
[714] The data comes from, <http://economy.enorth.com.cn/system/2001/12/07/000211041.shtml>, latest visited on May 12, 2019.
[715] Source: *Yearbook of China's Insurance* (2000-2013), and CIRC website. http://bxjg.circ.gov.cn/web/site0/tab5203/.

stock market, while in the process of non-tradable share reform and also in the face of the issue of lifting the ban on a small or large portion of non-tradable shares, experienced the most severe bear market in 2008, [716] with Shanghai securities composite index decreased from point 6120.04 on October 16th, 2007 to point 1664.93 on October 28th, 2008, which is 70.71% in terms of the cumulative range of drop. Under this background, large scale surrender incidents had occurred to both AEGON CNOOC Life Insurance and Sino Life Insurance companies. For example, in more than two months from August to October 2008, the number of complaints received by the regulatory authority against AEGON CNOOC Life Insurance had exceeded 270 cases, even for a single month in September, the number had exceeded 220 cases, many policyholders demanded AEGON CNOOC Life Insurance to allow their insurance policies surrendered in full amount with no additional charge.[717]

By analyzing two large scale surrender incidents, it is concluded that there are two reasons for this. First, whenever there is a significant downturn in the stock market, more often, there will be losses incurred to the investment under the investment account, which will cause dissatisfaction among investors. Second, severe misleading sales are found in the sale of the ILI, because it has been clearly specified in the contract of ILI that risk bearer of the investment account is the policyholder rather than the insurance company. However, the ILI, as a new type of financial product, especially the one that is issued in the name of life insurance, many policyholders have not realized the differences between this insurance and traditional life insurance and thus have not accepted this kind of risk allocation. What is even worse is that in the sale of the ILI, many salespeople are in blind pursuit of sales performance. Losses are concealed, and the earnings are overstressed, while there is no emphasis on the difference in risk-bearing and specific risks. For example, in the sale of "Ping An Century Finance Management," the most powerful achievements used by the salesman of Ping An Insurance to persuade customers to buy ILI was that the monthly return for "Century Finance Management" was up to 4.87% and that it had accumulatively created 16.14% of the rate of return for the 14 months of operation.[718]

Moreover, as it was advertised in many product descriptions at that time, "if the

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[716] See Xie Baisan & Liu Meiou, *The reason and Prospect of the adjustment of China's stock market in 2008*, 1 Price theory and Practice, 62(2009).

[717] See Chen Tianxiang, Haikang Life Insurance Surrender, <http://finance.sina.com.cn/column/complain/20081017/14145402317.shtml>, Latest visited on May 4, 2019.

[718] See Chen Ken, *Chinese Insurance History: 1978-2014*, (Hangzhou: Zhejiang University Press, 2014), p.83.

estimated rate of return for each year is 20%, a lump sum investment of 50 thousand will bring you 10.68 million (including both the principal and the interest) after 30 years".[719] Thus it can be seen that dangerous misleading sales activities can be found throughout the development of the ILI in China. In light of this, in order to prevent misleading sales, the sales manager of the ILI has always been the focus of the supervision of the CIRC, and a series of normative documents have also been enacted to regulate the sales activities of the ILI.

First of all, *Notice about Entrusting the Banks for the sale of the ILI and the Universal Products* (CIRC No.22 [2004]) is a normative document enacted earlier on the sale of the ILI. This document requires that the insurance company should truly and practically strengthen its management over the disclosure of the information on and the publicity for a new type of personal insurance products sold by the agent banks, including the strengthening of the training and management for those agent salesmen.[720] However, the normative contents in this document remain to be less specific, and no clear and specific requirements on the public management and the training of sales personnel have been put forward; instead, they are left to the discretion of the insurance companies.

Secondly, in 2007, the complaints received by the CIRC about the misleading sales to the ILI are mainly shown by those circumstances, including the failure to explain products clearly, hiding the cost deduction and being exaggerative in telling the return of the contract.[721] Under this background, the CIRC enacted the *Notice about Relevant Matters Relating to the Strengthening of the Management of the Sale of the Investment-linked Insurance* (CIRC No.76 [2007]). This regulation requires that the sales personnel shall have specific qualifications and also requests a 100% return visit via call during the hesitation period.[722] In 2009, the CIRC enacted the *Notice about Further Strengthening the Management of the Sale of the Investment-linked Insurance* (CIRC No.10 [2009]). This document has made specific and detailed provisions on the sale of the ILI. For example, it has raised particular requirements on the qualifications of the sales personnel, i.e., at least one year experience in the sale of life insurance, with no

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[719] See Chen Ken, *Chinese Insurance History: 1978-2014*, (Hangzhou: Zhejiang University Press, 2014), p.83.

[720] See Article 3 & 4 of *Notice about Entrusting the Banks for the sale of the ILI and the Universal Products* (CIRC No.22 [2004]).

[721] See Article 1-3 of *Strengthening of the Management of the Sale of the Investment-linked Insurance* (CIRC No.76 [2007]).

[722] See Article 2 & 4 of *Strengthening of the Management of the Sale of the Investment-linked Insurance* (CIRC No.76 [2007]).

bad record and has received no less than 40 hours of specialized training. More importantly, in this special document, the "suitability" on the part of the policyholder has been put forward, and the insurers are further demanded to establish a risk assessment system. The sales staffs need to complete the analysis on the financial status, the investment experience, the investment purpose, the recognition of relevant risks, and the risk-bearing capacity, together with customers.[723] In 2012, the CIRC also enacted documents to prevent misleading sales. For example, in *A Guideline on the Identification of Misleading Sales of Personal Insurance* (CIRC No.87 [2012]), it has further enumerated some misleading sales activities, which are mainly divided into "no cheating acts"[724]and "no concealing acts."[725]

Thirdly, for the local regulations, they may be even stricter than the rules of the CIRC. For example, for the *Measures for the Management of the Business Operations of Personal Insurance in Beijing Area* (No. 213[2014]), it follows an even stricter regulation on the ILI while still being bound by the documents of CIRC. For example, for the qualifications of the sales personnel, it explicitly requires that the one should be at least an undergraduate graduate with more than one year experience in selling life insurance, without any material irregularities or fraudulent acts.[726] Meanwhile, it has also stressed the "suitability" on the part of the "policyholder," which is that the policyholder should be recommended to buy products with the corresponding risk level according to their risk-bearing capabilities, in a word, suitable products should be sold to appropriate policyholders.[727]

5.1.3 A Critical Review on the Means of Regulation Carried out by the CIRC on the ILI

Although the CIRC has been playing a significant role in the development of the ILI and has thus accumulated much experience on the supervision over it, it has many problems with the supervision of the ILI, and it is worthy of having our review and reflection on this. It is mainly shown by the fact that attitude maintained and the

[723] See Article 3,4 & 6 of *Notice about Further Strengthening the Management of the Sale of the Investment-linked Insurance* (CIRC No.10 [2009]).
[724] See Article 6 of *A Guideline on the Identification of Misleading Sales of Personal Insurance* (CIRC No.87 [2012]).
[725] See Article 7 of *A Guideline on the Identification of Misleading Sales of Personal Insurance* (CIRC No.87 [2012]).
[726] See Article 7 of *Measures for the Management of the Business Operations of Personal Insurance in Beijing Area* (No. 213[2014]).
[727] See Article 28 of *Measures for the Management of the Business Operations of Personal Insurance in Beijing Area* (No. 213[2014]).

regulations followed by the CIRC, the regulatory authority of the ILI, is not unified or even contradictory to each other.

On the one hand, the ILI is positioned by current regulators as a “new type of personal insurance.” If we view from its literal meaning, this expression does not quite hold water, because if we merely intend to express that the ILI belongs to non-traditional personal insurance products, then it would be more sensible if we use the expression, “new personal insurance.” However, the CIRC did not adopt this more habitual expression; what is behind this is that it seems to emphasize that the ILI is a product under the category of personal insurance. In fact, this expression is not the problem itself. Behind the fact it is positioned as an innovative product of personal insurance is an expansion and derivation of insurance function, because the continuous derivation of new functions based on the guarantee function of insurance is not only the demand for product innovation but also the necessity for institutional innovation.[728] As the CIRC stresses it in the *Guiding Opinion on Promoting the Innovation of Personal Insurance Product*, the effect the personal life insurance has on promoting economic growth and ensuring social development has to be realized through product innovation.[729] In May 30th, 2012, in the colloquium themed as “Increasing Product Competitiveness for the Life Insurance Industry”, Chen Wenhui, the Vice-Chairman of the CIRC, also expressly noted that, “to increase the competitiveness of the life insurance product, we must first take into account the actual situation of the industry and then establish a leading product development strategy that regards the ‘risk guarantee + proper finance management’ as its mainstream businesses.”[730]

Also, from the normative documents enacted by the CIRC, the acknowledgment of the securities attributes of the ILI by the regulatory authority can be reflected. For example, as it has been discussed in the foregoing paragraph, the former CIRC did adopt a regulatory line of thought which is either similar to that for securities or at least being different from the regulatory line of thought adopted by the traditional life insurance, concurrently, the CIRC also expressly specified that the ILI is a finance management product. For instance, in the Press Conference held by the persons in charge of relevant departments of the CIRC in order to answer the questions raised by

[728] See Tuo Guozhu & Zhu Junsheng, *The Current Development of Insurance and Risk-prevention,* 12 Insurance Studies 20, 20 (2004).
[729] See Article 2 of *Guiding Opinion on Promoting the Innovation of Personal Insurance Product.*
[730] See Chen Wenhui, The Current Situation and Measures of Life Insurance Product Competitiveness in China, 7 Insurance Studies 3, 6 (2012).

the Journalists on *Notice about Further Strengthening the Management of the Sale of the Investment-linked Insurance,* the ILI has been specified as "an insurance product with a focus on the investment and finance management."[731] The report made by the Xinhua News Agency also stressed that "the ILI is an investment-oriented life insurance product which is in connection with the capital market and is also an embodiment of investment and guarantee functions. [732] In the *Notice about Relevant Matters Concerning the Regulation over Personal Insurance Product with Small to Medium Duration*, the CIRC again excluded the ILI and the variable annuity from the application of such regulation, which essentially is also a reflection of its normative line of thought that regards the ILI and the variable annuity as finance management products.[733]

On the other hand, there has been an inconstant positioning for the ILI among regulators, and also contradicts each other in terms of the supervision contents and ideas. For instance, over recent years, we have been continuously advocating and stressing the idea that "insurance has to be insurance." For example, in the *Notice from the CIRC about Strengthening the Regulation over Personal Insurance Product*, it is required that liabilities and characteristics of an insurance product should be given prominence to and that a number of words, such as "interest," "expected return," etc., should not be used by the insurance company to advertise products.[734] Besides, in the *Notice from the China Insurance Regulatory Commission about Regulating the Product Development and Design of Personal Insurance Companies*, it is further required that expressions, such as the financial management and investment plan, should not be contained in the names of insurance products, product descriptions, and related product publicity materials.[735] Of course, the idea of the regulators is to have the insurance regressed to its functional category of insurance guarantee and to prevent financial risks. However, the meaning that the "insurance has to be insurance" lies in that we should stress the functional positioning of guarantee which is available with the traditional insurance, as well as the "keynote" that the insurance industry should regard

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731 See CIRC's Answers Reporters on Strengthening the Management of Investment-linked Insurance Sales, <http://www.gov.cn/gzdt/2009-02/02/content_1219876.htm>, Latest visited on May 3, 2019.

732 See the Misleading Phenomenon of Sales on Investment-linked Insurance, <http://www.gov.cn/jrzg/2007-09/11/content_745712.htm>, Latest visited on May 12, 2019.

733 See *Notice about Relevant Matters Concerning the Regulation over Personal Insurance Product with Small to Medium Duration*, (CIRC No. 22 [2016]).

734 See Article 6 of *Notice from the CIRC about Strengthening the Regulation over Personal Insurance Product,* (CIRC No. 199[2016]).

735 See Article 3 of *Notice from the China Insurance Regulatory Commission about Regulating the Product Development and Design of Personal Insurance Companies*,(CIRC No. 134[2017]).

insurance guarantee as to its foundation, but this does not mean that the insurance industry is only limited to the insurance guarantee. The ILI bears the financial attributes of finance management products ever since its formation. For this financial product with particular stress on finance management, a complete return to the guarantee function of insurance, in fact, means an end to this product. China keeps advocating the return to its "original essence" and the services provided to the real economy by the financial products over recent years, in this sense, the entrance into the capital market and participation in investment by the fund in the investment account of the ILI may also eventually serve the development of the real economy.

More importantly, the ILI itself is likely to have the issue of misleading sales, if expressions, such as finance management, are not allowed to appear in the publicity materials, it is bound to again increase the misunderstandings the public have about this kind of insurance itself. As can be known from above, the regulatory authorities lack an accurate understanding of the "righteousness" of the ILI. The attitude maintained by the regulators towards the ILI is "wandering" between "a problematic product" or "an innovative product."

Undoubtedly, our understanding of insurance must be based on guarantee, a core concept of traditional insurance. However, insurance also can not only confine itself to the core concept of conventional insurance without making any step forward. The innovation and composition of modern finance give rise to composite insurance products – the coexistence of essential functions and derived functions. From the form of development for a life insurance product, the development of life insurance product has undergone a process that starts from the one purely with the function of insurance guarantee to the one with savings function, and then to the one with investment function. The appearance of the ILI in our country complies with this development trend, reflecting the change of the course of development for our life insurance products, as well as an enrichment and expansion of the life insurance products.[736]

Moreover, the appearance of the ILI also manifests the economic reality that the insurance industry has moved towards the mixed operation. Insurance can be divided

[736] From the perspective of the development of the overseas insurance market, the investment business has become an important part of the insurance industry. For example, from 1994 to 2004, the average annual growth rate of premium income of continuous insurance in the UK was as high as 6.6%, and the proportion of continuous insurance in the total premium of life insurance reached 58.06% in 2004. See Liao Jianmin, *Theory and Practice of Insurance Asset Management*, (Beijing: China Economic Publishing House, 2014), p.18.

into the insurance business and investment business based on business contents. Judging from the current situation, the business development of insurance does not limit to the traditional insurance business itself, and its investment business has also acquired rapid growth. What has been reflected by the insurance account of the ILI is the insurance business, and what has been "carried" on its investment account is the investment business. For example, viewing from the development of the insurance market in China, despite the development of the ILI is not stable, it still constitutes an essential constituent of the insurance market (See below Table). At present, though some financial companies have independent legal standings, they belong to some financial holding groups. It is the reflection of the trend of mixed operation for the financial industry. For example, Ping An Insurance (Group) Company of China, Ltd. was established in Shenzhen in 1988. Now it has become one of the three major comprehensive financial groups with subordinated subsidiary companies, including Ping An Life Insurance, Ping An Property Insurance, Ping An Endowment Insurance, Ping An Health Insurance, Ping An Bank, Ping An Trust, Ping An Securities, Ping An Fund, etc., covering various fields of the financial industry.[737]It is also the case for China CITIC Group Corporation,[738] China Ever-bright Group,[739] etc., with business covering various financial fields and has already stepped into a mixed operation at the group level. Therefore, it is worth to have reflection and make improvement on the inconstant regulatory attitude maintained by the regulatory authorities towards the ILI.

Table. The sales of ILI and traditional life insurance (unit. million yuan)[740]

Year	ILI	Traditional life insurance	Year	LIL	Traditional life insurance
2000	1,660	98956	2010	552.23	1050088
2001	10,661	142404	2011	454.24	956000
2002	6,935	227464	2012	436.33	995789
2003	6,389	301099	2013	8,317.51	1074093
2004	5,295	319359	2014	28,949.79	1269028
2005	4,584	364623	2015	67,788.33	1585913
2006	5,982	406109	2016	93,897.44	2169281
2007	39,383	494897	2017	47,041.76	2603955

737 See the official website of Ping An, < http://pingan.cn/about/overview.shtml >, Latest visited on My 14, 2019.
738 See the official website of China Citic, < https://www.group.citic/html/About_CITIC/Brief_Introduction/>, Latest visited on My 14, 2019.
739 See the official website of China Ever-bright Group , < http://www.ebchina.com/ebchina/gywm/jtjj/index.html >, Latest visited on My 14, 2019.
740 See Yearbook of China's Insurance (2000-2013), and CIRC website. http://bxjg.circ.gov.cn/web/site0/tab5203/;<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=887995&itemId=954>.

2008	42,549.8	733757	2018	33,285.30	2626087
2009	11,247.8	814418	2019	37,600.00	2275400

In conclusion, ILI is nothing but a financial product that appears in compliance with the development of the times. It is an innovative presentation resulting from a continuous enriching of the variety of insurance in the development of the insurance industry, a reflection of the development of the life insurance – roughly from the guarantee type, to the savings type, and then to the investment type. Also, it has described the evolution process in which the insurance function has changed from economic compensation to financing and then to social management. To the policyholders (the investors), it is merely providing them with more options for their purchase of financial products. The shock caused by the ILI to the existing laws is not due to the problem of the product itself. Just as what has been pointed out by a scholar, an evaluation not only based on the past, but also with an expectation for the future, financial innovation, regulatory arbitrage, regulatory capture, etc. are not the ten unpardonable crimes - original sin, to the contrary, they have facilitated the market improvement and the replacement of the "bad law" by the "good law."[741] Therefore, to the regulators, what needs to be improved is how to adopt a reasonable regulation concept or means, etc. so as to implement an effective and reasonable regulation over the ILI and avoid the conflict between development and regulation.

5.2 A Change in the Idea to Be Followed and Current Improvement for the Regulation of the ILI under the Public Power

5.2.1 The Rising and Practice of Functional & Conduct Regulation

For the reflection and improvement in the mode of regulation over traditional financial institutions, there is no doubt that the functional & conduct regulation theories are the most influential regulatory theories across the world. Particularly after the financial crisis in 2008, they became the most familiar regulatory theories in the field of financial regulation.

The function supervision, proposed by Robert C. Merton, is a legal response to financial supervision under the background of financial mixed operation, that is, under

[741] See Li Siqi, *Review and Reflection on the Innovation of Post-crisis Financial Regulation: From the Perspective of Institutionalization and Comprehensiveness*, 5 Modern Law Science 76, 82(2013).

the background of mixed operation, the supervision of financial products is guided by its function.[742] There are two basic assumptions in the concept of functional supervision: "financial functions are more stable than financial institutions" and "competition will cause the changes in institutional structure to evolve toward greater efficiency in the performance of the financial system."[743] Merton divided the financial function into six aspects: (1) a payments system for the exchange of goods and service; (2) a mechanism for the pooling of funds to undertake large-scale indivisible enterprise; (3) a way to transfer economic resources through time and across geographic regions and industries; (4) a way to manage uncertainty and control risk; (5) price information that helps decentralized coordinate decision-making in various sectors of the economy; (6) a way to deal with the asymmetric-information and incentive problems.[744]

The background under which the functional regulation was formed was in a time when it was aimed at the drawbacks of the separate operation and classified regulation in the US. The traditional separate regulation for the financial sector in the US, established under the *Glass-Steagall Act of 1933* in 1933, was a lesson learned from the economic crisis that lasted from 1929 to 1933. The Glass-Steagall Act of 1933 has legislation on the separation of powers within the financial sector. Financial sectors were not allowed to engage in each other's sector of business, but to follow the practice of separate operation and separate regulation.[745] Subsequently, the US abolished this principle in the *Gramm-Leach-Bliley Act of 1999* and established a financial system featuring mixed operation based on the view that mixed operation is an inevitable trend of financial development. Especially after the financial crisis in the US in 2008, there was a further reform on the financial system of the US. We have researches that indicate this crisis was originated from the subprime crisis.[746] Legally speaking, the cause of the subprime crisis lies in the lack of regulation over composite financial products, as well as the protection of investors.[747] For this reason, the US strengthened its regulation

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[742] See Robert C. Merton, *A Functional Perspective of Financial Intermediation*, 24 Financial Management 23, 23-41(2009).

[743] See Robert C. Merton, *A Functional Perspective of Financial Intermediation*, 24 Financial Management 23, 23 (2009).

[744] See Robert C. Merton, *A Functional Perspective of Financial Intermediation*, 24 Financial Management 23, 24 (2009).

[745] See Glass-Steagall Act, sections 16, 20, 21, and 32.

[746] See Charles W. Murdock, *The Dodd- Frank Wall Street Reform and Consumer Protection Act: What Caused the Financial Crisis and Will Dodd-Frank Succeed in Preventing Future Crises?* 64 SMU Law Review 1243, 1249, 1324 (2011).

[747] See Charles W. Murdock, *The Dodd- Frank Wall Street Reform and Consumer Protection Act: What Caused the Financial Crisis and Will Dodd-Frank Succeed in Preventing Future Crises?* 64 SMU Law Review 1243, 1248-1249(2011).

over the financial products and its protection of financial consumers and also carried out a thorough reform on the financial regulatory authorities.[748] In the *Dodd-Frank Act* enacted by the US in 2010, a series of measures, including the establishment of the Financial Stability Supervisory Committee, Volcker rule, the reform on the regulation over financial derivatives, etc., have formed an "umbrella" shaped regulation pattern, in which the Federal and State Governments have the regulatory power and multiple regulatory bodies have the regulatory responsibilities. More specifically, the Federal Reserve System (the "FED") is responsible for the regulation over registered member banks of the Federal Reserve and the Financial Holding Companies, whereas the subsidiary companies under the financial holding companies receive the regulation from different regulators according to their specific businesses. If certain businesses belong to securities, then they will be under the regulation of the SEC. If they belong to insurance, they will be subject to the regulations from both the insurance regulatory bodies in various states and the National Association of Insurance Commissioners (the "NAIC"). If they belong to banking businesses, they will be under the regulation from FED, bank regulatory bodies in various states, Federal Deposit Insurance Corporation, Office of the Comptroller of the currency, etc.

For conduct regulation, we have scholars who have discerned that this concept was first noticed in the "market conduct regulation" put forward in the *Market Conduct Check Handbook* enacted by the NAIC in the 1970s. However, since liberalism prevailed at that time, this proposition failed to draw due attention.[749] Subsequently, it was Michael Taylor, a British scholar who elevated this concept of conduct regulation to an important financial regulation theory. Taylor proposed the "Twin Peaks Regulation Theory" in 1995, believing that there are two goals for financial regulation, namely the prudential regulation and conduct regulation, with the former includes two levels, the macro prudence, and micro prudence. In other words, the target of financial regulation is to prevent systemic financial crisis (at the macro level) and safeguard the robust operation of financial institutions (at the micro-level). The latter is mainly about those aspects, including the increase in financial efficiency, the prevention of financial fraud, the protection of the rights and interests of the financial consumers, etc.[750] This

[748] See *Dodd-Frank Wall Street Reform and Consumer Protection Act*, available at <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf>.
[749] See Liao Min, *Re-understanding of "Behavior Supervision" of Banking Industry after the Crisis*, 1 Financial Regulation Research 64, 66 (2012).
[750] See Michael Taylor, *Redrawing the regulatory map: A proposal for Reform*, 5 Journal of Financial Regulation and Compliance 49, 49-58(1996); Michael Taylor, *The Search for a New Regulatory Paradigm*, 49 Mercer L. Rev.

theory holds that if one institution is responsible for two goals, the macro prudence and conduct regulation, it is likely that it may attend to one thing at the cost of neglecting the other and can not give consideration to two things at a time. Therefore, this theory advocates the use of two different institutions that are held responsible for the realization of the two goals for financial regulation.

Comparing with the context of separate operation for the financial industry, which was proposed by the functional regulation, the context in which the Twin Peaks Regulation Theory was proposed was the mixed operation for the financial industry. In 1979, the UK, by enacting the *Banking Act* and *Depositors Protection Act,* endowed the statutory financial regulatory power to the Bank of England and established the separate regulation for the financial industry. Later on, in 1986, the cabinet government led by Mrs. Thatcher, the Prime Minister of the UK, started to promote the reform on liberalization within the financial industry, with an expectation to break the separate operation which was previously adopted in the financial industry of the UK, thus to achieve mixed operation for the financial industry. In 1997, the British Prime Minister Blair again integrated nine financial regulatory bodies represented by the Bank of England and established the new Financial Service Authority (the "FSA"). Thereafter, a unified financial regulation pattern with joint regulation from the Ministry of Finance, the Bank of England and the FSA is thus established. The unified mixed regulation pattern for the financial industry in the UK was formally established in the *Financial Services and Markets Act 2000*. However, there is the issue of lacking adequate coordination between the financial regulations carried out jointly by the multiple regulatory bodies. The negligence in the prudential regulation at the macro level by the FSA itself and the insufficient protection of financial consumers is found in its concentrated regulation over conduct.[751] Thus it can be seen that the background against which the "Twin Peaks Regulation Theory" was proposed by Taylor mainly surrounded the question as to how to increase financial safety and efficiency.

However, despite the "Twin Peaks Regulation Theory" was being adopted by Australia and Holland during early times, the "Twin Peaks Regulation Theory" of Taylor was not adopted in the reform initialized by the UK. Until in the year 2008, when the financial industry in the UK was deeply affected by the financial crisis at that time,

793, 793-807 (1998).

[751] See Zheng Yang, etc., *The Practice of Global Functional Supervision and the Exploration of China's Comprehensive Financial Supervision*, (Shanghai: Shanghai People Press, 2016), pp.27-28.

where there was less impact on Australia and Holland. The British authority then had a reflection over the financial crisis it had suffered. At that time, in 2009, *From Crisis to Confidence: a Plan to Stabilize Banking* was enacted by the UK in 2009 to strengthen its prudential regulation at the macro level. Afterward, the UK enacted the *Financial Service Act 2012,* in which three goals for financial regulation are expressly specified – the protection of consumers, the protection of the financial market, and the promotion of competition. In terms of the reform on financial regulatory bodies, the core position of the Bank of England in the prudential financial regulation at the macro level was established, including the establishment of the Financial Policy Committee (the "FPC") within the bank of England, responsible for the prudential financial management at the macro level. The FSA was removed and then had it divided into the Prudential Regulation Authority (the "PRA") and the Financial Conduct Authority (the "FCA"), with the former responsible for the prudential management at the micro-level and the latter responsible for the regulation of the business acts of the financial institutions and for the protection of financial consumers, both of them received the guidance and suggestions from the FPC.

The abovementioned theories on functional and conduct regulations, as well as the reforms on financial institutions, are of considerable significance to the improvement of the financial regulation in our country. Because those two regulatory theories have provided much beneficial enlightenment to the status quo of the financial regulation in China, hence they are much favored and advocated. For example, it was explicitly noted in the National Financial Work Conference held in 2017 that "the country should strengthen its construction of the system for prudential management at the macro level, strengthen its functional regulation and attach more importance to the conduct regulation."[752] This practice of "setting the keynote" at the central government level for the approach taken to improve future regulation also provides the direction for the current improvement of the regulation over the ILI.

In terms of functional regulation, so far, an exploration framework with commonalities has gradually come into being. More specifically, the framework, legislation, information, and platform are the main entry points, whereas the "clear-cut responsibilities and reconstruction," "collaborative policies," "coordinative

[752] "National Conference on financial work", <http://www.gov.cn/xinwen/2017-07/15/content_5210774.htm>, latest visited on May 9, 2019.

regulations," "financial consumer protection," "legislative support," "framework adjustment," "information sharing" and "joint governance across industries" are the eight exploration directions.[753] Financial regulations in China are also analyzed from the abovementioned aspects [754] In terms of "clear-cut responsibilities and reconstruction," financial regulations in China are conducted by the general headquarters of the People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission, and China Banking Regulatory Commission. As far as the traditional financial products are concerned, there are clear-cut responsibilities among each of them. Nevertheless, in other fields, such as the field of financial composite products, fierce "departmental competitions" exist, i.e., different finance management methods are enacted, and each of them is implementing different standards of regulations. In terms of the collaborative policies, administrative levels are the same among various authorities, so when it comes to financial cross-fields, responsibilities are not clear cut, and there is no strong regulation and coordination mechanism among them. When it comes to the protection of financial consumers, though the importance of the protection of financial consumers has been stressed by various authorities, also the idea to protect financial consumers has been advocated by them. Still, it is in material shortage of the efforts spent on the protection of financial consumers in actual implementation. For example, in each regulatory body, there is a department separately established for the protection of financial consumers, but it has not been set in a high administrative position, which is so high as to be elevated to the core position of the financial regulatory framework. In terms of the legislative support, regulative legislation in China mainly relies on the promotion by the various regulatory bodies. Currently, at the level of the basic laws of finance, we remain under the pattern of "separate operation and management." In terms of the framework adjustment, the present financial framework is still built mainly based on the "separate operation." For a financial product covering multiple financial fields, its regulation is still carried out in the form of traditional institutional regulation. In terms of the information sharing, China has also established an inter-departmental joint conference mechanism which is used to strengthen the information sharing between regulatory authorities, but only to find its actual effect is not evident. In terms of joint governance across industries, China

[753] See Zheng Yang, etc., *The Practice of Global Functional Supervision and the Exploration of China's Comprehensive Financial Supervision,* (Shanghai: Shanghai People Press, 2016), p.7.
[754] See Wu Xiaoling, *Improving Financial Legislation and Strengthening Financial Supervision*, 10 Economic Herald 24, 25(2017).

relies on administrative intervention. Despite there exist market organizations such as the industry associations, those organizations actually only serve as a part of the administrative management. Self-discipline is an industry, and government regulation fails to achieve the real scenario of joint governance. Taking into account the defects we have discussed previously on the ILI, and the eight exploration directions for functional regulations are also the ILI-regulation related aspects that are in urgent need of improvements.

The enlightenment is given to the financial regulation in China by the theory on conduct regulation mainly lies in those aspects, including the handling of the relation between macro-prudential management and conduct regulation and the protection of financial consumers. For the two targets to financial regulation, the idea adopted by China for its financial regulation throughout the years attaches more importance to the macro-prudential regulation with strengthened efforts on the prevention of financial risk but has not paid enough attention to the conduct regulation. In terms of the institutions which are exclusively responsible for the protection of financial consumers, under the traditional framework consisted of the general headquarters of People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission, and China Banking Regulatory Commission, all of them set an authority department for the protection of their financial consumers with limitation to the regulation scope for each specific sector (The CIRC established the bureau for the protection of the rights and interests of the insurance consumers in April 2011;[755] the CSRC established the investor protection bureau in December 2011;[756] the People's Bank of China established the bureau for the protection of the rights and interests of the financial consumers in July 2012; [757] Bureau for the protection of the rights and interests of the banking consumers was established by the China Banking Regulatory Commission (the "CBRC") in November 2012).[758] Because the protection of financial consumers is the responsibility of various authorities, it is easier to have the phenomenon that each authority is acting on its own in enacting policies in this respect. In case it involves a composite financial product, it is easier to have unclear-cut

[755] See the Official Website of CIRC, < http://bxjg.circ.gov.cn/web/site0/tab5175/ >, latest visited on May 29, 2019.
[756] See the Official Website of CSRC, < http://www.csrc.gov.cn/pub/newsite/tzzbh/ >, latest visited on May 29, 2019.
[757] See the Official Website of the People's Bank of China, < http://www.pbc.gov.cn/jingrxfqy/145720/145821/index.html >, Latest visited on May 29, 2019.
[758] See Xinhua Website, < http://www.xinhuanet.com/politics/2012-11/20/c_113742210.htm >, latest visited on May 29, 2019.

responsibilities, dispute over trifles, and prevarication. Moreover, for the protection of financial consumers, despite regulators in China keep emphasizing the importance of it, there is no provision of any strengthful protection measure to financial consumers at the level of private laws. In addition, for the regulation of the ILI, as it is discussed in the foregoing paragraph, China has shown a "campaign oriented financial governance paradigm." In a word, many defects still can be found in the protection of financial consumers by China, many measures have not been effectively implemented, and problems with respect to the protection of the investment rights of the ILI have not been solved fundamentally. This also highlights the reference sign of the idea about conduct regulation to the improvement of the financial regulation in China.

5.2.2 China's Proposal of the "Look-through" Regulation & the "Ought to Be" Paradigm for the Regulation of the ILI

For the functional and conduct regulation theories, financial regulators in China keep exploring on how to have a local use of them. Over recent years, regulators have put forward a "look-through" regulation to compensate for the defects of the traditional regulation. A similar situation is also found in foreign countries where the "look-through" provision or "look-through" approach is taken.[759]

The appearance of the "look-through regulation" in China's normative documents was in the State Council enacted the *Notice about Issuing the Implementation Plan for Special Rectification of Risks in Internet Finance* in 2016 to prevent the risks in internet finance. In Article 2 of this *Plan*, the division of labor and collaboration among departments, the ‘’look-through" regulation method is expressly adopted, and the responsibilities shall be specified according to the business nature.[760] Later on, on the basis that there was such a phenomenon that multiple nesting layers were found in the assets management business in China, a series of documents enacted by the regulators also adopted the idea of "look-through" regulation. For example, in Article 7 of the *Measures for the Supervision and Administration of the Wealth Management Business*

[759] "To prevent circumvention of the 100-investor limit, section 3(c)(1)(A) (the 'Look-Through Provision') requires, in some instances, that a fund seeking to rely on section 3(c)(1) 'look through' certain compan ies (e.g., corporations, partnerships and other investors that are not natural persons) that hold its voting s ecurities and count the company's security holders as beneficial owners of the fund's securities." See Sec tion 3 (c)(1)(A) of Investment Company Act of 1940, <https://www.sec.gov/rules/final/ic-22597.txt> Latest visited on Oct. 8, 2019.

[760] See *Notice about Issuing the Implementation Plan for Special Rectification of Risks in Internet Finance*, No 21 [2016].

of Commercial Banks (No. 6 [2018]), it stipulates that "look-through" regulation should be carried out on the wealth management business, more specifically, final investors of the finance products should be identified upwardly, the underlying assets of the finance products should be identified downwardly, and a comprehensive dynamic regulation should be carried out on the operation and management of finance products. In Article 5 of the *Notice from the China Insurance Regulatory Commission about Issues concerning Further Improving the Actuarial System of Personal Insurance (No. [2016]76)*, it stipulates that all companies should strictly carry out relevant provisions in *Notice about Relevant Matters Concerning the Regulation over Personal Insurance Product with Small to Medium Duration (No. [2016]22)* and do well in the estimation of the expected duration of their products pursuant to the principle of "substance over form" and relevant determination standards. "Look-through" regulation means that the regulator spots the real identity of market participants and identifies the "essential trading" hidden behind the form, and then realizes its in-depth and effective adjustment of financial transaction relations with the help of proper legal norms and regulation means.[761] It can be known that this "look-through" regulation is mainly intended to compensate for the deficiencies in the country's traditional financial regulation. Because traditional institutional regulation has fixed the domain between the regulators and what is being regulated, along with the development of the internet and the innovation and blending of various composite finance products, traditional financial regulation is thus trapped into a difficult situation. Under this circumstance, the regulators must adopt "look-through" regulation on cross-sector financial products and conducts or those with multiple nesting layers.

As a matter of fact, "look-through" regulation is also a reflection of "substance over form." Both of them have common points in terms of the contents, which is to specify the regulatory bodies and applicable rules based on the product functions, business natures, and legal attributes, and then conduct the whole process regulation over the businesses and conducts of the financial institutions.[762] The problem exposed by the separate regulation is that "each family takes custody of its children." Hence it will result in a "vacuum space" for the regulation of financial composite products. This traditional regulatory idea featuring "each family takes away the children of its own for their best" is not only possible to result in financial repression within the institution –

[761] See Ye Lin & Wu Ye, *On the "Look- through Supervision" of Financial Market*, 12 Law Science 12, 14 (2017).
[762] See Gou Wenjun, "*Look-through" Supervision and Asset Management*, 8 China Finance 17, 18 (2017).

"giving birth to less child," but may also result in the loss of control for risk beyond the institution – "being indifferent to a wild child."[763] Therefore the core principle of the "look-through" regulation is the "substance over form," and the idea is upheld by it should be "an increase in the transparency of the market."[764] The purpose is to prevent systematic risk, evade blind spots for regulation, prevent sales errors, and adapt to the demands for the regulation over the mixed operation.[765] Therefore, this means of regulation benefits the prevention of systematic financial risk and the reduction in the number of blind spots for financial regulation and also compensates the defect of the system of traditional institutional regulation that "each one manages each one's businesses.

It is worth noting that the "look-through" regulation, functional regulation, and conduct regulation have many things in common. However, the "look-through" regulation does not equal to theories on functional regulation and conduct regulation. In particular, so far, the "look-through" regulation is only a practice adopted to describe the practice of regulating over financial industry in China, and no strict legal terms have been formed in this regard. It's "out to be" nature in the field of financial regulation remains to be discussed. In terms of the differences of those means of regulation, the background against which the functional and conduct regulations are formed mainly based on the traditional separate operation or for the sake of improving financial stability and efficiency, and the corresponding means of regulation to this purpose is the institutional regulation. The application of "look-through" regulation does not limit to the circumstances of separate operation or mixed operation. However, as a method of regulation, theoretically, "look-through" regulation can be widely applied to various fields of financial regulation. We have scholars who have pointed out that to realize the goals set for functional and conduct regulations, the method and means of "look-through" regulation should be adopted.[766] Also, there is a contention that rather than maintaining that the theory of "look-through" regulation originates from the functional and conduct regulation, it is better to say that the "look-through" regulation is the result achieved by applying the "look-through" idea to the functional and conduct

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763 See < http://finance.ifeng.com/a/20160819/14776475_0.shtml >, latest visited on May 23, 2019.
764 See Ye Lin & Wu Ye, *On the "Look- through Supervision" of Financial Market*, 12 Law Science 12, 14 (2017).
765 See Tan Renyou, Ye Yao, and Yu Tan, *The Concept, Purpose, and Practice of "Look-through"*, 11 International Financial 72, 72 (2017).
766 See Gou Wenjun, *"Look-through" Supervision and Asset Management*, 8 China Finance 17, 18 (2017).

regulations.[767]

Based on the drawbacks exposed by China's existing financial system, how for the financial regulatory system in China to improve? If it intends to adopt functional regulation completely, then large adjustments have to be made in the framework of the financial institutions – a practice that is not in compliance with the stability requirements for our reform on the financial system. Because in view of the 70 years' experience in the financial regulation of China, once our financial operation is not run in a stabilized order, the normal functioning of various financial functions, the opening up of the financial market and the consolidation of the achievements made through financial development will undoubtedly be severely affected, which will also inevitably impose a direct threat on the development of the real economy or even the development of the national economy, let alone the continuously deepened reform on the financial industry. Under this background, even the best plan for financial reform can not be implemented either. Therefore, in the process of advancing the reform and opening up targeted at the financial aspect, maintaining a stable order for the country's financial operation is overwhelming and on top of everything.[768] However, in the long run, the mixed operation for the financial industry is an inevitable trend for financial development. In the future, the further adjustment of the financial institutions should continue to be functional and conduct regulations oriented. As for now, once the "look-through" regulation is introduced in the financial market, especially when the "look-through" is pointed to the financial products, it indeed lays a good foundation for the functional regulation.[769] For example, for the "contents" of "look-through" regulation, it can be divided into "look-through main body," "look-through product attribute," and "look-through nesting layer,"[770] thereby they realize the purpose of essential regulation in different and complicated transaction circumstances. For example, for the insurance industry, the introduction of the idea of "look-through" regulation may improve the existing regulation mode and make the regulation over insurance more adaptive to the trend of mixed operation. At the "capital end," the identification of the ultimate controller and capital of the insurance company; at the "asset end," the identification of

[767] See Du Jiajia, *On The "Look Through" Supervision in the Financial Field: The Origin and Application of The System*,2 Southwest Finance 65, 69 (2019).
[768] See Wang Guogang, *70 years of Chinese Finance: Brief History, Brilliant Achievements and Historical Experience*,7 Economic Theory and Business Management 4, 24-25(2019).
[769] See Ye Lin & Wu Ye, *On the "Look- through Supervision" of Financial Market*, 12 Law Science 12, 14 (2017).
[770] See Ye Lin & Wu Ye, *On the "Look- through Supervision" of Financial Market*, 12 Law Science 12, 17-18 (2017).

the final "whereabouts" of the insurance assets; at the "liabilities end," the identification of the ultimate bearer of the risk-return relating to the insurance policy.[771] Specific to the ILI, it mainly involves the "looking through product attribute," the "looking through the surface morphology of the ILI." The showing of the diversified financial businesses the ILI covers; therefore, the idea of "look-through" regulation is of great significance to the resolution of the inadequate regulation over the ILI.

However, the "look through" regulation merely resolves the "looking-though the product attributes of the ILI, a product with composite attributes, or is deemed as a regulation method or means, rather than a regulatory theory or idea, so it can not solve the law application issue concerning the ILI, that is the failure to offer a rationale for the regulation over the investment account by the CSRC or to provide the theoretical basis for the application of laws to the ILI by the CBRC or CIRC in accordance with relevant laws relating to the securities law. If we have a further analysis of the "look-through" regulation, we may find that the primary purpose for the rise of the "look-through" regulation still consists in the macro-prudential regulation, rather than mainly lying in the resolution of the issue concerning the protection of financial consumers. The legal system for the protection of financial consumers was one of the essential systems in the age of mixed regulation.[772] Thus it can be seen that currently, the "look-through" regulation is only the partial practice of the functional and conduct regulations in China. Under the separate operation and management system which is established by the fundamental laws in China, "look-through" regulation is still unable to effectively conform to the "ought to be" targets of the functional and conduct regulations respectively, especially for the inadequacy in the field of the private law, which is hard to be perfected. The direction for the improvement in the regulation over the ILI should still be functional and conduct regulations oriented. In other words, being guided by the idea of the functional and conduct regulations, the breaking away from the regulation by a single financial institution on the part of the business pattern of the ILI, also means that it involves the coordination between financial institutions or the joint regulation by multiple financial regulators, as well as the special attention paid to the protection of financial investors.

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[771] See Wang Fuling, *Application of "Look through" Supervision Concept in Insurance Supervision*, China Insurance News (Dec. 15, 2017), p.004.

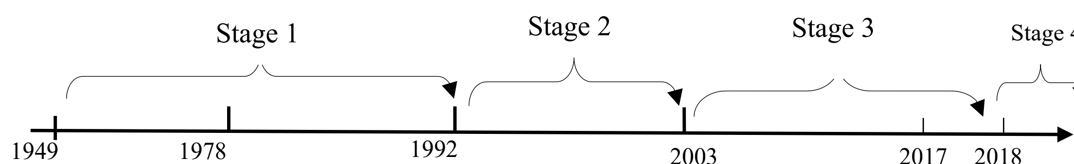
[772] See Ma Jianwei, *Legal Protection of Financial Consumers: Based on the Reform of Financial Supervision System,* 6 Tribune of Political Science and Law 178, 178 (2013).

5.3 Evolution of China's Institutional Regulation and Exploration of ILI's Regulation

5.3.1 The Evolution and Reform on the Financial Institutions in China

From the founding of new China until now, the evolution of China's financial industry and its regulatory institutions can be roughly divided into the following four stages:

Figure. the evolution of financial institutions in China



Stage 1 – From 1949 to 1992. This stage was the period in which the insurance industry was being suspended for quite a long time and started to resume, and also the period in which the country adopted mixed regulation over the financial industry. The reform and opening-up policy initialized in 1978 is roughly deemed as the division line for this period, and two critical periods are further divided based on this line. From 1949 to 1978, it was the period in which the regulation of the financial industry was dominated by the People's Bank of China and the Ministry of Finance.[773] From 1978 to 1992, five large state-owned banks of China, the ICBC, the ABC, the Bank of China, the CCB, and the Bank of Communications became independent from the Central Bank and the Ministry of Finance one after another. Because the domestic insurance had been suspended for many years, in 1979, to resume domestic insurance business, the People's Bank of China promulgated the *Notice about Restoring Domestic Insurance Business and Strengthening Insurance Institutions (No. 16 [1979])*. In 1983, the State Council promulgated the *Decision on the Exclusive Exercise of the Functions of the Central Bank by the People's Bank of China*, in which it stipulates that the People's Bank of China is a state organ through which the State Council leads and manages the nation's financial undertakings, which marks the formation of the centralized regulation by the Central Bank.[774] In 1984, the People's Insurance Company of China (the "PICC")

[773] It should be noted that the people's Bank of China was incorporated into the Ministry of Finance in 1969, and then the central bank was independent from the Ministry of Finance in 1978.

[774] See Article 1 of *Decision on the Exclusive Exercise of the Functions of the Central Bank by the People's Bank of*

became independent from the Central Bank. In order to strengthen the country's management over the insurance enterprises and promote the development of the insurance undertakings, the State Council promulgated the *Provisional Regulations Governing the Administration of Insurance Enterprises ([1985] 33)* in 1985.[775] Through the abovementioned reforms, the Insurance industry in China gradually resumed and developed, so did the other financial sectors and institutions; a basic pattern of the financial industry was thus formed.

Stage 2 – From 1992 to 2003. This stage was the period in which the financial industry in China stepped away from the mixed regulation and came towards separate operation, and also the period in which the separate regulation was established. The background against which the CSRC was founded has been discussed in the preceding paragraph. In fact, during the time when the preparatory work in relation to the establishment of the CSRC was being carried out, there were disputes over the modes of financial regulation, and the controversies are mainly concentrated on whether it should be based on the large and unified mode (in which the banking and the securities will be regulated jointly) as adopted by Germany or the separate mode (the regulations over the banking and the securities are separated) as adopted by the US. Because of the lesson learned from the economic crisis in 1929 to 1933, as well as the impact of both the *Glass-Steagall Act* of *1933* and the *Securities Exchange Act of 1934*, most Chinese scholars are in favor of the US mode.[776] The background behind the disputes over the modes of financial regulation is mainly the following. The financial industry in China was resumed and established in the 1980s, but with evident risk in its operation. At that time, many financial institutions were sailing under false colors as they had no core business, but to carry out or carry out under various disguised forms the loan business targeted at enterprises, some of them were still engaging in deposit-like businesses that absorbed public funds; also there were a large number of issues that can be categorized as the so-called three financial disorders (indiscriminate collection of funds, the indiscriminate establishment of financial institutions and indiscriminate handling of financial business).[777] In the *Opinion on Current Economic Situation and*

China, No. 146[1983].

775 See Article 1 of *Provisional Regulations Governing the Administration of Insurance Enterprises,* G. F. [1985] 33.

776 See "Establishment of CSRC", <http://finance.sina.com.cn/china/gncj/2018-12-03/doc-ihprknvs7752798.shtml>, latest visited on May 10, 2019.

777 See Shi Lei, Li liqun, etc., *The Separation and Integration of China's Financial Supervision*, 1 China Banking 21,22 (2019).

Strengthening the Macro-control (No. 6 [1993]) promulgated by the Central Committee of the Communist Party of China and the State Council, it was pointed out that the non-bank financial institutions or other economic entities created by the people's banks, specialized banks, and commercial banks shall completely terminate their connection with those banks, first of all, the connection in aspects of personnel, finance, and fund must be terminated entirely. The people's banks should take the lead in terminating those connections as soon as possible.[778] In the same year, in the *Decision of the State Council on Reform of the Financial System* enacted by the State Council (No. 91 [1993]), it expressly stipulates that separate operation should be adopted for insurance, securities, trust, and banking sectors.[779] Later on, the classified operation and classified regulation were established in a number of laws of China, i.e., the *Commercial Bank Law* of China, in addition to the establishment of the CIRC and the CBRC in 1998 and 2003, respectively. It was then that a financial system, featuring classified operation and classified regulation and including the general headquarters of People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission, and China Banking Regulatory Commission, was established in China.

Stage 3 – From 2003 to 2018. This stage was a different financial regulation period in China involving the general headquarters of the People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission, and the China Banking Regulatory Commission. Due to the establishment of "classified operation and classified regulation," the regulation responsibilities within the financial industry became apparent, and the efficacy and capabilities the corresponding regulation bodies had in regulating the field for which they are responsible kept strengthening up. However, with the tendency of mixed financial operation becoming evident, the drawbacks of a financial regulation pattern involving the general headquarters of People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission, and China Banking Regulatory Commission became more and more prominent and thus were widely criticized. Just as there are scholars who have concluded that the mismatch between separate regulation and mixed

[778] See Article 7 of *Opinions on Current Economic Situation and Macroeconomic Regulation*, No 6 [1993].
[779] See Article 6 of *Decision of the State Council on Reform of the Financial System* enacted by the State Council, G. F. No. [1993]91.

operation has caused three regulation issues: regulatory arbitrage, regulation conflict, repeated or "vacuum" regulation.[780]

Stage 4 – From 2018 to now. This stage was another unique financial regulation period in China involving the Stable Financial Development Commission under the State Council, People's Bank of China, China Banking and Insurance Regulatory Commission, and CSRC. Because the regulation information can not be effectively shared under a regulatory framework that involves the general headquarters of People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission and China Banking Regulatory Commission (i.e., the CSRC can not effectively know about relevant information on the insurance companies' capital operation in the capital market). So in order to solve those problems in relation to the coordination of financial regulation, i.e., strengthening the information communication between regulatory bodies, in 2013, the State Council agreed to establish an inter-departmental joint conference system, which is led by the People's Bank for the coordination on financial regulation (including functions, such as the coordination among the policies, laws, and regulations with respect to financial regulation).[781] The members of the joint conference include the People's Bank (leading member), the CBRC, CSRC, CIRC and the State Administration of Foreign Exchange, and when necessary, relevant departments, including the National Development and Reform Commission and the Ministry of Finance, etc. can be invited to join the conference. In order to further strengthen the overall planning for the financial industry at the macro level and to prevent its systematic risk, as well as for some other considerations, in the National Financial Work Conference held in 2017, it was announced to establish the "Stable Financial Development Commission under the State Council," which was formally established in November of the same year. On March 13th, 2018, in order to deepen the reform on the financial regulatory system and solve issues, such as unclear-cut regulation responsibilities, cross-regulation and "vacuum" regulation, which were found in the existing system,[782] the 1st Session of the 13th NPC adopted the *Decision on the State Council Institutional Reform Proposal*, which includes the formation of

[780] See Zhang Yu, *The fortieth anniversary of reform and opening up: the evolution of China's financial regulatory system*, 9 Times Finance 157, 157-158 (2019).
[781] "Reply of the State Council on Approving the establishment of the inter ministerial joint meeting system for financial supervision and coordination", < http://www.gov.cn/zwgk/2013-08/20/content_2470225.htm >, latest visited on May 15,2019.
[782] See Wang Yong, *Notes on the institutional reform plan of the State Council*, < http://www.xinhuanet.com/politics/2018lh/2018-03/14/c_1122533011.htm >, latest visited on May 15,2019.

China Banking and Insurance Regulatory Commission (the “CBRC”). It was then the financial regulatory system in China had turned from “a framework that involves the general headquarters of People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission and China Banking Regulatory Commission” to “another framework that involves the Stable Financial Development Commission under the State Council, People's Bank of China, China Banking and Insurance Regulatory Commission and CSRC.”

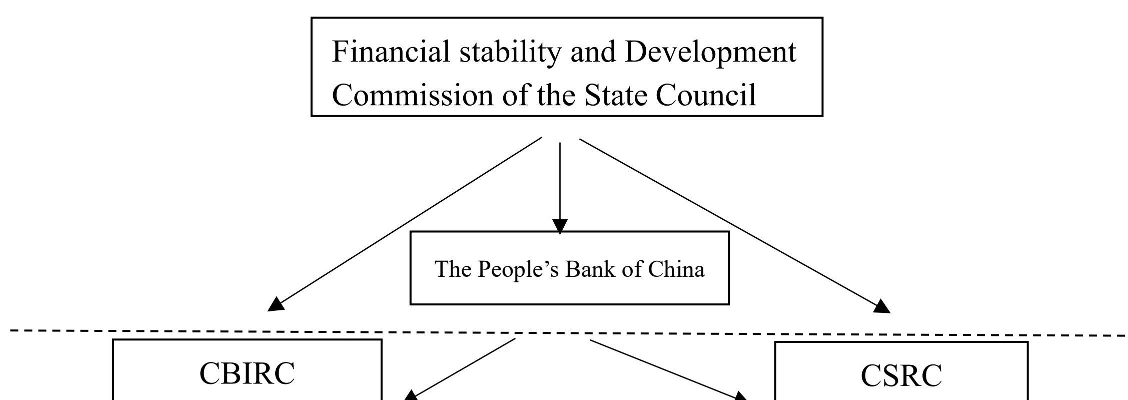


Figure. China’s current financial regulatory framework

Judging from the abovementioned evolution of the reform on financial institutions in China, financial regulations in China mainly have the following characteristics or defects. Firstly, there is an imbalanced relation between macro-prudential regulation and conduct regulation. The reform on financial institutions in China over the years has always been focusing on the prevention of systematic financial risk, so it attaches more importance to macro-prudential regulation but pays less attention to conduct regulation. Also, the “contents” of conduct regulation is relatively abstract. For example, despite basis rules and regulations have been set forth on those aspects in relation to the ILI, including information disclosure, sales management, etc., the specific contents still remain to be quite rough, in particular, those contents of conduct regulation are only limited to things at the administration level, but lack relieves at the civil level; hence the protection it offers to the financial consumers is less convincing. The second is about the problems relating to the coordination of regulations among regulatory departments. The financial system, featuring “classified operation and classified regulation,” is being implemented in China for many years. Therefore, the regulation idea –like the “railway policemen all manage things in their jurisdiction” has taken root

among regulators. Those circumstances, including overlapping or conflicting regulations, as well as the regulatory arbitrage, are found to be serious among regulatory authorities.

Based at defects above found in financial regulation, the current “framework of financial institutions”, in which it involves the Stable Financial Development Commission under the State Council, People's Bank of China, China Banking and Insurance Regulatory Commission and CSRC, is just a response to an improvement on those defects. Under the framework that involves the Stable Financial Development Commission under the State Council, People’s Bank of China, China Banking and Insurance Regulatory Commission and CSRC, the “Stable Financial Development Commission under the State Council” and Central Bank are responsible for the macro-prudential regulation, in particular, they play those roles, including the overall planning for the whole financial field, coordination of those things relating to the regulation, such as policies, information, etc., and prevention of the systematic financial risk, while on the other hand, the China Banking and Insurance Regulatory Commission (the “CBRC”) and CSRC do not attach more importance to macro-prudential regulation. Instead, they attach more importance to the regulation over the individual financial institutions and specific market conduct. This financial framework is also the framework that tallies with the “Twin Peaks Regulation” for international finance. Besides, on this basis, for conduct regulation, the CBRC and CSRC have further followed the regulation differences between different modes of financing, i.e., the direct and indirect financing. In other words, the CBRC is responsible for regulation over those aspects of the indirect financing field, i.e., capital adequacy, solvency, etc., whereas the CSRC is regulating those aspects of the direct financing field, e.g., information disclosure. For this mode of regulation, since both the CBRC and the CSRC are considered as the two paralleling financial institutions in the financing field, the roles they have played have far-reaching significance to the improvement on the traditional issue of an overlarge proportion of indirect financing and to increase in the proportion of direct financing – the status quo as we have. However, this financial reform has not been a thorough one. For example, the lack of independence on the part of the “Stable Financial Development Commission under the State Council,” because in terms of the staffing issue, the persons in charge of the “commission” are not solely appointed to each specific positions within the “commission,” but concurrently they are responsible persons in other institutions as

well. Although its personnel is high ranking officials, there are concerns about their physical effort or doubts about their focus of attention.

Moreover, it is also in the absence of the formulation of corresponding rules and regulations. Of course, it might because it is a newly established institution. However, this should be improved in the future. For example, we have scholars who have suggested that we should formulate the *Rules of Stable Financial Development Commission under the State Council*, so that the functions, procedures, operation mechanism and accountability system of it can be detailed.[783] In a word, the regulators have been reflecting on the defects of the traditional regulation mode and have tried to make improvements to regulatory bodies. This macro-level adjustment will have a direct impact on the resolution and exploration of the regulatory issues to the ILI.

5.3.2 Resolution and Exploration of the Regulatory Issues to the ILI

5.3.2.1 Joint Regulation over the ILI

Because of the diversified financial businesses available in the ILI, the limitation of its regulation subject to CIRC (or CBRC) in its current regulation by the public power can not give full coverage of the regulation of all the businesses involved in it, and thus has not completed the "task" of offering an effective solution to the regulation of the ILI. Based on the design of the ILI as a composite financial product, the fund in its insurance account is no different from that of the traditional life insurance, which is a kind of indirect financing method, whereas the fund in its investment account is not taken from the insurance guarantee, but is raised for investment and finance management, so it comes down to a kind of direct financing method. Then judging from the idea of functional regulation, and the status quo of the current financial institutions in China, the regulation subject of the ILI should consist of different financial regulators – joint regulation. In other words, the CBRC is responsible for the indirect financing part, while the CSRC is responsible for the direct financing part. Also, since the investment account of the ILI has certain independence, which allows its distinction from the insurance account, which makes it operable for the regulation of the investment account under the ILI by the CSRC.

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[783] See Xing Huiqiang, *Target Orientation and Function Improvement of the Financial Stability and Development Commission of the State Council*, 3 Law Review 88, 97 (2018).

For those above "ought to be" regulation subject of the ILI, it does not mean that the CBRC can not regulate the investment account of the ILI, especially for the composite financial products, the overlapping and conflicting regulations are inevitable in practice. Because the "regulation competition" spurs the regulatory bodies to grasp and expand their "territories" through "legislative competition," thus intensifies the control of the market via regulation. Consequently, this results in several negative effects, i.e., regulatory preemption, overlapping regulation, and excessive regulation.[784] In other words, the allocation of the regulatory power of the ILI itself will involve competition for interests among regulatory departments. This puts more weight on the necessity of a unified and independent financial regulation and coordination institution (e.g., the Stable Financial Development Commission under the State Council) and on its coordination of the competition among various regulatory bodies for the regulatory power.[785] As far as China is concerned, through many years' development, a pattern in which various financial regulatory bodies are competing against each other for regulatory power has been formed, which has multiple complicated effects on the financial market; hence it should be paid great attention.[786] Irrespective of which country it applies, in the coordination of financial regulations, what has been directly involved in the gaming between departmental interests. From the perspective of the US Law, the regulation over variable annuity remains to be the same. Regulatory competitions are found between Federal and various state regulatory bodies, which eventually forms a pattern in which there is a joint regulation over a variable annuity.

The *McCarran Ferguson Act of 1945* restricts the power owned by each state for the regulation of insurance to activities specifically relates to the business of insurance.[787] However, this law has not defined that to what extent, it can be called "specifically relates" and what is the "business of insurance" and its corresponding scope. In general understanding, those traditional activities that are being regulated, i.e. obtain the insurance business license granted by each state, insurance underwriting, advertisement sales, the calculation of reserve funds and the protection of the rights and

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[784] See Feng Hui, *On Financial Supervision Competition and Its Legal Governance*, 3 The Jurist 110, 117 (2019).
[785] At present, the governance strategy based on central bank containment and institutional and personnel adjustment cannot solve the negative externalities brought about by financial supervision competition, but will weaken its institutional competitiveness. See Feng Hui, *On Financial Supervision Competition and Its Legal Governance*, 3 The Jurist 110, 194 (2019).
[786] See Feng Hui, *On Financial Supervision Competition and Its Legal Governance*, 3 The Jurist 110, 110 (2019).
[787] No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance…See 15 U.S.C. § 1012(b).

interests of the policyholder, are generally considered as the ones under the category of the insurance business.[788] However, for a variable annuity which has apparent securities investment nature and is also being different from the variable annuity, the act, the issuance of such product by the life insurance company, does not belong to the "insurance business" under the *McCarran Ferguson Act of 1945,* which is particularly the case after the judicial evolution, the business of insurance is by and largely limited to three key elements, namely the transferring or spreading a policyholder's risk, the policy relationship between the insurer and the insured and the insurance industry.[789] Therefore, the variable annuity should be regulated by the federal government. If we view it from another aspect, judging from the response of the states in the US, the diversity of the insurance products and the expansion of the territorial scope of the insurance industry will affect the regulation of the insurance by a local state. After the "*Paul v. Virginia* Case," the competent authorities in all states established the NAIC in 1871. One of the purposes of setting up the NAIC was to promote the unification of the insurance regulations and to establish a nationwide insurance regulatory system.[790] The NAIC tried to unify the Insurance Acts of various American states and reduced the impact the different state acts may have on the insurance industry; the purpose was to maintain the regulation of insurance by the states and reduce the risk of federal intervention.[791] For example, to regulate the anti-fraud acts in the insurance industry, NAIC had already enacted the *Model Unfair Trade Practices Act* in 1947. This *Model Law* was either directly adopted by each American state and by the District of Columbia or clauses similar to it were formulated in the Insurance Acts of various states.[792]

However, the *Model Law* enacted by the NAIC has not weakened the competition for the regulation of variable annuity by the federal government. Thus, it can be concluded that since the launch of the variable annuity into the US market, there has been a competitive and yet cooperative relation between relevant regulatory bodies in that country when it comes to power for the regulation of variable annuity. The legal attributes of the variable annuity were led to the direction of the "regulation under securities" after the ruling made by the US Federal Court. Thus a pattern in which there

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788 See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1053 (1973).
789 See *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129,131 (1982).
790 Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 Florida State University Law Review625, 635 (1999).
791 See Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 Florida State University Law Review625, 640 (1999).
792 See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1029 (1973).

is a joint regulation of the variable annuity by the federal government and various states is formed.

5.3.2.2 The Measures Taken to Realize the Joint Regulation of the ILI and Governance of the Competition for Its Regulation

What has been stressed in this thesis is that from the academic theory level, the "out to be" regulation for the ILI, the necessity and rationality for the involvement of the CSRC in the regulation of the "investment account", and the CBRC should not take in hand all the regulatory power of the ILI; otherwise, it is not only inconsistent with the existing financial regulation logic for both the insurance and the securities, but also not in compliance with the current idea for the reform on financial regulation, hence it will fail to achieve really effective and reasonable regulation of the ILI. However, we can know from the above discussion that the US takes the way of filing up a judicial lawsuit in order to realize the joint regulation over a variable annuity. Now China is not a country where the case law is being followed, subject to the hysteresis quality of the statute law, and it is not feasible in reality if we intend to realize the joint regulation of the ILI through a court judgment. Therefore, it awaits a response from the legislation.

The response and acknowledgment in the fundamental laws on the investment attributes of the ILI should be made. The most significant barrier for the formation of a joint regulation over the ILI by both the CBRC and the CSRC is that there is no response and acknowledgment in the fundamental laws on the investment attributes of the ILI. For one thing, "take facts as the basis and laws as the criterion" is the basic principle for the law applicable in countries where the statute law applies. For another thing, though officially, China has already announced long time ago that a socialist legal system with Chinese characteristics and consisted of a set of multi-layer legal norms, including laws, administrative laws and regulations, and local laws and regulations, has formed, based on the fact that the statute law has a natural hysteresis quality, it can not give a timely response to the "rule of law" which is required in the process of social development, especially in current society where the commercial transaction mode is evolving the new from the old, the circumstance where no law can be observed can be found everywhere. The lack of a response to the securities attributes of the ILI is one of such reflection. Currently, the response to the securities attributes of the ILI by the basic laws is the most potent way used to stop the dispute over this issue. For the ILI, from its creation to its development to this day, there have been repeated doubts about

its legal attributes and the application of relevant laws. In terms of the policyholder, the lack of acknowledgment of the ILI in the basic laws, and it is only limited to the application of the Insurance Law, the investment interests of the policyholders can not be protected by other laws, such as the securities law and trust law. When their rights and interest can not be legally protected, or when the investment account does not have an excellent performance, it is quite likely that large scale surrender incidents will occur or people seek relieves through non-legal approaches, such as making appeals to the higher authorities for help. This shall not be the "out to be" approach for the settlement of private disputes in a modern country with the rule of law. Secondly, in terms of the regulators, if there is no response from the fundamental laws on the securities attributes of the ILI, then it is unable to carry out an effective regulation over it. Although the CIRC has enacted some normative documents for the regulation of the securities attributes of the ILI, it has not specified this attributes. This ambiguous "handling" of the ILI is not an adequate response to the regulation of the ILI. Due to the lack of response from the fundamental laws, the CSRC also can not apply laws, such as the *Securities Act*, for the regulation of the ILI. Existing rules can not be applied either.

CIRC (CBRC) adopts rules similar to the information disclosure rules or separately promulgates some general rules and regulations with broadly defined contents and not impressive in terms of their actual effect, and also add the regulation cost.

Furthermore, due to the lack of provisions from the statute law, it has also resulted in the absence of a legal basis for the regulation of the investment account under the ILI by the CSRC, which is especially the case for the expansion of the scope of the securities under the *Securities Act*. For example, there is a view that the core of "looking-through" a product is actually about how to define the "securities" under the *Securities Act*.[793] The expansion of the scope of securities under the *Securities Act* or the adoption of the definition for "substantial securities" are considered to be the crucial points when it comes to the application of the laws to investment products, such as the ILI. Apart from that, in terms of the product itself, the ILI as a composite financial product, throughout its development in China, sometimes, it is affirmed as an "innovation product," sometimes, it is suppressed as a problem product. This unreasonable phenomenon also awaits clarification from the basic laws. Therefore, the

[793] See Ye Lin & Wu Ye, O*n the "Look- through Supervision" of Financial Market*, 12 Law Science 12, 18 (2017).

response from basic laws is a fundamental issue for the effective and reasonable regulation of the ILI.

Secondly, a thorough play of the "strength" of the coordination function of the "the Stable Financial Development Commission under the State Council." For the joint regulation of the ILI, it is easy to have such problems, such as the subject to different regulation standards, threshold requirements, or the overlapping or competition for regulatory power. This is also a common problem being faced by the regulation of financial composite products. For example, in order to please the interest groups within their units and attract potential objects of regulation or expand their regulatory sphere of influence, regulatory bodies in the US are competing against each other in lowering down their standards of regulation – the so-called "competition for being inferior."[794] This is also something about the financial regulation in the US that draws the reflection from and reference by our scholars.[795] Therefore, aimed at the defects of joint regulation, it is of great importance for us to set up a unified and independent financial coordination body.[796] The goal of the coordination is not limited to the resolution of the allocation of powers in light of the competitive and cooperative relation found in their regulation; more importantly, it is about reviewing and finding solutions for overlapping or conflicting regulation rules. However, the Central Bank, a traditional powerful regulatory body, is not suitable to be designated as the coordination body for current competing financial regulatory bodies. The reason is not only because the current regulation mode, involving the Stable Financial Development Commission under the State Council, People's Bank of China, China Banking and Insurance Regulatory Commission and CSRC, has already been formed, it is also because that at the practice level, the Central Bank can not effectively fulfill its function for the coordination of regulatory competitions. The regulation functions of the traditional CBRC, CSRC and CIRC come from a constant deprivation of the same from the regulatory functions of the Central Bank, which results in a fact that their regulatory powers are constrained by the willing of the Central Bank as to separate or decentralize its powers, as well as by the institutional arrangement, which for one thing has formed the powerful position the Central Bank has been maintaining, and for another thing, it

[794] See Luo Peixin, *A Reflection on the Dilemma of American Financial Supervision Law and Policy*, 3 China Legal Science 91, 97 (2009).

[795] There are serious regulatory duplication and conflict in American financial regulatory system, which are often criticized by scholars. See Luo Peixin, *A Reflection on the Dilemma of American Financial Supervision Law and Policy*, 3 China Legal Science 91, 91 (2009).

[796] See Feng Hui, *On Financial Supervision Competition and Its Legal Governance*, 3 The Jurist 110, 122 (2019).

has also intensified the competition between regulatory bodies and their control of the market so as to transcend the constrains from the Central Bank, and strengthen each of their regulatory authority and their influence on the market.[797]

Viewing from the coordination bodies that have been established as of now, just as discussed previously, regulators in China have tried to establish an inter-departmental joint conference system for the coordination of financial regulation to improve the inadequate sharing of information between traditional regulatory bodies. However, it is only an initiative coordination mechanism advocated by the top regulation level. Hence there is no legal force in it, and its effect is not impressive at all for it has not fundamentally solved the issue with the traditional financial regulation system. The Stable Financial Development Commission under the State Council established in 2017 is different as more essential improvements have been made with it. Though it and the inter-departmental joint conference system for the coordination of financial regulation are the same in that both of them are considered as a kind of deliberation and coordination bodies, the two still have significant differences. First of all, from the founding of the "two bodies," the Stable Financial Development Commission under the State Council is higher than the interdepartmental joint conference system in both the official ranking and functional positioning. The former is titled "under the State Council" and is a functional body established pursuant to a proposal made in the National Financial Work Conference, it is a deliberation and coordination body used by the State Council to plan as a whole, as well as to coordinate significant issues concerning the financial stability and the reform and opening up.[798] The latter is led and advocated by the People's Bank and is also not an independent institution. The inter-departmental joint conference has no official seal and no written official notice will be issued by it.[799] Secondly, judging from the responsibilities and the tasks of the "two bodies," both of them stress the coordination in those aspects, including the financial regulation policies and cross-market financial innovation. However, the former lacks essential coordination in those aspects, including the regulatory functions, so it is not an option for seeking to have control over the systematic financial risk for cross-field financial

[797] See Feng Hui, *On Financial Supervision Competition and Its Legal Governance*, 3 The Jurist 110, 118 (2019).
[798] "The financial stability and Development Commission of the State Council was established and held it s first meeting",< http://www.gov.cn/guowuyuan/2017-11/08/content_5238161.htm >, latest visited on May 16, 2019.
[799] See "Reply of the State Council on Approving the establishment of the inter ministerial joint meeting system for financial supervision and coordination", < http://www.gov.cn/zwgk/2013-08/20/content_2470225.htm >, latest visited on May 16, 2019.

products and for new financial products.[800] Apart from that, "the Stable Financial Development Commission under the State Council" also examines the major plans for financial reform and development, plans as a whole the various functions and responsibilities involved in the financial reform, development and regulation, with a focus on macro-prudential regulation and the prevention of systematic risk.[801] The Stable Financial Development Commission under the State Council was established with the expectation to strengthen the macro-prudential management and the prevention of systematic risk on the part of the functions of the People's Bank.[802]

Thirdly, from the composition of the members, the staffing of the Stable Financial Development Commission under the State Council is much higher, i.e., the director is served by the Vice Premier of the State Council, while the other members are chiefly responsible persons in other regulatory bodies. Fourthly, viewing from the governmental institutions involved, the institutions involved in the "inter-departmental joint conference" are the People' Bank, CBRC, CIRC, CSRC and the State Administration of Foreign Exchange, while "the Stable Financial Development Commission under the State Council" also includes cooperation units, such as the State Committee of Supervisory of the People's Republic of China, the Organization Department of the Central Committee of the CPC, Ministry of Public Security of the People's Republic of China, Legislative Affairs Office of the State Council of the People's Republic of China, the Supreme People's Court of the People's Republic of China and many others.[803] It can be seen that if compared with any previous financial coordination bodies, the Stable Financial Development Commission under the State Council has more substantial improvement and it will play a substantial role of coordination for either different regulations or competing and cooperating relations found in the regulation of financial composite products, such as the ILI. For example, the first primary task after the founding of the Stable Financial Development Commission under the State Council was to facilitate the enactment of the *Guiding Opinions on Regulating the Asset Management Business of Financial Institutions* (No. 106 [2018]), in which it involves the regulatory authorities, such as the Central Bank,

[800] See Feng Hui, *On Financial Supervision Competition and Its Legal Governance*, 3 The Jurist 110, 116 (2019).
[801] "The financial stability and Development Commission of the State Council was established and held it s first meeting",< http://www.gov.cn/guowuyuan/2017-11/08/content_5238161.htm >, latest visited on May 16, 2019.
[802] ""National financial working conference held in Beijing, < http://www.gov.cn/xinwen/2017-07/15/content_5210774.htm >, latest visited on May 16, 2019.
[803] "The first meeting of the new financial stability and Development Commission of the State Council", < http://www.gov.cn/guowuyuan/2018-07/03/content_5303229.htm >, latest visited on May 16, 2019.

CBRC and CSRC, they made the unified adjustment on asset management business of financial institutions. They broke the previous phenomenon in which various departments enacted each of their regulations on asset management within their scope of regulation.

5.3.2.3 Different focuses on the regulation by the CBRC and the CSRC

The ILI is under the joint regulation carried out by the CBRC and the CSRC; therefore, there exists a certain competing and cooperating relation between them. Consequently, overlapping regulations can inevitably be found either in the extent or in specific content; however, the content and focus are different from each other. Hence it is not surely a mutually exclusive relation between them. Therefore, except to have a unified coordination organization or mechanism, there has to be a specified emphasis and contents concerning the regulation carried out by the two regulatory bodies. In doing so, it will, to the maximum extent, reduce the pressure and cost brought to the insurance companies as a result of overlapping regulation.

First of all, different focuses of regulation are found between the CBRC and CSRC, for the major contents of the regulation by the CBRC, it has to be an omnidirectional regulation with relatively complete contents covering business qualifications, product structure cost, product pricing, product sales, solvency margin ratio, liability reserve funds, separate management of the investment account and so on. The line of thought being followed is still the logic for indirect financing. The regulation over the liabilities management of the insurance companies, the primary contents of the regulation by the CSRC is chiefly about the possibility to invoke provisions on information disclosure from basic laws, such as the *Securities Law* and *the Securities Investment Fund Law*, thus to enable the regulation over the investment account of the ILI, for example, the registration of it in accordance with the procedures for the registration of fund investment. The regulation of the investment account by the CSRC mainly includes information disclosure, antifraud, and sales practice.

Secondly, the prevention of financial risk and the improvement of the regulatory measures for ILI. At the legal level, what has been reflected by the ILI are many contracts signed between an insurance company and many unspecific purchasers – the existence of a group of deed holders. This makes it possible that the business and investment performance of the insurance company may directly affect the interests of

many unspecific purchasers. More often, it is easy to cause sensitive issues among many purchasers due to information asymmetry. In this context, the bandwagon effect appears, they buy or surrender together in a large number of people over the same period. Moreover, circumstances, such as the mutual investment and multi-layer nesting, are found between investment accounts, which extends the chains for the use of the insurance funds; risks at various links may easily spread far-wide. Once there is any large scale breach, the legal effect it generates may not be limited to an internal spread within the product, but to spread out to the outside of the product; hence there is a possibility that this may give rise to financial risk. The prevention in this aspect has been discussed in the foregoing paragraph. China mainly has two regulation tendencies, namely the "campaign" or "selective," which are not appropriate to be used as the major means of regulation. In other words, in terms of the direction of future improvement, except for the improvement in the regulation idea discussed previously, improvements should also be made on the regulation means and method. For example, approval and penalty are no longer considered as the most important and most frequently used regulation means, instead, we should introduce in a large quantity either those professional and information based regulatory tools, i.e., information disclosure, credit rating, etc. or those dynamic and routinized regulatory tools, e.g., risk monitoring and crisis alerting.[804]

5.4 Chapter Summary

This chapter mainly analyzes the supervision over ILI by the public power (involving no self-supervision), and discusses improvement measures.

In terms of the supervision conducted by the public power, there is a special background of the times and causes, which the CIRC's power to supervise ILI is formed. They are mainly shown by the following. ILI has been introduced as a new type of life insurance under the advocacy of the CIRC. Moreover, the CIRC had included ILI into its authorized scope of supervision by the enactment of a series of normative documents at the beginning of this century, a time when the CSRC had just formed a unified nation-wide securities regulatory institution, and it was also during a special time, which did not allow it to consider the securities features of ILI.

[804] See Feng Hui, *On Financial Supervision Competition and Its Legal Governance*, 3 The Jurist 110, 120 (2019).

The supervision of ILI by the CIRC is mainly through the adoption of a line of thought for information disclosure, which is similar to that for the securities investment fund, as well as through a number of other means, including the strict supervision over the sales of it. Those methods are considered as an actual acknowledgment of the securities attributes of ILI and a conclusion of the lessons learned from the large-scale policy cancellation event. However, the indecisive attitude being maintained by the CIRC toward its understanding of the attributes of ILI, and also many self-contradictory points are found in its regulatory rules. Consequently, it is easy to get trapped in such a situation where "laissez-faire may bring chaos, but manage and control may suppress its development." This supervision situation is because of the insufficient supervision, which has resulted from breaking away from the traditional "separated operation and classified management" by ILI, as a new composite financial product. In terms of the improvement on supervision, the direction of the supervision over ILI should be guided by the idea of functional and conduct supervision in which joint supervision with different focuses are carried out by the China Banking Regulatory Commission and the CSRC, so as to realize the target of strengthening the protection of financial consumers, such as the policyholders, and the prevention of financial risks.

Chapter Six The Improvement of the Application of Rules: Taking Anti-fraud Content as the Main Analysis

Since the investment-linked insurance covers fields including the insurance, securities, and trust, it involves the application of rules at multiple legal hierarchies, i.e., fundamental laws, administrative laws and regulations, departmental rules and notices. In this thesis, it is difficult to discuss the application of each of those specific rules; otherwise, one thing is likely cited, and ten thousand may have been left out. Meanwhile, the main dispute of investment-linked insurance is sales fraud in practice. Thus, the discussion of the law application for investment-linked insurance in this chapter is mainly focused on relevant "anti-fraud" transactions and the application of supervision rules, including some analysis and discussion on some other rules.

6.1 Good Faith Provisions in *Insurance Law* and Its Supervision Regulations

Investment-linked insurance has brought many challenges to many provisions in the *Insurance Law*, which can not be applied unless they are duly interpreted. In the following paragraph, we will take the application of the obligation to tell (Article 16) and the obligation to explain (Article 17), which are from the *Insurance Law,* as our chief analysis, but include the analysis of corresponding supervision rules as well.

6.1.1 The Policyholder's Obligation to Tell

6.1.1.1 The time, subject, and content for the performance of the obligation to tell

As for the time for the performance of the obligation to tell, Article 16 of the *Insurance Law* stipulates that in the event of concluding an insurance contract, the policyholder's obligation to tell should be performed at the time of concluding the insurance contract.[805] The risk that occurred before the "promise" is made, but after the "offer" is received, the policyholder should assume the obligation to tell in the event of increased risk, as stipulated in Article 52.[806] However, this "additional notification"

[805] See Li Yuquan, *Insurance Law*, (Beijing: Law Press, 2003), p.60.
[806] See Zhong Weiheng, *A Study on the Duty Of the Policyholder to Tell the Truth*, 6 Journal of Comparative Law 38, 43(2010).

requirement is too harsh for the policyholder, and it conflicts with the notification-mode, "ask & answer." The time of notification should be the time when the contract is concluded or the time when the intention to conclude the contract is expressed.[807] Article 16 of the *Insurance Law* stipulates that the obligation to tell is limited to the conclusion of an insurance contract and that the "scheduled period" for the right to terminate the contract should be calculated from the date the contract is established. Thus it can be seen that in legislation, the obligation to tell exists as a pre-contract obligation. The period from the time the parties concerned are negotiating, meeting, or preparing for the signing of a contract, till the time the contract takes effect, is the duration stage for pre-contract obligation. In other words, pre-contract obligations can only exist in this specific stage.[808] Therefore, the time for the performance of the obligation to tell should limit to the time when the contract is concluded.

As for the performing subject of the obligation to tell, Article 16 of the *Insurance Law* stipulates that such subject is the policyholder, but remains unspecific as to whether the insured should be regarded as the subject of the obligation to tell. It is a legal loophole in legislation that China's *Insurance Law* has not covered the issues relating to the insured's obligation to tell what is known to it.[809] This thesis holds that irrespective of the traditional life insurance or the investment-linked insurance, the subject of the obligation to tell should all include the policyholder and the insured. It is worth noting that the "dichotomy" in the Anglo-American law system, means the parties to a contract are "the insured" and "the insurer." The "insured" as in the US law all refer to the persons whose losses may trigger the insurers' obligation to pay. The confirmation method in this regard in general is to specify whose lives, properties or other interests are being protected, i.e., for an insurance in general, the insured refers to the party concerned that signs the contract with the insurer, however in the life insurance, when the life of another person is insured, the one that signs the contract with the insurer is the policyholder.[810]

[807] See Li Fei, *A Critical Review of the Duty of Disclosure in Insurance Law*, 1 Chinese Journal of Law 140, 147-148(2017).
[808] See Fan Jun, *The Connection between Prior-Contract Obligation and Other Related Duties of Contract*, 1 Fudan Journal (Social Sciences Edition) 136, 137(2006).
[809] See Zhong Weiheng, *A Study on the Duty of the Policyholder to Tell the Truth*, 6 Journal of Comparative Law 38, 39(2010).
[810] See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), p. 145.

The reason we have problems with the performing subject of the obligation to tell lies in Article 10 of the *Insurance Law*, in which it stipulates that in case the parties to an insurance contract are the policyholder and the insurer, based on the principle of relativity for contract, the insured, as the relevant part to a contract, rather than the party concerned to a contract, shall not have an obligation to tell the insurer. However, Article 12 (5) of the *Insurance Law* stipulates that the insured is the object being protected by the insurance contract, and has the right to claim insurance benefit, which shall be provided to the insured only if there is any damage occurred to it, and that the insured is the original beneficiary of the right to claim insurance benefit, and in the event, the beneficiary is a third person other than the insured, then this third person is the successor of the beneficiary. To prevent moral risks, Article 12 of the *Insurance Law* stipulates that for the policyholder to buy insurance for the insured, there must be insurable interests involved.[811] It can be seen that under the right and obligation structure of the insurance contract in China, though the policyholder, as a party concerned in a contract, bears contractual obligations, such as the payment of the premium, there is no doubt, it can directly enjoy the right to claim insurance benefit if it is the insured party. However, if an insurance contract, in which the insured is another person, is signed by the policyholder, the one that directly enjoys the right to claim insurance benefit is the insured rather than the policyholder. This contract is a third-party beneficiary contract signed for the benefit of another person.[812] The insured, not being a party to the third-party beneficiary contract, enjoys the right to raise a claim for the insurance benefit, but not necessarily means that it does not assume any obligation.

However, if Article 16 (1) of the *Insurance Law* limits the performing subject of the obligation to tell the policyholder, then it will violate the principle of “consistency” between rights and obligations of a party concerned and the legal fairness.[813] Because the insured could not be more explicit about those aspects of them, including their health status and anamneses, if they are not the subjects of the obligation to tell, then this will increase the difficulties for the insurer to acquire real information about the insured, it is likely that this will not realize the original value of this institutional system and the regulatory purpose. Therefore, based on the principle of “consistency” between

[811] See Article 31 of Insurance Law.

[812] See Fan Qirong, *Reflection and Prospect of China's Insurance Legislation,* 6 Studies in Law and Business 63, 67-68 (2011).

[813] See Li Fei, *A Critical Review of the Duty of Disclosure in Insurance Law*, 1 Chinese Journal of Law 140, 155(2017).

rights and obligations, Article 16 (1) of the *Insurance Law* should include the insured into the scope of the performing subjects of the obligation to tell. When the policyholder buys the investment-linked insurance, not only he or she needs to perform his or her obligation to tell, but the insured also needs to assume the same obligation.

Article 16 of the *Insurance Law* stipulates that in the event an insurer asks about the subject-matter insured or relevant conditions concerning the "insured," the policyholder should tell faithfully. "Relevant conditions" are usually considered as "important matters" – mainly those that may have impacts on risk assessments. For example, the reason the insurer must increase the premium for subject-matter to be insured must because the occurrence of such matter has decisive impact;[814] or the untold matters have no causal relationship with the occurrence of insurance accident. However, since the basis for the judgment of those "important matters" is the subjective judgment of the insurer or the objective judgment, different opinions may exist. Some people argue that the subjective standard does not help urge the insurer to improve their risk assessment capabilities, and it is also challenging to prove, which it is easier to cause malicious rejection of claims by the insurer.[815] Some scholars also maintain a suspicious attitude towards this, from the perspective of the principle of the balance of consideration, it is quite reasonable to hold that the subjective standard is relative to an objective standard.[816]

This thesis holds that subjective standard is more appropriate and that we should refer to the "subjective judgment" of the insurer to determine "important matters", which is that in the context of written inquiry, all the inquired matters should be the content to be told.

First of all, the scope of content to be inquired by the insurer is not infinite. The CIRC requested the insurer must make inquiry in writing,[817] and also at the technical level, the "possible capacity" of the scope of the inquiry conducted by the insurer is limited. In practice, this is mainly done by ticking "yes" or "no" in the columns containing contents to be notified.

[814] See Jiang Chaoguo, *Basic theories of Insurance Law*, (Beijng: China University of Politic Science and Law Press, 2002), p.82.
[815] See Ma Ning, *The Obligation of Telling the Truth in Insurance Law*, 1 Political Science and Law 58, 62(2014).
[816] See Li Fei, *A Critical Review of the Duty of Disclosure in Insurance Law*, 1 Chinese Journal of Law 140, 145-146(2017).
[817] See Article 2 of *Announcement of China Insurance Regulatory Commission on Reminding Personal Insurance Policyholders to Perform the Obligation to Tell*, CIRCNo.55[2003].

Secondly, viewing from the consideration of the contract, the matters to be inquired by the insurer has become part of the contents in the standard form of the insurance contract. The scope of the issues obliged to be told has in fact been counted, clarified and then presented in consideration of premium through mathematical techniques, such as the law of large numbers applied on risks. In such circumstances, the choice of the policyholder to enter into a contract means its approval of the content of the contract, and the binding force is thus formed, and the corresponding obligation to tell for a specific individual case should further be performed. Where the insurer has not inquired, even if the policyholder knows about some matters that might be important, it may choose not to tell.[818] Since some of the important matters are up to the determination of the insurer, those important matters should be included into its consideration when designing the product, the responsibility of its negligence of failure to inquiry important matters shall not be passed on to the policyholder.

Thirdly, the external environment of the obligation to tell has also made it unnecessary to have too much concern over the possibility that the insurer may expand its inquiry of "important matters infinitely." Because in the market economy environment, competitions are found between various insurers and their products, products of the same type in the market will automatically form a hidden general reference standard for "important matters," if an individual insurance product has too many matters included as "important," which has exceeded the general standard, it will be too harsh in terms of the scope of the obligation to tell. It will loose its competitiveness and be weeded out in the market. Moreover, the trend of enhancing the protection of the insurance consumer, as well as the unfavorable contractual interpretation made against the insurer in case there is any doubt over the insurance clauses (Article 30 of the *Insurance Law*), all of them have provided a prevention mechanism for the subjective judgment on "important matters" relating to the obligation to tell. Besides, there are matters which the policyholder is not obliged to tell. Article 16(6) of the *Insurance Law* has stipulated the circumstance in which the insurer has known the policyholder's failure to perform the obligation to tell faithfully at the time the contract is concluded. Also, after the establishment of an insurance contract, if the insurer either knows or should have known the policyholder's failure to

[818] The insurance company has waived the inquiry of the policyholder about the relevant situation, and the policyholder is not required to perform the obligation accordingly. See *Ping An v. Zhang Hong*, Hubei Court No.47[2018].

perform the obligation to tell faithfully, he still charges the premium, then it shall not terminate the contract based on this.[819] Therefore, it is more reasonable if "relevant circumstances" relating to the obligation to tell is up to the insurer's subjective judgment.

6.1.1.2 Legal consequence for the violation of the obligation to tell: the distinction between "risk premium" and "investment premium"

The investment-linked insurance contract is signed between the policyholder and the insurer, though the fund that enters into the investment account is in the name of "insurance premium," it is different from the risk premium in the traditional sense. Therefore, it is necessary to differentiate between "risk premium" and "investment premium" among the premium paid by the policyholder and further distinguish between different legal effects for the two in the event the contract becomes invalid by following the line of thought – "substance over form," which is analyzed in the preceding paragraph.

6.1.1.2.1 The "risk premium" to analogize the "return effect" of the premium of the traditional life insurance

The violation of the obligation to tell by the policyholder or the insured may result in the invalidity of the contract. Article 16 (2) of the *Insurance Law* stipulates that where the policyholder fails to perform the obligation to tell, deliberately or due to gross negligence, the insurer shall have the right to terminate the contract. Also, this clause further differentiates different legal consequence at the different subjective state of the policyholder, "deliberateness," or "gross negligence" – In Sub-article 5 of that Article, it stipulates that where it is under the "deliberate state of mind," except that the insurer shall have the right to terminate the contract, it also shall not assume the liability to pay the insurance benefit and will not return the premium;[820] where it is under the circumstance of "gross negligence," the insurer shall have the right to terminate the contract and shall not assume the liability to pay the insurance benefit, but shall return the premium.

[819] See Article 7 of the *Judicial Interpretation to the Insurance Law (II)*.
[820] See Wu Yiwen & Pan Chongyang, *On the Private Law Effect of Claim Fraud in Insurance Contracts*, 7 Insurance Study 101, 101-110(2016).

Thus it can be seen that for the legal consequences relating to the performance of the obligation to tell as contained in Article 16 of the *Insurance Law*, it can be differentiated as the followings: If the policyholder and the insured have faithfully performed the obligation to tell, then the insurer shall assume the insured liability; if the policyholder and the insured, either deliberately or due to gross negligence, fail to perform the obligation to tell, the insurer will not assume the insured liability. For the abovementioned legal consequences relating to the performance of the obligation to tell, the insured liability bearable by the insurer exists in two forms only – either assume it or not to assume it, the "either all or none" mode.

However, some defects can be found in this mode. For example, general negligence exists in the performance of the obligation to tell by the policyholder and the insured, and it remains unspecific if this has any impact on the assumption of the insured liabilities by the insurer. If it is analyzed from the principle of the consideration of the contract and the principle of the balance of the consideration is used as the basis for the explanation, then the general negligence found with the policyholder should also be deemed as the basis for the evaluation of the legal effect, in other words, the "either all or none" mode (the legal consequences in the event of the violation of the obligation to tell in the context of the *Insurance Law*) should be changed to "corresponding adjustment" mode.[821]

We have scholars who point out that the protection of insurance consumers can not be realized fundamentally unless we stick to the principle of the balance of consideration.[822] German Scholar, Wilhelm Lexis put forward the principle of the balance of consideration. This principle stresses that the premium paid by the policyholder and the risks assumed by the insurer must be maintained a balance between their considerations, which, if expressed by a formula, is $P=\omega Z$ (P is purely the premium, ω is the accident rate, Z is the insurance benefit).[823] Thus it can be seen that P, the premium paid by the policyholder, is in positive relation with WZ; the larger the W or Z is, the higher the value of P is. This principle is in line with those characteristics of the insurance contract, including the compensational nature and

[821] See Li Fei, *A Critical Review of the Duty of Disclosure in Insurance Law*, 1 Chinese Journal of Law 140, 140 (2017).
[822] See Wu Yiwen, *Legal Regulation Path of Fraud During Insurance Contracting on Party of Insureds*, 5 Law Review59, 69 (2019).
[823] See Wilhelm Lexis, Allgemeine Volkswirtschaftslehre, Druck und Verlag von BG Teubner ,1910, p.563; Quote from Fan Qingrong, *Legal Provisions on the Return of Premium of Double Insurance under the Principle of Consideration Balance*, 6 Political Science and Law 130, 132(2015).

mutual obligation between parties concerned, showing that the obligation to tell itself has reflected the connotations in two aspects, namely, the risks evaluation and the balance of the consideration for an insurance contract. This requires that the risk assumed by the insurer shall be in mutual compensational relation with the premium paid by the policyholder, and the two are matching each other with balanced compensation. In other words, when concluding a contract, it is required that the policyholder should tell the insurer about the matters inquired by it for the convenience of evaluating the corresponding premium consideration for the assumption of the risks.

Therefore, the legal consequence relating to the obligation to tell assumed by the policyholder and the insured can be divided into four circumstances: First of all, if the policyholder and the insured has faithfully performed the obligation to tell, then the insurer shall assume the agreed insured liability; secondly, if the policyholder and the insured has deliberately concealed some confirmed health condition, then the insurer has the right to cancel the contract and is not obliged to return the premium. This "deliberateness" belongs to the acts of contractual fraud, and under Article 16 of the existing *Insurance Law,* the insurer is entitled to the right to terminate the contract. However, according to Article 54 (2) of the *Contract Law*, the insurer also has its discretion to interpret insurance contracts to be revoked. [824] In other words, under this circumstance, the insurer can determine the validity of contract based on its intention, if the insurer chooses to terminate the contract, then the contract becomes invalid eventually; if the insurer chooses to amend or revoke the contract, then the contract is not necessarily invalid. Judging from Article 8 of the *Judicial Interpretation to the Insurance Law (II)*, in the event the insurer has not exercised its right to terminate the contract, it shall not refuse to compensate directly on the excuse of the policy holder's "deliberateness" or "gross negligence", except for such circumstance where the parties concerned has achieved another agreement concerning the refusal to compensate or the existence of the insurance contract. It can be seen that the *Judicial Interpretation to the Insurance Law (II)* has interpreted the likelihood of a contract amendment as the legal consequence of the violation of the obligation to tell by the policyholder. Therefore, under the circumstance of "being deliberate," Article 16 (2) of the *Insurance Law*

[824] See Han Yongqiang, *The Misread of "Duty of Disclosure" in the Article16 of Insurance Law*, 2 Law Science 115, 124 (2010).

should be interpreted as that the insurer shall have the right to revoke the contract rather than having the right to terminate the contract.

Thirdly, in case the acts of the policyholder or the insurer have constituted gross negligence, the insurer shall have the right to terminate the contract and return the premium or amend the contract, i.e., charge an additional premium or lower down the payment of the insurance benefits in order to maintain the validity of the contract. Fourthly, in case the policyholder and the insured are found to have general negligence for some matters to be notified, based on the principle of the balance of consideration, the insurer should also be allowed to request an increase in the premium or a reduction in the insurance benefit amount to be paid; also, in order to prevent the insurer from easily terminating the contract even for general negligence by taking advantage of its dominant position, so that the purpose of this contract may fail. The interests of the beneficiary will remain unprotected, in case of general negligence on the part of the policyholder and the insured, the insurer can not terminate the contract or put an end to the contract through other means.

6.1.1.2.2 The explanation and basis for the return of the cash value for the "investment premium"

Irrespective of subject intent or gross negligence on the part of the policyholder, the legal effect as stipulated in Article 16 of the *Insurance Law* should only limit to the non-return of the "risk premium," but should not extend to an investment account, except for the legal consequence of the termination (or cancellation) of the contract. For the cash value of the capital in the investment account (the "investment premium"), it should be returned, and the reasons are analyzed as below:

Firstly, the existence of investment accounts is subject to the effectiveness of the insurance part of the content of the contract. Under normal circumstances, the dependency on the effectiveness of the "investment account" will be deemed as the necessary points of the investment-linked insurance contract. The so-called necessary points of the investment-linked insurance contract mean the factors in each contract type that determines the essence of that specific contract type, as long as those essential factors are identified, the Judge can apply laws or even makes additional explanations. For example, in the mutual obligation contract, payment, reciprocity, payment method,

and price are the necessary points.[825] This thesis has discussed in Chapter two that the investment-linked insurance contract should at least include three factors, namely "the provision of death or pure endowment insurance guarantee," "the specially established independent investment account," and "the complete assumption of the investment risk by the policyholder." All those three factors are the necessary points of the investment-linked insurance contract, wherein "the specially established independent investment account" is the carrier and real reflection of the investment attributes of the investment-linked insurance. Nevertheless, though the investment account has considerable independence, it is established under traditional life insurance and can not get rid of such character that its investment attribute has a reliance on the insurance part. Therefore, in case the "deliberateness" or "gross negligence" is found with the policyholder and the insurer, which results in the invalidity of the insurance content of the contract, based on the dependency of the "investment account," the ineffectiveness of the insurance content will directly cause the whole contract to be ineffective, which further causes the loss of the foundation on which the investment account exists, consequently, the legal relation in the investment account is also terminated thereafter.

Secondly, the premium paid by the policyholder is not completely used as the "consideration" of the insurance risk. As it is discussed previously, though the capital paid by the policyholder of the investment-linked insurance is under the name of "premium", the "premium" that once enters into the investment account is intended to obtain an increase in "the return on investment," rather than risk guarantee. Based on the "caveat emptor" principle – the self-sharing of the securities investment risks, the increase or the loss in "return," as yielded by the capital in that account, shall all be borne by the policyholder. In the process of performing the obligation to tell by the policyholder and the insured, if there is any "deliberateness" found with them, though the contract is invalid, the part that the insurer will not refund should only limit to the risk premium of the traditional life insurance, for the "premium" in the investment account, its cash value should be returned. The same principle applies under the circumstance of "gross negligence," which is that the contract will be terminated, and the premium refunded by the insurer should be the "risk premium" of the traditional life insurance and the cash value in the investment account, rather than the whole premium. Otherwise, when the policyholder is suffering from a loss in its investment,

[825] See Wang Hongliang, *Essential Parts of a Contract*, 6 Tsinghua University Law Journal 122, 122(2019).

it will claim the contract is invalid and request the return of all premiums and shift the investment loss to the insurer through this way.[826]

Thirdly, Article 32 of the *Insurance Law* should be applied by analogy as the basis for the return of the "premium" in the investment account. Article 16 of the *Insurance Law* stipulates that the legal effect of the contract termination is generated either under the circumstance of "deliberateness" or "gross negligence," and in either case, it involves the issue of how to return the "premium" in the account of the investment-linked insurance. As discussed in the previous paragraph, Article 16 of the *Insurance Law* should not be referred to for the handling of the return of the premium under the two circumstances, because the return of the premium in the investment account should be the return of cash value in the investment account. Article 32 and 47, among other Articles of the *Insurance Law,* are the clauses on the "return of cash value if the personal insurance contract is terminated. Among them, Article 47 stipulates that in case the policyholder terminates the contract, the insurer should return the cash value, however, if the circumstances of "deliberateness" or "gross negligence" are identified in the process of performing the obligation to tell, the one that enjoys the right to terminate is the insurer instead of the policyholder. Among the clauses of the *Insurance Law* that stipulate that the cash value shall be returned in case the contract is terminated, Article 32 is the one most similar to the rule to be followed for the return of the premium in the investment account if the "deliberateness" or "gross negligence" is identified in the process of performing the obligation to tell. This Clause provides that the insurer may terminate the contract and return the cash value if the age of the insured is not real. Thus we can see that this clause is similar to the "circumstance of deliberateness or gross negligence" in terms of the handling of the legal consequence. Also, Article 32 of the *Insurance Law* stipulates that if the insurer exercises its right to terminate the contract, Article 16 (3) and Article 16 (6) of this law shall apply. What has been stipulated by Article 16 (3) of the Insurance Law is the scheduled period set forth before the exercise of the right to terminate the contract by the insurer, whereas Article 16 (6) stipulates that if the insurer knows the reason why the policyholder has not performed the obligation, it shall not terminate the contract. In fact, those two clauses have reflected the insurer's sluggishness and waiver in exercising the termination right. This limitation is also applicable to the circumstances where the insurer has the right to terminate, as

[826] See Ye Qizhou, *Insurance Premium Repayment upon Voidable Investment-linked Insurance and Culpa in Contrahendo*, 6 Global Law Review 45, 50 (2014).

is stipulated in Article 32 of the *Insurance Law.* This suggests that Article 32 and Article 16 are correlated and tied up with each other. Therefore, Article 32 of the *Insurance Law* can be applied analogically as the basis for the return of the cash value of the "premium" in the investment account.

Nevertheless, it is worth noting that in the judicial practice of Taiwan, the unjust enrichment in the civil law is still often considered as the basis for the return of the premium in case the investment-linked insurance contract becomes invalid.[827] Under this line of thought, the insurer, as the bonafide recipient of the unjust enrichment, is not obliged to return the capital loss for the loss arising out of the investment account, whereas if earnings have been acquired from the investment account, then the insurer should return that earnings to avoid making an additional profit out of it. This line of thought is referable to some extent. However, its rationality is also worth discussing. Because on the premise that the contract might be invalid under certain circumstances and the rule that the one in possession of the capital in the investment account is the one who owns it, the insurer, as the "manager" of the assets in the account, carries out outward investment operation, but is still existing as the nominal owner of the capital in the investment account of the investment-linked insurance. Under this circumstance, the insurer's role of the owner of the capital in the investment account is based on the factual basis of the "ownership", and will not "vanish" because of the invalidity of the investment-linked insurance contract. The earnings or losses arising out of the capital in the investment account operated by the insurer are all difficult to be explained as the loss or earnings acquired by the insurer from unjust enrichment. Therefore, it is inappropriate if the legal consequence for the return of the "premium" in the investment account is to be handled using the unjust enrichment as the basis of the right to make claims.

6.1.2 The Insurer's Obligation to Explain

6.1.2.1 The irrationality of explaining "the provisions on self-bearing of the investment risk" as the exceptions

As it has been discussed in Chapter Two, in the investment-linked insurance, if the insurer is only limited to the objects of the obligation to explain, prescribed within the

[827] See Ye Qizhou, *Insurance Premium Repayment upon Voidable Investment-linked Insurance and Culpa in Contrahendo*, 6 Global Law Review 45, 50 (2014).

framework of the original insurance law, then it cannot be sure that the signing of the insurance contract by the policyholder is based on thorough understanding. Therefore, the objects of the obligation to explain must be extended to the investment part of the contract. Of course, the information provision system of the investment-linked insurance contract can not completely depend on the obligation to explain, but should further apply by analogy a number of systems adopted by the *Securities Law*, such as the information disclosure system (application analysis will be carried out in the following paragraph). Here, this thesis intends to discuss the application of the "obligation to explain bearable by the insurer" in "the provisions of the investment-linked insurance contract on self-bearing of the investment risk."

In general, the self-bearing of the investment risk will be provided in the investment-linked insurance contract, e.g., "the policyholder can choose investment account, but the policyholder will completely bear the investment risk."[828] In fact, "the provisions on the self-bearing of the investment risk by the policyholder," as the critical point that differentiates the investment-linked insurance product from other insurance products, is also the most crucial clause in a contract.

Therefore, in judicial practice, the court, in general, requires an explanation made on the provisions of the investment-linked insurance contract on "self-bearing of the investment risk." The general line of thought as adopted in judicial practice: Article 17 of China's *Insurance Law* explicitly provides that the "contents to be explained" are the exceptions – "the clauses contained in an insurance contract that exempts the insurer from assuming responsibilities," so the court usually explains the "provisions on self-bearing of the investment risks" as "exceptions," and further determines if the insurer has duly performed the obligation to explain.[829] The question is that "the self-bearing of the investment risk" is largely different from the "exceptions" on the part of the insurer by their connotations. Also, this clause has not stipulated the "exceptions" part in the contract, then under the circumstance that the investment-linked insurance is not covered in the *Insurance Law*, apparently, it will have law application problem, if the exceptions are applied in this clause to determine further the insurer's obligation to

[828] See "Haier New York Life Investment-link Insurance Clauses".
[829] See China Insurance Association, *Annual Report on Typical Cases of Insurance Litigation*, (Beijing: Law Press, 2013),p.54-58.

explain. This irrationality in terms of the law application is mainly listed in the followings:

First, the connotation of "exceptions" is different from that of "the provisions on self-bearing of the investment risk." Article 17 of the *Insurance Law* of China divides the contents of the obligation to explain general standard clauses and exceptions. For the general standard clauses, the insurer should give instruction and explanation, whereas for the exceptions, the insurer must give special prompts and explanations. It can be seen that the main contents is regulated by the "obligation to tell" are the exceptions in the standard contract. The principle is that the significance of the practice of *Insurance Law* in stipulating that the insurer must make the prompt or specific explanation in order to apply the exceptions is to reveal or expound the meaning of the contractual clauses,[830] and manifests the importance of those exceptions on the decision of the policyholder to conclude a contract.[831] Therefore, as a pre-contract obligation of the insurer based on the good faith principle, it should also inform the policyholder of the contents of exceptions and ask the policyholder to be careful or even help the policyholder to understand it correctly.[832] However, the "provisions on self-bearing of the investment risk" are stipulated as a reflection of the self-sharing of the risks relating to securities investment - the "caveat emptor" principle.

Secondly, the scope of "exceptions" is quite controversial. For example, some people hold the viewpoint that "exceptions" that must be included by the obligation to explain should undergo an extensive interpretation, including not only the clauses that exempt the insurer from assuming responsibilities, but should also include the clauses that limit the responsibilities of the insurer, e.g., the clauses with conditions or terms.[833] Also, some people believe that the exceptions should mainly include three categories: No liability for compensation clause, limited responsibility clauses, and clauses with those effects, such as the one relating to the effectiveness of the contract.[834] Thus it can be seen that for the "insurer's exceptions," which are stipulated by Article 17 of the *Insurance Law* as the ones requiring specific explanations, there are many differences of opinion on the extension of it. Different understandings about this are also found in

[830] See Wen Shiyang, *Study on the Obligation of the Insurer to Explain*, 2 Juridical Science Journal 16, 17 (2001).
[831] See Yu Haichun, *Research on the Protection System of Insurance Consumers' Rights and Interests*, (Beijing: University of International Business and Economics Press, 2015), p.174.
[832] See Zou Hailin, *New Development of Insurance Law*, (Beijing: China Social Sciences Press, 2015), p.194.
[833] See Zou Hailin, *New Development of Insurance Law*, (Beijing: China Social Sciences Press, 2015), p.182.
[834] See Liang Peng, *Performance of Explaining obligations under New Insurance Law*, 7 Insurance Study 13, 13(2009).

judicial practice. For example, the Jiangsu Higher People's Court holds that "disclaimer of liability", "exclusions", as well as other clauses which partially or wholly exempt the insurer from the responsibility of compensating or paying insurance benefit, such as those on "excess rate" or "excess amount", are exceptions stipulated by Article 17 of the *Insurance Law*.[835]

However, regardless of how the scope of "exceptions" is being extended in the paragraph mentioned above, all of them are carried out with a focus on "insurance accidents". The exceptions contained in the *Insurance Law* are aimed at liabilities that are exempted from being assumed by the insurer, as found in the traditional products. In other words, insurance liabilities clauses are risk-guarantee clauses, whereas the "exception clauses" are mainly targeted at risk exclusion matters.[836] Under the investment-linked insurance, the risk borne by the insurer is not the risk guarantee assumed by the insurer of the traditional life insurance. If the "provisions on self-bearing of investment risk by the policyholder" are deemed as the "exceptions," they are not in conformity with the scope of "exception clauses."

Thirdly, if this Article is deemed as an "exception clause," it may result in some irrational legal consequences. According to Article 17 of the *Insurance Law*, for exceptions to which the insurer gives no prompt or specific explanation, this clause will not take effect. Therefore, the practice of regarding the "provision on self-bearing of the risk relating to investment account by the insurer" as the "exception," if the court identifies that the insurer has not performed the obligation to explain, and the court further affirms this "clause" as being invalid, then the risk in the investment account will thus be transferred to the insurer, which violates the "caveat emptor principle" set forth for securities investment risk, and is also not in conformity with the economical operation of the investment-linked insurance itself, and will also bring unfairness in terms of the allocation between rights and obligations.

Therefore, it can be known that since the connotation of the "provisions on the self-bearing of investment risk by the insurer" has evident difference with that of the "exceptions" of the traditional insurance, it is not appropriate if the line of thought, the use of "exceptions" as the "obligation to explain" bearable by the insurer against the

[835] See Article 1 of Summary of Discussions of Jiangsu Higher People's Court on Several Issues Concerning the Trial of Insurance Contract, No. 1 [2011].
[836] See Ma Tao, *Research on Judicial Cognizance of Exemption Clauses in Insurance Contract*, 3 Law and Economy 93, 95(2015).

"provisions on the self-bearing of investment risk." If the "provisions on the self-bearing of investment risk" is not deemed as the "exception clause," then the insurer will not be restricted by "specific explanation" – as found in Article 17 of the *Insurance Law*. If under this circumstance, it will put the policyholder in a disadvantageous position, and it is easy to cause sales fraud. Therefore, for the explanation on the "provisions on the self-bearing of investment risk," Article 17 of the *Insurance Law* is now facing a dilemma, in other words, based on the complicated nature of the investment-linked insurance and the necessity of the insurer's obligation to explain, but in Article 17 of the *Insurance Law*, the prescription of the obligation to explain from the perspective of the "standard clauses" or the "exception clauses" is inappropriate. And for that, this thesis holds that considerations and improvements may be done from the standard of "important matters" for the performance of the obligation to explain. In the following paragraph, we will give further analysis from the perspective of foreign laws.

6.1.2.2 Reference and enlightenment from the foreign regulations

In the context of the US law, whether or not the insurer has an obligation to explain to the insured about what is being guaranteed by the policy. Many courts hold that if the policy is clearly written without any ambiguity and people will understand it even at first glance, then the insurer is not positively obliged to explain it to the insured.[837] However, the insured are nothing but ordinary consumers and have pitiful little knowledge and understanding about what can be guaranteed by the insurance.[838] The insurer can not grab unfair interests from any transaction, and the court will give the verdict that the insurer shall pay the insurance benefit based on the rational expectation of the insured even if there is no such provision on the policy.[839] In other words, there is a reasonable expectation principle in US law.[840] The Court should respect the objective expectations from the insured or the beneficiary on the insurance contracts,

[837] See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), p. 45.

[838] See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), p. 22.

[839] "Unequal bargaining power between insurers and insureds very early gave rise to common law doctrines prescribing rights against insurers outside the terms of the insurance contract". See Keeton, Robert E., *Insurance Law Rights at Variance with Policy Provisions*, 83 Harvard Law Review 961, 961-985(1970). See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), p. 22.

[840] The connotation of the principle of reasonable expectation is uncertain, and its application is controversial. See Clarke Malcolm A., *Law of Insurance Contracts*, (Beijng: Peking University Press, Chinese translation edition, translated by He Meihuan,etc., 2002), p.355.

even if the stringent terms on the policy do not support those expectations.[841] Currently, at least two-thirds of the courts in the US adopt reasonable expectations principle.[842] This principle can impel the insurer to give more information on the insurance provided to the insured, if the insurer has misled the expectation from the insured, then this principle can correct it and promote the contractual fairness.[843] We have scholars who have further pointed out that the focus points of this principle are the "formulation of the policy clauses" and "contracting process," wherein, at the contracting process, the insurer should proactively perform the obligation to give prompt and alert on policy clauses. This "ex-post judicial relief" provided to the insured, in fact, have played the effect of a "beforehand regulation" over the insurer's abuse of its institutional superiority and contract freedom.[844]

However, the court has noticed that not all the insured have equal capabilities.[845] In the reasonable expectation of the application of interpretation rules, more often, the insurer will file a plea on the ground of the "sophisticated policyholder" – reasonable expectations principle does not apply to this group, most courts have not adopted this plea when applying this principle.[846] Because rather than concluding that the "sophistication factor" found in the insured determines whether or not the reasonable expectations principle is applicable, it is better to say that it is a factor that affects whether or not the expectation of the insured is reasonable.[847] For this, we have scholars who further argue that the US law adopts "the prudent insured" in describing the contents that the insurer should explain, and defines the matters that draw attention from the "prudent insured" as "material test" – whether factors, including the knowledge

[841] "The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations." See Keeton, Robert E., *Insurance Law Rights at Variance with Policy Provisions*, 83 Harvard Law Review 961, 967 (1970).
[842] See Robert H. Jerry & Douglas R. Richmond, *Understanding Insurance Law*, (Beijing: Peking University Press, Chinese translation edition, translated by Li Zhiyan, 2009), pp. 20-21.
[843] See Clarke Malcolm A., *Law of Insurance Contracts*, (Beijng: Peking University Press, Chinese translation edition, translated by Wu Meihuan,etc., 2002), p.356.
[844] See Fan Qirong, *On the Principle of Reasonable Expectation in American Insurance Law*, 3 Studies In Law and Business 117, 122 (2004).
[845] "courts have increasingly noted that not all insurance policyholders are equal." See Jeffrey W. Stempel, *Reassessing the Sophisticated Policyholder Defense in Insurance Coverage Litigation*, 42 Drake L. Rev. 807, 808 (1993).
[846] See Jeffrey W. Stempel, *Reassessing the Sophisticated Policyholder Defense in Insurance Coverage Litigation*, 42 Drake L. Rev. 807, 808 (1993); Fan Qirong, *Problems and New Prospects of Insurance Law*, (Beijng: Peking University Press, 2015), p.131.
[847] See Fan Qirong, *Problems and New Prospects of Insurance Law*, (Beijng: Peking University Press, 2015), p.135.

structure of the "prudent insured" are the significant matters that may affect the insured's decision to buy insurance.[848]

In the Japanese law, though the *Financial Instruments and Exchange Act* has not specified the obligation to explain which is bearable by the institutions represented by the financial instrument traders, the precedents and general theories have all believed that in order to engage in the financial business in pursuant to Article 1 of the *Civil Act*, the principle of honesty and trustworthiness, and Article 36 of the *Financial Instruments and Exchange Act,* the honesty and fairness, the financial instrument traders must bear the obligation to explain.[849] Also, Article 37 of the *Financial Instruments and Exchange Act* regulates the obligation to explain on the part of the financial instrument traders by stipulating the submission of written obligations before the conclusion of the contract for the trading of financial instruments. In other words, for its customers, financial instrument trader has the obligation of submitting written obligations, which mainly includes the submission of the obligations (e.g., business license number of the trader, name, residential address, etc.) in writing before contract concluding according to Article 37-3, the submission of the obligations in writing during contract concluding according to Article 37-4 and the submission of the obligations in writing at the receipt of the security deposit according to Article 37-5, as well as the submission of the obligation in writing concerning the best execution policy as stipulated in Article 40 of that Act.[850]

Relatively detailed provisions on the insurer's obligation to explain are provided in Japan's *Consumer Contract Act*, *Act on Sales, etc. of Financial Instruments* (the act was reformed and renamed to the *Act on Distribution of Financial Services* in June 2020),[851] and *Insurance Business Act.* In Article 3 of the *Consumer Contract Act,* the trader must try their best to provide information that is necessary to the contract, such

[848] See Yu Haichun, *Research on the Protection System of Insurance Consumers' Rights and Interests*, (Beijing: University of International Business and Economics Press, 2015), p.178.
[849] See Zhou Jianlong, *The Behavior Regulation of Financial Commodity Transaction in Japanese law*, 29 Commercial Law 76, 77-78(2016).
[850] As for the insurer's obligation to explain, Japanese Financial Supervision Bureau has stipulated that firstly, we must stress that unit linked insurance is an insurance financial commodity with risk, and we must explain in greater detail the particularity of that product. Secondly, we should provide the policy-holder with the insurance company's overall financial operation condition and the information with respect to the use of the special insurance fund (for investment purpose). Thirdly, it must state in the Product Plan that three sets of interest rate scheme must be provided to the policyholder at the same time. See Yinhua Sha, *A Review of Japanese Insurance Cases*, (Beijing:Law Press, 2011), p.78.
[851] See <https://www.fsa.go.jp/common/diet/index.html>,<https://www.fsa.go.jp/common/diet/201/01/shinkyuu.pdf>, latest visited on Oct. 22, 2020.

as those concerning the rights and obligations of the consumer.[852] Article 4 of that act defines “important matters” as those decisive matters about the consumer contract and has an impact on the decision of the general consumer to conclude a consumer contract.[853] Also, Article 2 of the *Act on Sales, etc. of Financial Instruments* (enacted in 2000) has included an “insurance contract” into its adjustment scope.[854] Article 3 of that act stipulates that the following matters should be explained: the matters that will result in a loss of the principal, e.g., change in the interests of the financial commodities, currency price or fluctuation of the market conditions of other negotiable securities; the change in the business or the financial status of the trader; or the selling of the financial instrument affects the judgment of the customer; the term of the rights and restrictions set forth concerning the sales of a specific financial instrument.[855] In June 2020, this Act was reformed and renamed to Act on Distribution of Financial Services. These provisions were kept in Article 3 and 4 in the new act. Apart from that, Article 300 (1) of the *Insurance Business Act* has stipulated several circumstances for improper explanation: forbid false explanation or give no explanation to important matters concerning contract clauses, forbid the provision of comparative information for insurance contracts in different types as it may cause misunderstanding, prohibit from making affirmative judgment over uncertain dividend or return, etc.[856] Therefore, it can be seen that Japanese laws are focusing on “important matters” when it comes to the “contents” of the obligation to explain. “Important matters” are set in the core

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[852] “a trader must also endeavor to provide the necessary information about those contract details when soliciting a consumer to enter into a consumer contract, in order to deepen consumer understanding.” See Section 3 of the *Consumer Contract Act,* <http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=Consumer&x=0&y=0&ia=03&ja=04&ph=&ky=&page=5>, latest visited on Dec. 3, 2019.

[853] “A consumer may rescind the manifestation of an intention to be bound by the offer of a consumer contract or by the acceptance of an offer for such a contract if either of the actions set forth in the following items in which the trader engaged when soliciting the consumer to enter into the consumer contract caused the consumer to be under the mistaken belief prescribed in the relevant item, based on which the consumer manifested the intention to be bound by the offer of that consumer contract or by the acceptance of the offer for such a contract.” See Article 4 of the *Consumer Contract Act*, <http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=Consumer&x=0&y=0&ia=03&ja=04&ph=&ky=&page=5>, latest visited on Dec. 3, 2019.

[854] “conclusion of an insurance contract in which the person engaging in the insurance business defined in Article 2, paragraph (1) of the Insurance Business Act (Act No. 105 of 1995) is the insurer (hereinafter referred to as an "insurance contract" in this item) or conclusion of a contract related to insurance or mutual aid which is specified by Cabinet Order as being similar to an insurance contract with policyholders persons similar thereto;” See Article 2 of *Act on Sales, etc. of Financial Instruments*， < http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=Financial+Instruments&x=0&y=0&ia=03&ja=04&ph=&ky=&page=12>, latest visited on Dec. 23, 2019.

[855] See Article 3 of *Act on Sales, etc. of Financial Instruments*， < http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=Financial+Instruments&x=0&y=0&ia=03&ja=04&ph=&ky=&page=12>, latest visited on Dec. 23, 2019.

[856] See Article 300 of *Insurance Business Act*, < http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=+Insurance+Business+Act&x=42&y=13&ia=03&ja=04&ph=&ky=&page=4 >, latest visited on Dec. 30, 2019.

position when it comes to the information provided by the insurer or the rules on the obligation to explain as in the context of Japan's Insurance Law.[857]

As it has been suggested through the above analysis, the performance of the obligation to explain by the insurer is mainly limited to important matters. The standard of the judgment on "important matters" involves many factors (including both the subjective and objective perspectives, involving factors, such as the age, financial status, education level, and knowledge structure, etc.), and possibly includes the exemptions, e.g., Article 3 (7) (i) of Japan's *Act on Sales, etc. of Financial Instruments* (Article 4 (7) (u) in *Act on Distribution of Financial Services* 2020) stipulates the exemptions from the application of the obligation to explain: specific customers with knowledge or experience in the selling of financial commodities and important matters that the consumer expressly does not need any explanation.[858] Also, the risk-bearing clauses of the financial products are expressly specified as the ones among important matters, the sellers should explain to them. For example, Article 3 of Japan's *Act on Sales, etc. of Financial Instruments* (the Article 4 of the *Act on Distribution of Financial Services* 2020) expressly includes the matters that can lead to a loss to the principal as the contents of the obligation to explain.[859] The reason is that the rights about financial products have abstractness and expectation, and there is an uncertainty risk as to whether it can make a profit. To the customer, whether the consideration it has paid can ensure the security of the principal is the decisive judgment standard for its purchase.[860]

From the above analysis, for the "provisions on self-bearing of investment risk," it is not appropriate to regard it as an explanation of "exceptions," but to identify it based on the "important matters" standard for the obligation to explain bearable by the insurer. The self-bearing of the risks relating to investment account by the policyholder should be deemed as a reminder of the risk of investment-linked insurance given by the insurer. It is something that has to be explained by the insurer in the process of selling

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[857] See Yu Haichun, *Research on the Protection System of Insurance Consumers' Rights and Interests*, (Beijing: University of International Business and Economics Press, 2015), p.113.

[858] "if the customer is a person specified by Cabinet Order as a person having expert knowledge and experience on sales, etc. of financial instruments", "the customer has manifested the intention not to require an explanation for the important matters." See Section 3 of Act on Sales, etc. of Financial Instruments, < http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=Financial+Instruments&x=0&y=0&ia=03&ja=04&ph=&ky=&page=12>, latest visited on Dec. 30, 2019.

[859] See Section 3 of Act on Sales, etc. of Financial Instruments, < http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=Financial+Instruments&x=0&y=0&ia=03&ja=04&ph=&ky=&page=12>, latest visited on Dec. 30, 2019.

[860] See Yu Haichun, *Research on the Protection System of Insurance Consumers' Rights and Interests*, (Beijing: University of International Business and Economics Press, 2015), p.180.

investment-linked insurance. It is an analysis of the risk-bearing capacity of the policyholder to see if it is qualified and then give a prompt after that. In doing so, it is also more in conformity to regulate the obligation to explain. The insurer is required to give explanation to the policyholder about important matters relating to the contract, and bring them to the attention of the policyholder and ensure that they understand the risk characteristics of the financial products they intend to buy.

6.1.3 Fraudulent Acts That Cause the Contract to Be Invalid: the Return of Premium and the Assumption of Liabilities

In some other clauses, corresponding legal consequences can not be extended to the investment account. For example, Article 27 (1) of the *Insurance Law* stipulates that in case the insured or the beneficiary lies about the occurrence of an insurance accident, the insurer shall have the right to terminate the contract and does not return the premium. This Article is targeted at traditional insurance, whereas in the investment-linked insurance, the premium in the investment account is not subject to the restriction of this clause, in other words, when the legal effect of this Article takes place, the amount the insurer will not return is only limited to the "capital" in the form of "risk premium." The jurisprudence lies in it is the same with the legal effect for failure to perform the obligation to explain. Article 27 (2) of the *Insurance Law* stipulates that the insurer will not assume any insurance liability and does not return the premium in case there is any deliberately caused insurance accident.

However, this Article also stipulates that if the premium has been paid in full amount for more than two years, the insurer shall return the cash value shown on the policy. As for the application of this Article in the investment-linked insurance, if the premium of an investment-linked insurance has been paid in full amount for more than two years, the insurer shall have the right to terminate the contract and return the cash value shown on the policy in case the policyholder or the insured has deliberately caused an insurance accident. However, if the premium has not been paid in full amount for two years, the premium not returned is only limited to "risk premium," excluding the cash value in the investment account once the insurer terminates the contract.

6.2 The Suitability Obligation

6.2.1 The Application of Basic Terms, Including Regulation Basis & Performance

Subjects

Investment-linked insurance is a complicated financial product featuring high investment risk; there should be a certain threshold and suitability standard set for the policyholder so as to reduce the fraud in the sales of it. Therefore, before the signing of the investment-linked insurance contract, the insurer should reasonably identify the risk-bearing capacities of the policyholder. If the risk-bearing capacity of the policyholder is weak, then it should not be suggested to buy the product. However, *Insurance Law* in China has not established this obligation, but merely it was stipulated in some departmental regulations or notice of the former CIRC.[861] For example, Article 1 of the *Notice about Further Strengthening the Management of the Sale of the Investment-linked Insurance* (CIRC No. 10 [2009]) stipulates that the investment-linked insurance should be sold to the group of customers who have corresponding risk-bearing capacities by qualified salespeople through the proper sales channel. Article 5 of this document further stipulates that for insurance companies that sell investment-linked insurance through the bank channels, the premium paid in lump-sum for any new order should not be less than 30 thousand RMB. Also, for the selling of investment-linked insurance through bank channel, in 2004, CIRC has expressly specified in *Notice about Entrusting the Banks for the sale of the Investment-linked Insurance and the Universal Insurance Products* that the insurance company can sell new personal insurance products, i.e. the investment-linked insurance and the universal insurance products at the financial management counter or the financial management center of the bank.[862] Later on, this was again reiterated in Article 2 of the *Notice about Further Strengthening the Management of the Sale of the Investment-linked Insurance*. Nevertheless, this *Notice* stresses that in case an insurance company entrusts banks for the sale of investment-linked insurance, the sales places should be limited to financial management centers or financial management counters of those banks, and should not sell it through bank savings counters. Therefore, for the suitability of the sale of investment-linked insurance, China has now established it through departmental regulations and notices.

Germany Jurist Jhering has long pointed out that what has been protected by law is not only an existing contractual relation, and the “ongoing” contractual relation

[861] See Article 88 of China’s *Securities Law*.
[862] See Arcticle 1 of *Notice about Entrusting the Banks for the sale of the Investment-linked Insurance and the Universal Insurance Products*, No. 22 [2004] of CIRC.

should also be included. Otherwise, a contract deal will be exposed to the outside and remains unprotected. Consequently, it is unavoidable that one party to a contract will become the victim of another party's negligence or carelessness.[863] Therefore, being different from the traditional contract law theory, in order to protect the "reliance interests" among contracting parties, the modern contract law has established the pre-contract obligations before the signing of the contract, in the form of statutory obligations, which if violated, the relevant party shall also assume the liability for damages arising out of such reliance. Suitability obligation is a pre-contract obligation, which exists before the signing of the contract, requiring that the sale of financial products should start from knowing your customer. Moreover, viewing from the subordinative relation of contractual obligation, the performance of such obligation does not require the consideration paid for they are not the master contract obligation, but the attached obligation, which is intended to sell financial products to suitable customers.

As for the performing subjects of the suitability obligation, since it was the insurer and the policyholder who sign the investment-linked insurance contract, undoubtedly, the insurer, as a contracting party, is the performing subject of the suitability obligation. Despite Article 500 of the *Civil Code* in China stipulates that the party assuming the liability for contracting fault is limited to the contracting parties, in the *Minutes of the National Courts' Civil and Commercial Trial Work Conference*, the performing subjects of the suitability obligation are described as the "seller agencies" and "financial service provider", [864] – including the financial agencies and its employees who are providing suggestions in the sale of financial products.

Specific to the introduction and sales of investment-linked insurance, the performing subjects of the suitability obligation are not limited to insurers, but also include insurance agents and insurance brokers. Nevertheless, it is worth noting that the legal natures of the performance of the suitability obligation by those two intermediaries are different. The legal effect of the acts committed by the insurance agent in the name of the insurer has directly belonged to the insurer. The performance of the obligation by the insurance agent still takes place during the consultation stage

[863] Jherings jb. 41 (1961), S.lf. Quote from a secondary source: Wang Zejian, *Civil Law and Case Study (I),* (Beijing: Peking University, 2009), p.72.

[864] See Article 72 & 74 of *Minutes of the National Courts' Civil and Commercial Trial Work Conference*, No. 254 [2019] of the Supreme People's Court of China.

before the time the investment-linked insurance contract is signed, so the suitability obligation performed by it is still the pre-contract obligation. However, the insurance broker acts for the interests of the policyholder and provides intermediary services for the conclusion of an insurance contract between the policyholder and the insurer, thus to facilitate the conclusion of an insurance contract between them and collect commissions by law – an act of agency.[865] In other words, the reason the insurance broker provides service to the policyholder is based on another contractual relationship with the policyholder - the insurance brokerage contract, only if the two parties enter into a contractual relationship with each other, can the insurance broker have an obligation to provide professional suggestions for the policyholder. Therefore, the suitability obligation bearable by the insurance broker belongs to a contractual obligation, and is also the most fundamental element of the insurance brokerage contract. Its contents relate to the realization of the purpose of the contracting parties in concluding a contract; hence it belongs to master payment obligation.[866]

As for the objects to be protected by the suitability obligation, the regulation purpose of the suitability obligation is mainly for the protection of financial consumers. Therefore, if the purchasers of the financial products have corresponding risk identification and bearing capabilities, then they will not be deemed as the objects being protected by the suitability obligation. In general, normative documents in China divide the investors into individual investors and institutional investors. Certain financial standards are set for both of them as the form standards, i.e., the threshold capital of 1 million.[867] For another example, in Taiwan of China, Article 4 of the *Law on the Protection of Financial Consumers* excludes “specialized investment institutions” and “natural or legal persons” who meet certain financial requirements or have professional capabilities, from the category of financial consumers.[868]

Specific to the suitability of the investment-linked insurance, it is designed within the framework of traditional life insurance, and requires the presence of the life of a natural person as the subject-matter insured; also the signing of the contract needs the involvement of insurable interests. Thus it can be seen that the suitability obligation of

[865] See Shi Tiantao, Commercial Law, (Beijing: Law Press, 2018), p.103.

[866] See Zhang Xiaomeng, S*tudy on Suitablity of Insurance Contrac*t, 2018 Doctoral Dissertation of Zhongnan University of Economics and Law, p.31, 33.

[867] See Article 6 of *Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds*, Order No.1 [2009] of the China Banking Regulatory Commission.

[868] See Artilce 4 of Taiwan's *Financial Consumer Protection Act*.

the investment-linked insurance rules out the institutional investors, but only limits to natural persons. Also, for the financial standard, the satisfaction of certain financial requirements does not necessarily mean that it is a qualified investor. Especially for the traditional life insurance and investment-linked insurance, many purchasers are the old people who usually have accumulated certain savings, but lack of investment experience and the capabilities in identifying risks. In fact, those people need the protection of the suitability principle more than others do. Therefore, in terms of the objects being protected by the suitability obligation under the investment-linked insurance, they are limited to the natural person (excluding institutional investors), and also from the substantial perspective, "frequency," or "occupational" as found in the commercial activities, can be referred to examine the risk-bearing and risk-identifying capabilities,[869] because the compliance with certain financial capabilities does not necessarily mean the subject is a suitable purchaser of the investment-linked insurance.

As for the liability of violating the pre-contract obligation, as previously discussed, the subject of liability or the performing subject of suitability obligation is the insurer, including the insurance agent. Article 500 of the *Civil Code* stipulates three acts by which one that commits the "contracting fault" should assume the liability for damages: "malicious consultation," "intentional concealment," and "other acts that violate the good faith principle." Thus it can be seen that the principle of liability identification as adopted by the *Contract Law* against the "contracting fault," is the fault principle. Moreover, the burden of proof is not bearable by the party that commits the contracting fault. However, from the perspective of protecting financial consumers, if the burden of proof is to be assumed by the financial consumers, then the regulating purpose we have with the suitability obligation may fail easily. For the obligation to explain assumed by the insurer, the *Insurance Law* and its judicial interpretation adopt the presumption of fault, which is that the insurer has to assume the burden of proof. Likewise, as far as the suitability obligation is concerned, the presumption of the fault should also be adopted and let the insurer assume the burden of proof.

Article 75 of the *Minutes of the 9th Conference on the Civil and Commercial Trials Held by Nationwide Courts* expressly specifies that the "seller institution shall assume the burden of proof as to whether the suitability obligation has been duly performed by

[869] See Li You, *The Applicable Logic of Caveat Emptor and the Inequality Found in Financial Consumption Relationship,* 7 Social Sciences of Beijing 38, 47 (2019).

it," which indicates that the standpoint of the judicial organs is also the "presumption of fault," whereas whether the suitability obligation has been duly performed crucially lies in whether or not the seller institution has provided the risk evaluation for its financial product, and has further run tests on the risk perception, risk preference and risk-bearing capacity of its financial consumers.[870] The *Minutes of the 9th Conference on the Civil and Commercial Trials Held by Nationwide Courts* has also stipulated the exemptions for the suitability obligation, which mainly are those personal causes of the financial consumers, i.e., the deliberate provision of false information by the financial consumers, the refusal to hear advice from the seller institution, etc., that have resulted in the purchase of inappropriate products or the receipt of inappropriate services.[871]

However, the hierarchical level of the regulations on the suitability obligation relating to the investment-linked insurance in the context of the laws in China is low and what kinds of specific assessment factors we may have about it, are questions await to be discussed, and we may also try to find the improvements on those aspects from the comparative analysis made on foreign laws.

6.2.2 Comparative Analysis: Contents and Improvements

In the US law, NYSE at early times has released Rule 405, requiring its members to know their customers and to have due diligence in getting to know the essential facts behind each order given by their customers.[872] This rule is considered as an important basis for the suitability obligation among the US's disciplinary supervisions. However, this rule only raises the demand to know the customer without specifying specific rules concerning the suitability obligation. NASD has also enacted some rules on the suitability, among which a typical one is the Rule 2310 (b) enacted in 1991. NASD Rule 2310 (b) stipulates that when the securities dealers introduce securities to non-institutional investors, they should acquire financial status, tax status, and investment objectives of their customers, as well as the reasonable information needed for introducing products.[873] In terms of the application of the suitability principle to variable products, NASD enacted a "*Notice to Members 96-86*" in 1996, requiring its

[870] See Article 75 of *Minutes of the National Courts' Civil and Commercial Trial Work Conference*, No. 254 [2019] of the Supreme People's Court of China.
[871] See Article 78 of *Minutes of the National Courts' Civil and Commercial Trial Work Conference*, No. 254 [2019] of the Supreme People's Court of China.
[872] See NYSE Rule 405 (1).
[873] See NASD Conduct Rule 2310 (b).

members to follow the suitability principle when selling variable products.[874] It was explicitly provided in this *Notice* that when selling the variable life insurance products, seven factors have to be considered, the satisfaction of the requirements for signing a life insurance contract, the customer expressly indicates the preference for investment rather than the traditional life insurance guarantee, the ability of the customer to understand those aspects including product cost and premium, the customer's willingness to invest, the liquidity demand for funds, income requirement, investment experience.[875] NASD raised a further requirement in 1999 that in the process of selling variable annuity, the members of NASD and their agents should make reasonable efforts to acquire customer information, which mainly includes the occupation of the customer, marriage status, age, number of persons need to be raised or supported, investment objectives, risk-bearing capacity, tax-paying situation, investment experience, net current assets, savings, income, etc.[876] In addition, NASD released another *Notice* in 2000, again requiring that in the sale of variable life insurance, the securities dealers and their agents should follow the suitability principle.[877]

After that, FINRA, founded in 2007, started to incorporate the suitability rules enacted by NYSE and NASD to form another set of relatively unified suitability rules gradually. In October 2010, SEC approved FINRA Rule 2111, the substitution for previous NASD Rule 2310. Rule 2111 also requires the securities dealers to have a reasonable basis to believe that the transaction or investment is suitable for the customer.[878] However, if comparing with NASD Rule 2310, FINRA Rule 2111 consists of three major obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability. [879] Also, it is stipulated that the institutional investors are exempted from the application of this rule.[880] Apart from that, FINRA 2111 has further

[874] See NASD Notice to Members 96-86, NASD Regulation Reminds Members and associated Persons That Sales of Variable Contracts Are Subject to NASD Suitability Requirements (Dec. 1996).

[875] See NASD Notice to Members 96-86.

[876] See NASD Notice to Members 99-35 (May 1999).

[877] See NASD Notice to Members 00-44(July 2000). Variable Contracts: The NASD Reminds Members of Their Responsibilities Regarding the Sales of Variable Life Insurance.

[878] "A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." See FINRA Rule 2111, < https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111 >, latest visited on Nov. 2, 2019.

[879] "such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation." See FINRA Rule 2111.

[880] See FINRA Rule 2111.

detailed the important matters – information including the age, financial status, investment objectives, and risk-bearing capacity of the customer, etc.[881]

In November 2010, FINRA Rule 2090 – "know your customer" was approved by the SEC to replace the previous NYSE Rule 405 (1). Comparing with Rule 405, FINRA Rule 2090 also requires reasonable diligence performed in order to know essential facts about the customer.[882] What is different is that for FINRA Rule 2090, the "obligation to know about the customer" is generated before the conclusion of a contract between the securities dealer and the customer, rather than depending on whether or not the securities dealer has made a recommendation. Also in terms of the applicable subjects, the subjects of suitability obligation are no longer limited to NYSE members, but have been expanded to include the members of FINRA.[883]

In the US, the rules of *Insurance Acts* of various States on "suitability" are mainly originated from the rules in two Model Regulations enacted by the NAIC - Article 3 and Article 8 of the *Variable Life Insurance Model Regulation* and *Annuity Transaction Model Regulation*. All those regulations require the sale of variable life insurance and a variable annuity to follow the suitability principle, and the sellers have a reasonable basis to believe that the products they recommend to the customer are suitable. Those rules have also referred to the standard requirements in NASD Rule 2310 about the "suitability."[884]

In Japan, in 1974, the Securities Bureau under the Ministry of Finance once required the financial institutions, such as the securities companies, in the form of notice that the suitability principle should be followed when carrying out their businesses. This was included in the *Securities Exchange Act* as a statutory obligation later in 1992 and was then inherited and preserved in the *Financial Instruments and Exchange Act* of 2006.[885] Based on Article 43 of the former *Securities Exchange Act* – the "suitability principle", Article 40 of the *Financial Instruments and Exchange Act* adds "to conclude a financial commodity transaction contract", which is that the judgment on suitability principle as in Article 40 of the *Financial Instruments and Exchange Act* has confirmed

[881] See FINRA. Rule 2111.
[882] See FINRA. Rule 2090, Know Your Customer.
[883] See Clifford E. Kirsch, *Suitability*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.16-14.
[884] See Clifford E. Kirsch, *Suitability*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.16-36.
[885] See Zhou Jianlong, *The Behavior Regulation of Financial Commodity Transaction in Japanese law*, 29 Commercial Law 76, 79-80 (2016).

many factors including the purpose of contracting, customer knowledge & experience and financial status, which are used to give a comprehensive consideration of the suitability of the financial instrument purchased by the customer.[886] In the law of Japan, the suitability principle can be in the broad or narrow sense. The suitability principle in the narrow sense requires that the trader of financial commodity shall not violate the willingness and actual conditions of the customer when persuading the customer to invest, while the suitability principle in the broad sense requires that the trader should know about those aspects of information on customer, including their investment objectives and financial status and should recommend financial commodities which are suitable for the customers. Also, the *Financial Instruments and Exchange Act* divides the investors into general investors and professional investors, and the suitability principle does not apply to the latter. However, the obligation of being impartial and honest to the customer, as stipulated in Article 36 of that law, applies to professional investors, which also means that fraudulent introduction is also not allowed when introducing financial commodities to professional investors.[887]

Judging from the above analysis of the regulations in the US and Japan laws, the main objects that are being protected by the suitability obligation and the performing subjects and regulating purpose of it are more or less the same. For example, they are all excluding the institutional investors, and their performing subjects include financial sellers and their employees. The differences between those foreign laws are the following: the suitability obligation under the US law is mainly a disciplinary rule, which is mainly intended to regulate the transactions of the securities dealers and protect the retail investors in the securities market. Law in Japan mainly stipulates the suitability obligation in legal clauses; Law in China mainly stipulates the suitability obligation in administrative regulations, and the content is comparatively abstract and less specific. Those differences further have an impact on the actual effect of the protection of financial consumers. In the following paragraph, we will analyze those differences mainly from the civil relief approach.

In terms of the laws in the US, though disciplinary rules containing suitability principle, as enacted by FINRA, have overlapping regulations and mainly are also ethical principle by contents, SEC in the US regards those suitability obligations as the

[886] See Article 40 of *Financial Instruments and Exchange Act.*
[887] See Article 36 of *Financial Instruments and Exchange Act.*

basic obligation requirements for securities dealers, who also have to observe Rule 10b-5 under the *Securities Exchange Act* and other anti-fraud clauses under the *Federal Securities Acts*. Thus it can be seen that SEC regards the suitability obligation as a statutory obligation, which originates from the "shingle theory," meaning that as long as a broker or dealer hangs out its shingle, it indicates it can fairly engage in a commercial transaction, and has reasonable basis to believe that the securities introduced by it to the customers are suitable.[888] In other words, if it violates the "suitability obligation," it will be restricted by the anti-fraud clauses in laws, such as the *Securities Act and Securities Exchange Act.* As far as the Japanese laws are concerned, the *Financial Instruments and Exchange Act* also defines the suitability obligation as the basic obligation bearable by the financial instrument trader, and if it is violated, such violation can also be deemed as the basis of the private right relief, including Civil Code.[889] For example, in 2005, the Supreme Court of Japan expressly indicated in the precedents that if the salespeople of securities companies proactively persuade the customers into engaging in those transactions that have extremely high risks, then such practice has clearly violated the suitability principle and constitutes unlawful acts in the sense of *Tort Liability Law* (Article 709 of the *Japanese Civil Act*).[890]

Comparatively speaking, the suitability obligation stipulated in the Laws of China can not be deemed as the basis of civil relief due to certain barriers. The main reasons are the following. Rules on suitability obligation in China are mainly limited to normative documents, such as the administrative rules, notice, guide, which are enacted by the State Council. To broadly discuss it, firstly, those rules are used to carry out sales management mainly from the perspective of administrative regulation, and if any of those rules are violated, mainly the administrative penalty will be imposed. For example, Article 9 of the *Interim Measures for the Management of Investment-linked Insurance* stipulates that the salespeople of the investment-linked insurance must meet

[888] See Clifford E. Kirsch, *Suitability*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.16-35.

[889] "Beyond what is provided for in this Act, the liability for damages of the financial instruments provid er, etc. due to the failure to explain important matters or due to the provision of conclusive evaluation, e tc. is governed by the Civil Code (Act No. 89 of 1896)." See Article 7 of the *Act on Sales, etc. of Fin ancial Instruments* (enacted in 2000, the Act was renamed to the *Act on Distribution of Financial Service s in 2020*), <http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=02&dn=1&yo=Financial+Instruments&x=0&y=0&ia=03&ja=04&ph=&ky=&page=12>, latest visited on Dec. 23, 2019.

[890] 参见日本最高裁判所 2005 年 7 月 14 日判决，载《最高裁判所民事判例集》第 59 卷第 6 号（2005 年）第 1323 页；Quote from a secondary source: Zhou Jianlong, *The Behavior Regulation of Financial Commodity Transaction in Japanese law*, 29 Commercial Law 76, 80(2016).

requirements, including having participated in a specialized training relating to it and should have qualified results thereof; more than one year experience in the sale of life insurance products with good sales performance; no serious irregularities or fraudulent acts. In Article 2 of the *Notice about Relevant Matters Relating to the Strengthening of the Management of the Sale of the Investment-linked Insurance* enacted in 2007, it requires that the insurance company should train its sales personnel, as well as sales personnel from the agencies and organize written examinations by itself to test the product and legal knowledge of each sales personnel. Article 6 of *A Guideline on the Identification of Misleading Sales of Personal Insurance (No.87[2012])* has enumerated seven kinds of typical fraudulent acts, i.e., overstate the insurance liabilities or income from insurance products, false propaganda about the previous business achievements of the insurance company.[891] If the sales personnel have committed any of the abovementioned acts, then it can be identified as "concealing important circumstances concerning the insurance contract," an act stipulated in Article 116 or Article 131 of the *Insurance Law*, and will be punished according to the *Insurance Law*.

Secondly, the regulations on the suitability obligation do not have a high hierarchical level in terms of their effectiveness, so they are hard to be directly used as the normative basis for civil relief. In judicial practice, the move is to make a judgment by identifying whether it is the validity-related regulations or managerial regulations that have been violated by breaching the obligation provided in the administrative regulations. If the validity-related regulations have been violated, it will result in an invalid contract, whereas if the managerial regulations have been violated, in principle, the contract remains valid. Therefore since the legislation level of the administrative laws and regulations, as well as the normative documents, is relatively low, it is unable to provide a beneficial civil relief guarantee.[892] As for the impact of the administrative laws and regulations on the effectiveness of the commercial contracts, some scholars have put forward a new line of thought for application: the logic of using the clauses on "public interests" to give verdicts on the invalidity of a contract due to the violation of administrative laws and regulations.

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[891] A personal insurance company, an insurance agency or a person that handles the insurance sales business shall not conduct any of the following fraudulent acts in personal insurance business activities: (1) exaggerating insurance liabilities or the return on insurance products; (2) making false publicity on any law, regulation or policy on the insurance business; etc. See Article 6 of Notice of China Insurance Regulatory Commission on Issuing the Guidelines for the Determination of Misleading Sales of Personal Insurance, No. 87 [2012] of CIRC.

[892] See Zhang Bin, *Research on the Theory and Judgment of Financial Consumer Protection*, (Beijing: Law Press, 2015), p.234-235.

On the one hand, we should grasp the point where it is different from the circumstance of violating laws and compulsory regulations in administrative laws and regulations. In the reasoning part, we should give an adequate demonstration of the specific damages it may have caused to the public interests. On the other hand, it should also be subject to a due restriction – the similar application of "the circumstance of violating laws and compulsory regulations in administrative laws and regulations."[893] From the perspective of protecting financial consumers, this line of thought benefits the expansion of the involvement of the administrative regulations in determining the effectiveness of commercial contracts, and also can provide adequate room for interpretation made on the approach of the judicial application of the suitability obligation onto the policyholder of the investment-linked insurance. However, in all the abovementioned explanations, the civil relief for the suitability obligation is realized via Article 52 of the *Contract Law* – "referral terms." This explanation has high requirements for Judges, and also the identification of contract validity in the case of violating compulsory clauses itself is easy to cause new divergence. Though the *Minutes of the 9th Conference on the Civil and Commercial Trials Held by Nationwide Courts* has stipulated specific rules, i.e., the violation of the suitability obligation and relief methods and in fact can have certain essential impact on the judicial adjudication, the *Minutes* is not a judicial interpretation by its form. It can not be deemed as the basis for the judgment.

Therefore, for the civil relief to the violation of the suitability obligation, we can learn from the approaches adopted in foreign countries, and uplifting the "regulations" about the violation of the suitability obligation from the level of administrative regulations, notices, etc., to the level of fundamental laws, or directly apply through analogy the stipulations on the suitability obligation from Article 88 of the *Securities Law* and Article 98 of the *Investment Fund Law.* In terms of the contents of the suitability obligation of the investment-linked insurance, we can concretize it from those aspects, including individual requirements of the policyholder (investment or financial management) and objective risk-bearing capacity of the policyholder.

6.3 Information Disclosure Rules

893 See Li Jianwei, *The Judicial Approach of Administrative Rules to Affect the Effectiveness of Commercial Contracts*, 9 Law Science 180, 180(2019).

6.3.1 Product Registration and Information Disclosure

6.3.1.1 The supervision rules on the registration of investment-linked insurance and its investment account

As for the declaration of investment-linked insurance, viewing from the *Interim Measures for the Management of Investment-linked Insurance*, Article 5 of the Interim Measures stipulates that the sale of investment-linked insurance has to be approved by the CIRC.[894] Article 7 of this Interim Measures stipulates requirements, including having at least one insurance liability, connection to at least one investment account, separate management of the investment account, insurance guarantee risk & expense risk should be borne by the insurer, insurance guarantee for policies should be confirmed at least once for each year, policy value should be confirmed at least once for each month, etc., should be satisfied. Those requirements are also the constitutive requirements of investment-linked insurance. For example, "this product must contain one or multiple insurance liabilities" is to specify that the insurer of the investment-linked insurance must have the "factor of assuming insurance guarantee risk," however, in practice, this insurance liability is mainly the risk of liability in the traditional life insurance. For another example, "(ii) connection to at least one investment account," "(iv) the assets in the investment account should be managed separately," etc. are settings to the investment account and show the characteristics of the investment account. Therefore, the "minimal product requirements" in Article 7 of the *Interim Measures for the Management of Investment-linked Insurance* is, in fact, a description of the characteristics of the investment-linked insurance.

As for Article 8 of the *Interim Measures for the Management of Investment-linked Insurance*, the contents included in this Article are materials, including the materials submitted for general products, feasibility study for the product, product finance, business management measures, etc. However, for those materials submitted, there is no detailed specific regulations and standard.

Furthermore, for requirements on the registration of a separated account, Article 10 of the *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insurance* has provided. Nevertheless, comparing with the material required by the CIRC for the establishment

[894] See Article 5 of the *Interim Measures for the Management of Investment-linked Insurance.*

of an investment account, the materials required by the public offering of the fund are more detailed and specific. For example, in Article 52 of the *Investment Fund Law*, it stipulates that the fund contract of the public offering of a fund should include among others the following contents: purpose and fund name, name and residential address of custodian and fund trustee, operation mode, shares, total shares, release date, price, and cost principle, the rights and obligations of fund custodian, fund trustee and fund share holder, call for a meeting of fund share holders, procedures and rules for discussing matters and for voting, the procedure, time, venue, cost calculation method relating to the selling, trading, subscription, and redemption of fund shares, time and method to pay redemption money, the principle for the distribution of the return from fund, execution method, the withdrawal of remuneration, payment method and proportion, the withdrawal of other fees and payment methods about the management and use of fund property, investment orientation and investment restrictions of the fund property, calculation method and manner of announcement for net asset value, etc. Article 53 of the *Investment Fund Law* stipulates that the fund prospectus of the public offering of fund should include the following contents: the name of the document that approves the registration (in the application for the public offering of fund) and the date of registration, essential conditions of the fund custodian and fund trustee, abstract of fund contract and fund trust agreement, date, price, fee, and deadline of the sale of fund share, sale method and sale agency of the fund share, name of the registration agency, name and address of the law firm that presents the *Letter of Legal Opinion* and name and address of the accounting firm that audits the fund property, remuneration of the fund custodian and fund trustee and the withdrawal of other relevant fees, payment method and proportion, risk alerting contents, other contents as may be stipulated by the securities supervision and management authorities under the State Council.

Those materials submitted also belong to the scope of information disclosure. Therefore the anti-fraud rules in the *Securities Law* should also be applied in this case, i.e., the principle of being open, fair & justice as in Article 3 of the *Securities Law;* the authenticity, accuracy, completeness, etc. of the information disclosed as in Article 74 of the *Investment Fund Law*.

Table. Documents to be submitted under the establishment of investment account and fund

	No. 32 [2015] of CIRC[895]	Article 51Securities

[895] See Article 10 of *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the*

		Investment Fund Law
Documents to be submitted	(1) An explanation on the opening, modification, combination, division, closing, or liquidation of the investment account. (2)An account statement, stating the characteristics, investment strategies, scope of assets for allocation, investment proportion limitations, performance comparation base, account valuation methods, liquidity management plan, major investment risks, asset custody, independence, and tunneling prevention of the account. (3) A compliance statement, stating that the opening, modification, combination, division, closing or liquidation of the investment account complies with the regulatory provisions, guaranteeing the independence of the account, and not engaging in tunneling. The compliance statement shall be signed by the chief compliance officer, the chief financial officer, the chief actuary, and the senior executive in charge of the investment who shall assume the corresponding compliance responsibility. (4) In the case of modification, the contents and basis of modification. (5) In the case of combination, division, closing or liquidation, a relevant plan. (6) Other materials required by the CIRC.	(1) The application report. (2) The draft fund contract. (3) The draft fund custody agreement. (4) The draft prospectus. (5) The legal opinions issued by a law firm. (6) Other documents required by the securities regulatory authority of the State Council.

If the restriction of "classified operation and classified management" is to be deleted by law amendment in the future, then the registration of securities investment funds can be referred to for the investment account. Article 2 of the *Investment Fund Law* distinguishes between the publicly offered funds and privately offered funds by means of raising funds and includes the two as the adjustment objects of the fund law. Article 3 of that law stipulates that for the publicly offered funds, the returns and risks should be enjoyed and assumed respectively according to the fund shares held, while the distribution of returns and the bearing of risks for the privately offered funds are based on the agreement in the fund contract. As for the issuance of the investment-linked insurance, the insurer is not facing a specific policyholder. An open issuance is adopted in this regard. Therefore the rules that are applied to it by analogy should be the corresponding rules for the publicly offered funds, rather than that for the privately offered funds. For example, Article 50 of the *Securities Investment Fund Law* stipulates that the publicly offered funds should be registered with the CSRC. Otherwise, it shall not raise funds either openly or in disguised open form. This concept of "registration," under China's current financial supervision regulations, substantially, is still a kind of

Investment Accounts for Investment-Linked Insurance, No. 32 [2015] of CIRC.

review and approval system, rather than a filing system.[896]

6.3.1.2 A comparation of Information disclosure between the investment-linked insurance and securities investment fund

As mentioned previously, the information rules for investment-linked insurance can not limit the obligation to explain but should strengthen the rules on information disclosure. Though basic laws in China give no response to the investment-linked insurance, the CIRC has enacted some rules (e.g., No.3 [2009] of CIRC) on the regulation of those new types of personal insurance, e.g., the investment-linked insurance, which thoroughly explains this point. Since we have discussed before that investment account of the investment-linked insurance is similar to the securities investment fund in terms of the independency, risk-bearing, legal structure, etc., it is necessary to compare the rules set forth by the CIRC on investment-linked insurance and securities investment fund in terms of information disclosure (See below Table).

Table. Information disclosure between investment-linked insurance and fund

Comparative terms	Investment-linked insurance	Securities investment fund
Subjects	The insurer, salespersons (Art.3)	the fund manager, fund custodian, the fund-share holder who convenes the fund-share holders' meeting (Art. 2 of No. 19)
Disclosure principle	Plain and easy-to-understand language, the objectiveness and authenticity (Art. 5)	the veracity, accuracy, and integrity (Art 74 of the Fund Law)
Disclosure content	Risk alert, Basic Characteristics, Introduction to the Investment Account, Benefit illustration, Cooling-off period and surrender (Art.18); the historical information on the unit prices of investment accounts (Art. 20); the investment strategies, the major investment vehicles, and the proportions of all assets, etc. (Art. 21).	(1)the prospectus of a fund, the fund contract, the fund custody agreement, and the fund offering information; (2)the net asset value of a fund and the net asset value per share; (3)the subscription and redemption prices for fund shares; (4)the resolutions of the fund-share holders' meeting; (5)any major personnel changes in the specialized fund custody department of the fund management institution or fund custodian, etc. (Art. 76 of the Fund Law)
Disclosure means	Company website, public media recognized by the CIRC, product presentation meetings, etc. (Art. 3 & 21)	the national newspapers, the websites of any fund manager or fund custodian (Art. 3 of No. 19)
Disclosure on the net value	Announcing the unit prices of investment accounts once every week at a minimum (Art. 20)	Making a public notice of the net value of assets and shares of a closed-end fund at least once a week. (Art. 14 of No. 19) After the fund contract of an open-end fund takes effect, a fund manager shall, before handling the purchase or redemption of fund shares, make public notice on the net value of fund assets and fund shares at least once a week. (Art. 15 of No. 19)
Forbidden acts	Defraud, mislead, and conceal information (Art.5); insurance companies and their agents may not use ratios to make a simple comparation with other insurance products or bank savings, funds, or treasury bonds, nor conduct the misleading or false promotion (Art. 8)	Making any false records, misleading statements or major omissions; Predicting securities investment performance; Promising any income or assumption of losses in violation of the relevant provisions, etc. (Art. 77 of the Fund Law)
Annual report	One policy status report shall be provided to the insurance applicant every year, including the number of units held, unit value, etc. (Art. 23)	Compiling and completing the annual fund report within 90 days at the end of each year, and publishing. (Art.18 of No. 19)
Semi-annual report	publishing an information announcement once every half year at a minimum, including the financial status of each investment account, etc. (Art. 21)	Compiling and completing the half-year fund report within 60 days from the ending date of the first half-year, and publishing. (Art.19 of No. 19)
Quarterly report	No rules	Compiling and completing the quarterly fund report within 15 working days from the ending date of each quarter, and publishing. (Art.20 of No. 19)
Interim report	If any matter requiring the disclosure of an interim report occurs, the insurer shall disclose the information. (Art. 22)	In case there occurs any major event in the fund, the relevant fiduciary of information disclosure shall compile an interim report within two days, and make a public notice. (Art.23 of No. 19)
Reference	*Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (No.3 [2009] of CIRC)	*Securities Investment Fund Law of the People's Republic of China* (the Fund Law); *Measures for the Administration of Information Disclosure of Securities Investment Fund* (No.19 [2004] of CSRC).

[896] See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.98.

Through the above comparation, we can find that the information disclosure for investment-linked insurance is not as much detail as that for a securities investment fund in terms of those aspects, including the subject of the disclosure, principle of disclosure, and content of the disclosure. The investment account mainly includes five parts: essential characteristics, asset allocation goals and principles, investment tools, portfolio restrictions and investment risks, and each part is relatively simple and rough, while the fund has detailed descriptions on product participation, investment management, asset custody and disposal, asset valuation, fees and taxes, net worth announcement, and risk disclosure, etc.[897] Meanwhile, as for investment management, there is no description in greater detail on the investment strategies adopted by the insurer, but just a broad description of the configuration of the asset for different investment accounts. For example, for a positive and aggressive investment account, the minimum ratio between investment in equity assets and the total assets should be 40%, while the highest figure for the share of investment in non-equity assets (e.g., the fixed return assets) is 60%.[898] Additionally, the total number of the investment-linked insurance prospectus usually is 44 pages, less than 6,000 words, while a fund prospectus has a total of 112 pages, up to 81,000 words.[899]

Above mentioned differences in information disclosure have reflected in the efforts taken in protecting the rights and interests about investment. For example, from the perspective of legal effect, *Securities Investment Fund Law* is considered as the fundamental law, while the rules on information disclosure enacted by the CIRC are deemed as departmental regulations. Rules at the fundamental law level can provide more robust protection. For example, viewing from the relations to be regulated, the rules set by the CIRC on information disclosure for the investment-linked insurance are limited to the administrative relations between the CIRC and the insurer, without directly adjusting the civil relationship between the policyholder and the insurer. In this regard, the objects to be regulated by the *Securities Investment Fund Law* include civil relations between "fund-share holder" and "fund management institution," "fund custodian," etc., and also include the administrative relations between the "CSRC" and "fund management institution," "fund custodian" and "intermediary service agency."

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[897] See Yan Tao, *A comparative analysis of Information Disclosure between Investment-linked Insurance and Fund*, 9 Insurance Studies 88, 88-92(2010).
[898] See *Ping An Ying-ding Investment-linked Insurance Contract*, No. 023 [2012] of Ping-an Co.
[899] See Yan Tao, *A Comparative Analysis of Information Disclosure between Investment-linked Insurance and Fund*, 9 Insurance Studies 88, 90 (2010).

Therefore, the information disclosure rules of the CIRC can not constitute the basis of the civil transaction relations for either information-based decision-making by the policyholder of the investment-linked insurance for the rational purchase or the information disclosure to an investment account. Otherwise, the obligation of information disclosure bearable by the insurer can not become a statutory duty for civil relations involved, which will cause insufficient relief available to the policyholder. For example, in the case of *Zhou Zhong v. Ping An Insurance Company*, the insurer is obliged to entrust a public accounting firm to carry out accounting work on the investment account provided by it. There are disputes whether the insurer is obliged to provide the audit report to the policyholder. The court held that there is no express provision in the contract, which stipulates that the insurer has the obligation of providing an audit report to the policyholder, so the court dismissed the action filed by the plaintiff.[900]

6.3.2 Comparative Analysis: Taking Registration and Information Disclosure Rules as An Example

The following contents are based on the US's *Securities Act of 1933* and *Investment Company Act of 1940*, and our analysis will be focused on those aspects, including the registration and information disclosure.

As it is previously discussed, Article 3 (a) (8) of the *Securities Act* of 1933 has made a quite broad definition of securities, and is quite easy to include insurance contract into it. At least, the listed evidence of indebtedness can extend to the insurance contract. However, Article 3(a) (8) of the law has excluded or exempted the insurance contract.[901] Nevertheless, after the "VALIC Case" and "UBLIC Case," the US includes the variable annuity and variable life insurance into the adjustment scope of the *Securities Act* of 1933. By the 1980s, there existed a dispute in the US over the nature of products, including universal life insurance and indexed annuity. SEC enacted regulations, such as Rule 151, to check if some products can be exempted from applying the *Securities Act* of 1933. In other words, to evaluate if the products, such as the indexed annuity can satisfy the requirements of Rule 151 – the safe harbor rule, the "Rule" has provided a number of factors, including "an investment performance linking

[900] See *Zhou Zhong v. China Ping An*, No. 5456 (civil) of Chongqing Fifth Court (2017).

[901] See Christopher S. Petito, *Status of Insurance Products Under the Securities Act of1933*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.2-2.

to the separated account," "guarantee of non-forfeiture rates," "market value adjustments," "frequency of declaration of excess rates," etc.[902] However, the legal attributes of a variable annuity and variable life insurance at the federal level are clear and affirmative – variable annuity and variable life insurance are securities under the *Securities Act of 1933* and are registered at SEC.

After the "Prudential Case," the US defines the separated accounts of a variable annuity and variable life insurance as investment companies, so the registration and information disclosure requirements set forth in the *Investment Company Act* also have to be followed. Under the current law of the US, if there is no special exemption, most of the rules in the *Investment Company Act* apply to the separated account of variable life insurance in the same way as they apply to the traditional common fund.[903] Article 7 of the *Investment Company Act* stipulates that non-registered investment companies shall not directly or indirectly engage in acts, including the publicly sale or sale of any securities.[904] Article 8 (a) of the law further stipulates that the investment companies should submit to the SEC the application for registration or disclose information to it in prescribed formats. According to Article 8 (b) (1) of the law, when the separated account is applied for registration at SEC, the investment company should be classified according to Article 4 and Article 5 of the *Investment Company Act* -- the registering party's business policy under a specific category, whether the investment company participates in price setting, whether senior securities will be issued, whether engages in underwriting of any securities issued by any other party, whether concentrates the investment in a particular industry or industrial group, whether involves in the sale and purchase of real estate, offer loan to other people, portfolio turnover, etc.[905] Also,

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[902] See Christopher S. Petito, *Status of Insurance Products Under the Securities Act of1933*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.2-34—2-39.

[903] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940,* Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-5.

[904] See Section 7 of Investment Company Act.

[905] "(1) a recital of the policy of the registrant in respect of each of the following types of activities, such recital consisting in each case of a statement whether the registrant reserves freedom of action to engage in activities of such type, and if such freedom of action is reserved, a statement briefly indicating, insofar as is practicable, the extent to which the registrant intends to engage therein: (A) the classification and subclassifications, as defined in sections 4 and 5, within which the registrant proposes to operate; (B) borrowing money; (C) the issuance of senior securities; (D) engaging in the business of underwriting securities issued by other persons; (E) concentrating investments in a particular industry or group of industries; (F) the purchase and sale of real estate and commodities, or either of them; (G) making loans to other persons; and (H) portfolio turnover (including a statement showing the aggregate dollar amount of purchases and sales of portfolio securities, other than Government securities, in each of the last three full fiscal years preceding the filing of such registration statement)". See Section 8(b)(1) of Investment Company Act.

Article 8 (b) further stipulates that at registration, all investment policies concerning the registering party, policy matters that are thought to be necessary by the relevant registering party, name and address of the persons affiliated to the registering party, brief description of the business experiences of the director or senior managing people of the registering party for the last 5 years should be explained one by one. [906]

Under the background above, based on the different essential characteristics and risks of the variable annuity contract and variable life insurance, SEC has established different registration forms and information disclosure requirements, hence providing a more effective information disclosure method for the policyholders.[907]

For the variable annuity contract, SEC requires the registration based on "Form N-3" or "Form N-4". If the separated account of the variable annuity is registered as a unit investment fund, then Form N-4 should be adopted. If the separated account is registered as an open-end management company, then we adopt Form N-3. As we have discussed earlier, at present, the US adopts the dual-layer structure mode typically for variable products. Therefore "Form N-4" is being used more widely and frequently than "Form N-3". Both forms are consisted of "items" and "guidelines," wherein the "items" part is the content that must be disclosed, whereas the "guidelines" part is the content that helps the insurer to complete what should be disclosed in the "items" part.

As for the variable life insurance contract, what has been adopted by the SEC is Form N-6. Comparing with Form N-4 structure, Form N-6 has not provided any "guidelines," but only the "items." Three parts are mainly included, either for Form N-4 or for Form N-6: Part 1 – the instructions; Part 2 – the instructions on additional information; Part 3 – other information (see below Table). Both of them have identical information disclosure contents in those aspects, including necessary information contained in the product instructions, expenses statement, description of handling charge or fees deduction in the "policy" part, product purchase procedure, death benefit, redemption, surrender, etc.

The main differences between the two are that, for the variable annuity contract, Form N-4 requires the inclusion of definitions section in the appendix, while the

[906] See Section 8(b) (2)(3)(4) of Investment Company Act.
[907] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-22.

variable life insurance, registered and disclosed based on Form N-6, has no such requirements; Form N-6 requires the disclosure of contractual interests and risks by the variable life insurance, as well as the investment risk in the separated account; Form N-4 requires a centralized disclosure of the financial information on cumulated unit value in the annuity contract over the last ten years, while the variable life insurance does not have such requirements; Form N-4 requires the explanation of investment cost in the contract with the use of examples, while Form N-6 does not have such requirements; Form N-4 includes the annuity period in its disclosure, while Form N-6 includes the loan terms, lapse, and reinstatement in its information disclosure.[908]

Table: disclosure between Form N-4 and Form N-6

<table>
<tr><td colspan="2">Form N-4 (Variable annuity)</td><td colspan="2">Form N-6 (Variable life insurance)</td></tr>
<tr><td colspan="2">General Instructions:
Rule as to Use of Form N-4, Registration Fees, Number of Copies, Special Terms, Application of general Rules and Regulations, Amendments, Incorporation by Reference, Documents Comprising the Registration Statement or Amendment, SEC's Collection of Information</td><td colspan="2">General Instructions:
Definitions, Filing and Use of Form N-6, Preparation of the Registration Statement, Incorporation by Reference</td></tr>
<tr><td rowspan="14">Part A: Information Required Prospectus</td><td>Item 1. Cover page</td><td rowspan="14">Part A: Information Registration Statement</td><td>Item 1. Front and Back Cover Pages</td></tr>
<tr><td>Item 2. Definitions</td><td>Item 2. Risk/Benefit Summary: Benefits and Risks</td></tr>
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<tr><td>Item 14. Table of Contents of Statement of Additional Information</td><td>Item 14. Financial Statements</td></tr>
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</table>

[908] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-23.

	Item 20. Underwriters		Item 20. Underwriters
	Item 21. Calculation of Performance Date		Item 21. Additional Information about Charges
	Item 22. Annuity Payments		Item 22. Lapse and Reinstatement
	Item 23. Financial Statement		Item 23. Loans
Part C: Other Information	Item 24. Financial Statements and Exhibits		Item 24. Financial Statements
	Item 25. Directors and Officers of the Depositor		Item 25. Illustrations
	Item 26. Persons Controlled by or Under Common Control with the Depositor or Registrant	Part C: Other Information	Item 26. Exhibits
	Item 27. Number of Contract owners		Item 27. Directors and Officers of the Depositor
	Item 28. Indemnification		Item 28. Persons Controlled by or Under Common Control with the Depositor or the Registrant
	Item 29. Principal Underwriters		Item 29. Indemnification
	Item 30. Location of accounts and Records		Item 30. Principal Underwriters
	Item 31. Management Services		Item 31. Location of Accounts and Records
	Item 32. Undertaking		Item 32. Management Services
			Item 33. Fee Representation

As it is previously discussed, variable annuity and many similar ones in the US are currently registered as unit investment trust at the SEC and adopt dual-layer structure mode. The underlying mutual fund takes the form of open-end management companies. For the underlying fund, SEC also requires that the fund should be registered and disclosed according to Form N-1A. Form N-1A includes three parts: the "Prospectus," the "Statement of Additional Information," and "Other Information." Among them, the "Prospectus" provides the investors with basic information on the fund, including the investment objectives, the annual cost of the fund operation, investment strategy, main investment risks, management organization, capital structure, distribution of profit, etc., thus to help the investors make informed decisions; Also the *Securities Act* of the US raises its demand on the prospectus update. For example, if the prospectus is used at a time which is more than nine months since the date the registration statement takes effect, the information contained in it should cover a period that is within 16 months before its usage.[909] For another example, if the sale of a variable product is stopped in such a circumstance where the number of the policyholder is less than 5000, and SEC provides "No Action Letters,"[910] then it is

[909] "when a prospectus is used more than nine months after the effective date of the registration statement, the information contained therein shall be as of a date not more than sixteen months prior to such use, so far as such information is known to the user of such prospectus or can be furnished by such user without unreasonable effort or expense." See Section 10(a)(3) of Securities Act.

[910] "An individual or entity who is not certain whether a particular product, service, or action would constitute a

allowed not to submit the updated prospectus of the contract.[911] The additional information in the second part is mainly a further detailed description of the essential contents of the prospectus which the investors care most; the third part – Other Information, includes the documentary evidence of the registered information, the description of the investment advisory business, the information of the fund underwriter, name and address of the fund account manager, outlined description of the management of relevant service contracts, etc.[912]

6.3.3 The Plain English Rule and Material Rule to Information Disclosure

The requirements of the *Management Measures for the Disclosure of the Information on New Personal Insurance Products* on the information disclosure of the investment-linked insurance and its investment account are in a relatively detailed manner, which also reflects that the administrative regulations require the information disclosure to be as complete as possible. However, the *Measures* also have many shortcomings. For example, low hierarchical level in terms of their effectiveness, less specific in terms of their contents. Those shortcomings can be improved in the future by law amendments or by the analogized application of relevant rules in the *Securities Law* or apply the regulations on the information disclosure relating to the public offering of funds. The “disclosure of the fund information,” as stipulated by China, has provided relatively detailed requirements on information disclosure, irrespective of the hierarchical level of the regulations or their contents, i.e., the way of disclosure and corresponding templates and standards, etc.[913] The maturity of those regulations remains incomparable by that of the information disclosure rules of the investment-linked insurance. Of course, the information disclosure for the public offering of the fund itself also has misleading information, delayed disclosure, passive disclosure without the focus on essential matters, etc.[914] However, those shortcomings can be improved through an amendment on related rules rather than being reasons for an objection to the application of those rules to investment-linked insurance and its

violation of the federal securities law may request a "no-action" letter from the SEC staff.” See “No Action Letters”, < https://www.sec.gov/fast-answers/answersnoactionhtm.html>, Latest visited on Nov. 22, 2019.

[911] Great-West Life and Annuity Company, SEC No-Action Letter (Oct. 23, 1990). Quote from Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-24.

[912] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-20.

[913] E.g., see Measures for the Administration of Information Disclosure of Publicly Offered Securities Investment Funds, No 158 [2019] of CSRC.

[914] See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.203-204.

investment account.

As for the principle requirements on the information disclosure for the public offering of funds, Article 2 of the *Management Measures for the Disclosure of the Information on Securities Investment Fund (No.19 [2004] of CSRC)* has stipulated the "authenticity," "accuracy" and "completeness" requirements on the information disclosed. The CSRC further amended *the Measures* by the enactment of the *Measures for the Administration of Disclosure of Information on Publicly Offered Securities Investment Funds*, and in Article 2 of it, the requirements of "authenticity," "accuracy," "completeness," "timeliness," "simplicity" and "availability" have been raised on the information disclosure. This indicates that the CSRC has even put forward higher demand on the information disclosure of the fund. Nevertheless, the "simplicity" and "availability" are quite abstract and lack the corresponding standard.

As for the information disclosure of the investment-linked insurance, there is no doubt we have to strengthen the requirements of "authenticity," "accuracy," "completeness," "timeliness," "simplicity" and "availability" on information disclosed by the insurer. The information disclosure of investment-linked insurance involves many professional terms, so it is hard to understand.[915] Also, the information disclosed is not the more, the better; not only it requires the "simplicity," but it also has to be significantly important and easily understandable. Because of the lack of "material standard" for the information disclosure, it results in a considerable amount of information to be disclosed, and people are avoiding important matters but dwelling on the trivial. Consequently, the actual results are far from satisfactory and have the issue of information incompleteness.[916] For this, SEC has further raised the requirements for "understandability" and "great importance," and this method can also provide references for corresponding legislation in China.

In 1998, SEC enacted many rules requiring that the issuers of the variable products to use plain and easily understandable language in their product prospectus. This rule is referred to as the "plain English rule," which requires the adoption of simple expressions in those aspects, including the organizational structure, language, cover

[915] "Purchasers may not be sufficiently sophisticated to understand the complexities of the policies, and it is difficult to prepare a legible prospectus for them." See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1020 (1973).

[916] See Li You, *The Applicable Logic of Caveat Emptor and the Inequality Found in Financial Consumption Relationship*, 7 Social Sciences of Beijing 38, 39 (2019).

design, summary, and risk factors.[917] SEC further stipulated six principles: the use of short sentences; the use of definite, concrete and everyday words; the use of active voice; the use of tabular presentations or bullet lists; do not use legal jargon or highly technical business terms; do not use multiple negatives.[918] Later on, SEC also made amendments to Rule 421(b), Rule 461 and Rule 481, which require that product prospectus, as a whole, must be clear, simple and easily understandable if the plain English rule is not observed, the SEC will delay the date on which the prospectus becomes effective.[919]

When it comes to the material standard on information disclosure, SEC enacted Rule 8b-2 under Rule 8 of the *Investment Company Act*. Rule 8b-2 defines the "material standard" as the following: "material standard" should be limited to the required information which should be reasonably told to the prudent general investors before they buy or sell securities of a specific company.[920] However, this definition is still abstract. When it comes to what kind of information should be provided to the investors, what is meaningful and easily understandable information, Mary L. Schapiro, then-Chairman of the SEC pointed out in 2009 that the purchase of securities is different from buying cereals at the grocery store where the nutritional ingredient labels and clear prices are attached to those foods, which makes it easier to compare with other products and easier to calculate the calories, however, for the purchase of securities, this may not be that easy, because the retail investors have to be provided with clear, simple and meaningful information disclosure, including information on understandable and comparable securities products and services, information on the remuneration to be obtained by each professional for the sale of each product and information on the possible conflict of interest.[921] In 2009, SEC released the summary prospectus rules, which require that the Form N-1A submitted should include the summary of the prospectus – key information including investment objectives, strategies, risks, costs, performance, etc. Also, the *Rules* have raised specific format requirements on the

[917] See Clifford E. Kirsch & Michael J. Mazza, *SEC Registration*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.8-3.
[918] See SEC "Plain English Disclosure", Release No. 33-7497, < https://www.sec.gov/rules/final/33-7497.txt>, Latest visited on Nov. 24, 2019.
[919] See Clifford E. Kirsch & Michael J. Mazza, *SEC Registration*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.8-4.
[920] "The term "material", when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling any security of the particular company." See Rule 8b-2 (g).
[921] See Mary L. Schapiro, *The Consumer in the Financial Services Revolution*, <https://www.sec.gov/news/speech/2009/spch120309mls.htm>, Latest visited on Nov. 15, 2019.

summary of the prospectus, i.e., the summary information should be placed on the cover page of the prospectus, and the summary shall include, among other things, the table of contents and incorporation by reference of the entire prospectus.[922]

Therefore, the information disclosure of the investment-linked insurance is mainly intended to make it clear to the purchasers and give them the emphasis that the return from investment account is not the scope of guarantee offered by insurance, but to be borne by oneself. To reduce misleading sales, a complete information disclosure should at least include sufficient explanations on product, balanced description of product advantages and disadvantages. More importantly, adequate alerts on all risks should be highlighted in advance.[923] On the other hand, from the perspective of incomplete information, we should also improve the understandability and material standard of information disclosure.

6.4 Fiduciary Duty

6.4.1 The Filling Up and Explanation under the Good Faith Principle in China

Under the Anglo-American law system, the fiduciary duty is originated from the trust, but is not limited to the trust relation, as the specific environment is frequently changing, the obligations of the trustee are being stipulated in a general open way, and expanded by analogizing the traditional trust relation. Being different from the flexibility of the case law based Anglo-American law system, which identifies the legal relation that possibly has the fiduciary duty, under the continental law system, the identification of the fiduciary duty requires an explanation based on existing laws. As it is discussed previously, the fiduciary duty is based on trust relation, in the legal principle of China, the one that is closest to the connotation of trust is the good faith principle. This principle combines both the moral rules and legal rules into one, so it has the dual function of both legal and moral regulating at the same time. Thus, the law has been given greater flexibility, and the Judge enjoys greater fair discretion, the autonomy of will on the part of the parties concerned can be ruled out to achieve a direct

[922] See 74 Fed. Reg. 4549-4560. Quote from Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-63.

[923] See Shen Wei, *Regulation and Improvement of Financial Products with Complex Structure*, 6 Peking University Law Journal 1297, 1308(2011).

adjustment of the right-obligation relation between the parties concerned. [924]

The good faith principle, as the "empire provision," is not only stipulated in civil laws, i.e., Article 7 of the *General Rules of the Civil Law* and Article 5 of the *Contract Law*, but is also explicitly stipulated in financial laws, such as Article 5 of the *Insurance Law,* Article 4 of the *Securities Law*, Article 5 of the *Commercial Bank Law* and Article 5 of the *Trust Law*. Judging from the cases in which the good faith principle is applied, except for the focus on the use of good faith principle as the code of conduct applicable to the parties concerned, the loophole fill-up function of it has also been properly utilized.[925] The good faith principle is the code of conduct containing legalized morality. It has handed considerable discretion to the Judges through "ambiguous rules" or "uncertain rules," which also means the acknowledgment of the creativity and initiative of judicial activities.[926] Also, the fiduciary duty is a rule with flexibility, meaning that the court may make specific judgments on each specific case. Thus it can be seen that in case the fiduciary duty on the part of the trustee is not specified in the financial management contract, nor has been provided in any financial law, then the good faith principle can be used to interpret. Some scholars have pointed out that the good faith principle, as the jurisprudential basis of the obligations bearable by trustees under the continental law system, is identical with the jurisprudence of the trust law under the Anglo-American law system.[927] In individual cases, we can introduce the fiduciary duty based on the good faith principle.[928]

In judicial practice, some courts interpret and apply the fiduciary duty on the party of the trustee through good faith principle.[929] Though the application of *Trust Law* in China is limited to nominal trust, however, among entrusted financial management products, be it the trust financial investment and management relation or the non-trust financial investment and management relation or regardless of whether it is fully entrusted financial management or non-fully entrusted financial management, the obligations of the trustee should all follow the standard for fiduciary duty. For the investors, the choice of the label - "trust" means the automatic application of "fiduciary

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[924] See Liang Huixing, *Principle of Good Faith and Its Interpretation*, 2 Chinese Journal of Law 22, 24(1994).

[925] See Xu Guodong, *The Application of the Principle of Good Faith in China's Judicial Practice*, 4 Law Science 22,31 (2012).

[926] See Xu Guodong, *Study on the Priciple of Good Faith*, 4 Chinese Journal of Law 74, 75(2002).

[927] See Zhao Lei, *The Definition of Role of Trustee and the Achievement of Relevant Institutions*, 4 China Legal Science 74, 81(2013).

[928] See Yan Yan, *Vendor's Duty of Fiduciary in Financial Derivatives Transaction*, 2 Science of Law(Journal of Northwest University of Political Science and Law) 126, 133(2014).

[929] See *Hu Laiying v. Li Lingxia*, Civil No.18657 of Beijing First Intermediate People's Court.

duty."[930] For financial management products under implied trust – the existence of a factual fiduciary duty,[931] the court may identify the fiduciary duty bearable by the trustee based on the good faith principle.

Therefore, though the *Insurance Law* has not specified the fiduciary duty bearable by the insurer, the rights and obligations of the parties to a contract are still established based on traditional insurance. The *Trust Law* and the *Securities Investment Fund Law* can be applied by analogy from the perspective of the good faith principle-based theory of interpretation, thereby the insurer's fiduciary duty can be specified, and the right-obligation relation in the investment-linked insurance can be balanced. Therefore the insurer, as the managerial trustee of the assets in the investment account, is required to engage in the entrusted matters for the maximized benefit of the beneficiary. This is like the investor gives money to the fund management company, trusts its professional management skills, and believes it will return the money exactly earned to the investor; what is being contained in it is the "trust."[932] In terms of the contents of the fiduciary duty assumed by the insurer, the core and foundation part should be the duty of loyalty, just as in a trade involves the conflict of interests, no damage will be brought to the interests of the policyholder (the principal) or the beneficiary. On this basis, the insurer should be diligent and responsible, invest prudently, prepare scientific investment strategies to realize the value preservation (safe), and appreciation (efficiency) purpose for the account assets.

6.4.2 The Performance of the Duty of Loyalty: Taking "Conflict of Interests" and " Management Remuneration" as Examples

The *Restatement of the American Law of Trust* expresses the core ideology of the duty of loyalty as "work in the best interests of the beneficiary," and this includes two connotations: First, the loyalty the trustee has for the beneficiary, the exclusion of the interests of any person other than the beneficiary. Second, the acts involve the conflict of interests will be forbidden, and the prevention of obtaining benefits for persons other than the beneficiary.[933] The purpose of the regulation on the insurer's duty of loyalty

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[930] See Shi Tiantao and Zhou Qin, *Commercial Trust: System Characteristics, Function Realization, and Legislative Adjustment*, 2 Tsinghua Law Review 114, 123 (2008).

[931] See Xing Huiqiang, *Fiduciary Duty and Suitability Doctrines of the Financial Institutions*, 3 Renmin University Law Review 38, 40 (2016).

[932] See Zhang Lu, Luo Xu, and Guo Xiaojing, *Comparison and Practice of Fund Law between China, America and Britain*, (Beijing: Law Press, 2007), p.12.

[933] See Jiang Xuelian, *Trustee's Duty of Loyalty*, 1 Peking University Law Journal 181, 196(2016).

is to ensure that the insurer should base on the good faith principle and dedicate to its job responsibilities without bringing any damages to the interests of the beneficiary. In the following paragraph, we will discuss the performance of the duty of loyalty by the insurer from the perspectives, including the handling of the trades that involve the conflict of interests and the collection of the fees by the insurer.

6.4.2.1 The handling of the trades that involve the conflict of interests

In the law of China, currently, there are no provisions on the trades that possibly involve the conflict of interests in the process of managing investment account by the insurer of the investment-linked insurance. The Article 73 of the *Investment Fund Law* applies anyway – anyone engages in other substantial affiliated transaction should follow the principle of giving priority to the interests of the fund share holders, prevent the conflict of interests and perform the obligation of information disclosure; Article 18 of the *Investment Fund Law* stipulates that the director, supervisor, senior management personnel and other employees under the fund custodian of the publicly offered fund shall not hold the post of fund trustee or any position provided by any other fund custodian, nor shall it engage in securities transactions or other activities that damage the fund property or harm the interests of the fund share holders. This *Article* includes that the fund practitioners shall not hold a concurrent post with "incompatible" job duties, involving non-competition or conflict of interests.[934] CSRC further stipulates that in the event where there is a conflict between the interests of the fund share holders and the interests of both the fund management companies and fund custodian banks, the principle of giving priority to the interests of the fund share holders should be persisted.[935] However, it still lacks a judgment standard on trades that involve the conflict of interests. Also, it is still hard for the fund trustees in China to effectively bring their supervision function into a play, because the fund custodians decide the recruiting and replacing of fund trustees. The fund trustee only collects a fixed amount of fund trust fee following the fixed-rate, and can not get any return from the fund property, whether it has tried its utmost efforts in supervising the fund custodian, and the performance of fund contract is not necessarily connected to the "income" it receives from the fund trusting.[936]

934 See Li Fei, *Interpretation of China's Securities Investment Fund Law*, (Beijing: Law Press, 2013), p.45.
935 See Article 19 of the *Measures for the Administration of the Appointment of the Senior Officers of the Securities Investment Fund Industry, CSRC No.23.*
936 See Wu Xiaoling, *Theory and Practice of Investment Fund Law*, (Shanghai: Joint Publishing, 2014), p.130.

For the trades involving the conflict of interests, the American *Investment Company Act* has provided the corresponding rules for the handling of affiliated transactions. For example, the transactions made by certain affiliated persons and underwriters are provided in Article 17 of the *Investment Company Act.*[937] This Article protects the interests of minorities from being used by insiders in strategic positions and ensures the maintenance of a “distance” in communication between the stakeholders and investment companies to make the best possible deals for the relevant share holders.[938] Article 17 (a), 17 (d), and 17 (c) of the law have stipulated specific provisions respectively on the principal transaction, joint transaction, and agency transaction.[939]

Under common company acts, when handling transactions that involve the conflict of interests, according to the fairness standard, as long as anyone of the following 3 conditions is met, the transaction will be effective: (1) obtain the consent from the uninterested directors; (2) obtain the consent from the board of shareholders; (3) the transaction is proved to be fair;[940] The “fairness standard” is also adopted in the *Investment Company Act*, for example, it is stipulated in 17 (b) that conditions in Article 17 (a) shall be satisfied for exemptions to apply: (1) the clauses (including considerations to be paid or received) based on which to engage in a transaction are fair and reasonable and do not involve any excessive requirements from any relevant person concerned; (2) the trade is consistent with the policies contained in registration statement or report submitted when registering an investment company; (3) the purpose of the trade is identical with the basic purpose of this chapter.[941] Thus it can be seen that the main judgment basis relating to whether an affiliated transaction is legal is the adoption of fairness standard. Article 36 of the law further stipulates the accountability in case the fiduciary duty is violated: Shareholder or SEC, as a plaintiff, can file a civil lawsuit against the investment adviser or any affiliated person of the investment adviser on the latter’s violation of the fiduciary duty, in which it shall assume the corresponding

[937] See 15 U.S.C. 80a-17.
[938] See Hazen Thomas Lee, *The Law of Securities Regulation*, (Beijing: China University of Political Science and Law Press, Chinese translation edition, translated by Zhang Xuean, 2003), p.850.
[939] See 15 U.S.C. 80a-17.
[940] See Shi Tiantao, *Company Law*, (Beijing: Law Press, 2018), p.439.
[941] “(1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned; (2) the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under this title; and (3) the proposed transaction is consistent with the general purposes of this title.” See 15 U.S.C. 80a-17(b).

burden of proof.[942]

In the case law, when an investment adviser is engaging in trades that involve the conflict of interests, "whether or not corresponding information disclosure has been performed for such trades" is the key factor used to determine whether it has violated the duty of loyalty. For example, in *SEC v. Capital Gains*, the Federal Court of the US held that the investment adviser should assume the fiduciary duty against its customer, and relevant investment advice must be free from any conflict of interests, and all material information shall be disclosed; [943] The investment adviser is not allowed to engage in relevant transactions before the disclosure of its personal interest to the customer thoroughly and fairly; [944] In addition, experiences indicate that under such circumstance, the disclosure of relevant information is of vital importance to the maintenance of fair transaction and the economic development.[945] Also, it is required in Form N-1A that the contents to be disclosed by the prospectus should follow Article 10 (a) of the *Investment Company Act*, which is to disclose the affiliation of directors – among board members of a registered investment company, the number of interested person of the registered investment company should be no more than 60%.[946]

However, those Articles are only applicable to the circumstance where the investment account is registered as an open-end management company, not applicable to the circumstance of separated accounts under registered unit investment trust. In fact, in the case of registered unit investment trust, the principle is a shared one if the duty of loyalty on the part of the trustee is referred to as the judgment standard – relevant transactions have to be disclosed, and the transactions have to be proved to be fair.

6.4.2.2 The collection of fees, by the insurer, e.g., the management remuneration

Article 26 of the *Trust Law* stipulates that except for the collection of remuneration

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[942] See 15 U.S.C. 80a-36.

[943] "The statute, in recognition of the adviser's fiduciary relationship to his clients, requires that his advice be disinterested. To insure this it empowers the courts to require disclosure of material facts." See *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 201(1963).

[944] "The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients." See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201(1963).

[945] "Experience has shown that disclosure in such situations, while not onerous to the adviser, is needed to preserve the climate of fair dealing which is so essential to maintain public confidence in the securities industry and to preserve the economic health of the country." See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201(1963).

[946] "No registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company." See 15 U.S.C. 80a-10.

under this law, the trustee shall not make use of the trust property for its own profit. If the trustee, by making use of its authorities of office, charges over high payment but can not provide corresponding services, then it shall also be considered as a violation of the duty of loyalty. Some scholars have pointed out that management remuneration is also, in fact, a self-dealing, or perhaps the most commonly seen trades involving the conflict of interests is the management remuneration.[947] This thesis truly believes so, as for the investment-linked insurance, there are no corresponding governance rules on the investment account, the insurer collects fees including the product cost of the investment-linked insurance, assets management fee, etc., especially the account assets management fee, whether the amount has been charged reasonably remains unclear, the remuneration collected by the insurer more often is identified by itself unilaterally, but lacks of corresponding supervision and judgment standard.

Viewing from the US law, for the governance rules on separated accounts under the registered unit investment trust, the main basis is the signed trust contract, which is subject to the regulation of the *Trust Indenture Act of 1939*.[948] Nevertheless, the *Investment Company Act* has stipulated provisions on some crucial matters. For example, on the insurer's collection of the fees relating to the separated account, Article 26 (f) of the Investment Company Act stipulates that except for fees and remunerations deducted according to the contract, overall, it is reasonable in terms of the services provided, anticipated expenses and the risk assumed by the insurance company.[949] This is also referred to as the "reasonableness standard", and the insurer has to follow this reasonableness standard, especially for the case of a variable contract, which provides the profit distribution arrangement for affiliated or unaffiliated underlying funds.[950] Furthermore, this has not set any limit on the choice of underlying funds by insurance. However, it is illegal unless SEC approves it if other funds are used to replace the previously chosen underlying funds.[951]

In 1996, the U.S. Congress authorized the SEC to enact rules on a reasonableness

[947] See Shi Tiantao, *Company Law*, (Beijing: Law Press, 2018), p.447.
[948] See Hazen Thomas Lee, *The Law of Securities Regulation*, (Beijing: China University of Political Science and Law Press, Chinese translation edition, translated by Zhang Xuean, 2003), p.832.
[949] "unless the fees and charges deducted under the contract, in the aggregate, are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company". See 15 U.S.C. 80a-26(f).
[950] See Gary E. Jenkins, *Regulation of Variable Insurance Products Under the Investment Company Act of 1940*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3A-43.
[951] See 15 U.S.C. 80a-26(c).

standard. In other words, if SEC affirms that it is necessary or appropriate out of consideration for maintaining public interests or protecting investors, it can then implement Article 2 (a) by enacting rules or regulations at an appropriate time.[952] SEC did not enact detailed rules on the reasonableness standard, but required that the insurer should submit a report on the reasonableness of the expenses and remuneration when registering the separated account, and also this report is allowed not to appear in the product prospectus.[953]

As for how to judge whether the cost of contract and remuneration are reasonable, SEC did not propose any specific referential factor. However, in Article 26 (f) of the *Investment Company Act,* it has expressly listed three factors – the "services rendered," the "expenses expected to be incurred," the "risks assumed by the insurance company."[954] Among them, the first one, the "service rendered" mainly includes the death benefit options, living benefit options, etc; the second one, the "expenses expected to be incurred" involves direct or indirect costs, i.e., the cost of contract insurance premium, cost of contract administration, cost of contract sales, cost of operation, etc.; the third one, the "risks assumed by the insurance company" mainly refers to mortality risk, the risk that the actual cost may exceed the expected cost, etc.[955] Apart from that, there are considerations, such as "reasonable profit" and "product innovation."

All in all, neither the U.S. Congress nor the SEC has specifically put forward the considerations in the reasonableness standard set for the cost of contract and remuneration. In fact, those are already in the business scope run by an insurance company. Too much interference from the public power, on the contrary, may not be conducive to the protection of investors. However, SEC has once noted in a report that this "reasonableness standard" has given the insurer the burden to evaluate the reasonableness of the expenses, which is intended for the flexible development of the insurer and the effective sales of the product.[956]

In addition, even for the case where the insurer is acting as the trustee, the

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[952] "The Commission may issue such rules and regulations to carry out paragraph (2)(A) as it determines are necessary or appropriate in the public interest or for the protection of investors." See 15 U.S.C. 80a-26(f)(4).
[953] See Christopher E. Palmer, *Variable Insurance Product Design*, Variable Annuities and Variable Life Insurance Regulation, ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.6-7.
[954] See 15 U.S.C. 80a-26(f).
[955] See Christopher E. Palmer, *Variable Insurance Product Design, Variable Annuities and Variable Life Insurance Regulation*, ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.6-10.
[956] See SEC 1992 Report, "*Protecting Investors: A Half Century of Investment Company Regulatio*n", pp.404-405.

performance of its duty of loyalty also needs to prevent the mixed-use of its self-owned capital and the fiduciary property, in other words, except for the required separate bookkeeping and separate management (Article 29 of the *Trust Law*), the law also requires the "presence of trusteeship". For example, judging from the investment fund trust, Article 5, 6, and 7 of the *Investment Fund Law* have stipulated the independence of fund property, stressing that the fund property has the legal effect of isolated trust assets.[957] Also, Article 36 of the *Investment Fund Law* stipulates that the fund trustee should have the job responsibilities including the safe preservation of the fund property, re-check and review the net value of the fund assets calculated by the fund custodian and the subscription and redemption price of the fund share, supervise the investment operation of the fund custodian. As for the fund trusteeship conducted in the investment account of the investment-linked insurance, if the capital in the account is not independent, it is easy to mix the use of self-owned capital and capital in the investment account, then it is easier to use self-operating account to make an unfair transaction with the investment account.

Therefore, the capital in the investment account must be managed and trusted separately to prevent the mixed-use of fund capital in various types. The CIRC, at an earlier time, had made provisions on the independence of the investment account of the investment-linked insurance, i.e., Article 3 of the *Interim Measures for the Management of Investment-linked Insurance* expressly stipulates that there should be no debtor or creditor relationship between a specific investment account and other investment accounts. Article 7 requires that the assets in the investment account must be managed separately, but the hard and rigid rules on the fund trust in investment account were stipulated in the *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insurance* (No. 32 [2015]). Article 7 of the *Notice* explicitly stipulates that the assets in the investment account should all be trusted. The problem is that despite the *Notice* expressly specified that the investment account should be trusted, the hierarchical level of its execution force is low, and it remains unclear as for how to exactly carry out the trust and the job responsibilities of the trustees.

6.4.3 The Performance of the Duty of Care: the Prudent Investor Rule

[957] See Article 5, 6 and 7 of China's *Investment Fund Law.*

The ultimate meaning of trust lies in that the trust property is being operated and managed by the trustee in order to acquire an income, thus enabling the acquisition of trust interest by the beneficiary.[958] This also means that the trustee, while performing its duty of diligence, unavoidably participates in the investment management, thus to realize the preservation (safety) and appreciation (benefit) of the value of the asset. The investment by the trustee is not only its power and responsibility but also its obligation. Judging by the trust laws of various countries, the duty of care bearable by the trustee is generally deemed as one of the basic obligations of the trustee, [959] whereas being prudent in investment is a detailed representation of the duty of care.[960] When the trustees are performing their obligations to invest, they are enjoying their discretions and may choose a suitable scheme from various investment schemes.[961] Therefore, we need to specify the standard for the performance of the duty of care by the trustees.[962]

In US law, it has roughly gone through such a process that is from the "statutory investment list" to "prudent person standard" and then to "prudent investor rule". First of all, the "statutory investment list"; Duty of care standard in early times focuses on the safety of the trust property, and believes that investment should be restricted to those with high-level safety (e.g., government bond & bank certificates of deposit) and "private securities" are deemed as "fierce floods and savage beasts", and the trustees are not allowed to "transgress the bounds" even if the "private securities" have high returns.[963] Therefore, the US law, in early times, adopted the "statutory investment list" for the duty of care bearable by the trustees – the trustees were only allowed to invest in the scope formed by the "statutory investment list." For example, in *King v. Talbot*, the court held that the trustee who is in possession of investment trust fund for the interests of the underage children, has the right to obtain remuneration from the income arising out of it and also has the obligation to maintain the security of the fund and ensures the benefits arising out of it.

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958 See Shi Tiantao, *Commercial Law*, (Beijing: Law Press, 2018), p.373.

959 "Tt is all very well to say that investment managers are bound to exercise reasonable care in carrying out their professional responsibilities." See Harvey E. Bines & Steve Thel, *Investment Management Law and Regualtion*, (New York: Aspen Publishers, 2004), p.24.

960 See Zhang Min, *A Study of the Trustee's Prudent Investment Obligation*, (Beijing: China Legal Publishing House, 2011), p.28.

961 See Huang Renjie, *Study on Investment Obligations of the Trustee*, 1 International Business 44, 46(2004).

962 "The problem with the reasonable-care standard in the context of investment management is not in understangding the theory that supports it, but in applying it to real situations." See Harvey E. Bines & Steve Thel, *Investment Management Law and Regualtion*, (New York: Aspen Publishers, 2004), p.24.

963 See Zhang Min, *A Study of the Trustee's Prudent Investment Obligation*, (Beijing: China Legal Publishing House, 2011), p.40.

However, according to the law of the State of New York, the trustee who owns investment fund for the interests of its underage children must invest in government or real estate securities,[964] so the investment of the fund in canal, bank, insurance, railway or stocks of other private companies has breached its job responsibilities and fiduciary duty.[965] Thus it can be known from above, though the "statutory investment list" attaches importance to the safety of trust investment, its scope of investment is narrow with poor flexibility and being too conservative in investment management. Secondly, the "prudent person rule"; For example, in *Creed v. McAleer*, the court held that the trustee must be loyal and make reasonable decisions when conducting the investment, that it shall manage its matters in the role of a prudent and smart person, rather than speculating, and that it shall consider the long term disposition of the fund, income and fund safety.[966]Also, the court brought forward some judgment factors – when the trustee is investing, it shall have a reasonable skill, prudence, and sound discretion; otherwise, it shall assume the liability for damages.[967] This rule was adopted in 1959 by the second edition of the *Restatement of the American Law of Trusts,* e.g., in Article 174 of it, and it stipulates that the trustee shall have an obligation to perform the duty of care, to have the reasonable skills and to be prudent.[968]

Thirdly, the "prudent investor rule"; This rule is mainly based on the Modern Portfolio Theory.[969] Under the "prudent investor rule," trustees are allowed to invest in any field. The only condition or the standard is that he or she must perform the duty of care to such an extent that it looks like any prudent man acts when managing or disposing of his property.[970] "Prudent investor rule" was adopted both by the third

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[964] In this State, a trustee holding funds for investment for the benefit of minor children, must invest in Government or real estate securities. Any other investment would be a breach of duty and the trustee personally liable. See *King v Talbot,* 40 N.Y. 76 (1869).

[965] The law, in this State, imposes upon trustees, holding trust funds for investment for the benefit of minor children, to be supported from the income accruing therefrom, the duty of placing them in a state of security, of seeing that they are productive of interest, and of so keeping them, that they may always be subject to future recall, for the benefit of the cestui que trust. The investment of such funds by a trustee in canal, bank, insurance, railroad or other stocks of private corporations, is a violation of his duty and the obligation of his trust. See *King v Talbot*, 40 N.Y. 76 (1869).

[966] "A trustee, to invest, is required to conduct himself faithfully and to exercise a sound discretion, observing how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, and considering the probable income as well as the probable safety of the capital involved." See *Creed v. McAleer*, 275 Mass. 353, 175 N.E. 761.

[967] "a trustee must exercise reasonable skill and prudence and sound discretion in making or retaining each investment and is chargeable with any loss by failing to do so." See *Creed v. McAleer*, 275 Mass. 353, 175 N.E. 761(1931).

[968] "The trustee is under a duty to the beneficiary to use reasonable care and skill to preserve the trust property." See Restat 2d of Trusts, § 174.

[969] "Modern portfolio theory has introduced a profound shift in perspective into portfolio management." See Harvey E. Bines & Steve Thel, *Investment Management Law and Regualtion*, (New York: Aspen Publishers, 2004), p.315.

[970] See Shi Tiantao, *Commercial Law*, (Beijing: Law Press, 2018), p.379.

edition of the *Restatement of the American Law of Trusts of 1992* and by the *Uniform Prudent Investor Act of 1994* and was deemed as a default rule, which could be extended, limited, removed based on the trust clauses or altered in another way.[971] Article 90 of the third edition of the *Restatement of the American Law of Trusts* provides a "General Standard of Prudent Investment," i.e., the trustees are required to maintain reasonable prudence, skill, and caution and adopt portfolio investment,[972] and are obliged to diversify the investments.[973] In the *Uniform Prudent Investor Act of 1994,* it has also stipulated that the trustee, as the prudent investor, should consider the trust purpose, requirements for dividends and other factors, and also there is an enumeration of other factors: "(1) general economic conditions; (2) the possible effect of inflation or deflation; (3) the expected tax consequences of investment decisions or strategies; (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property; (5) the expected total return from income and the appreciation of capital; (6) other resources of the beneficiaries; (7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries".[974]

In the continental law countries, there is no expression for fiduciary duty; more often, the expression – "the duty of bona fide manager" is used. This "duty of bona fide manager" is more or less the same with the connotation and denotation of the fiduciary duty under the Anglo-American law system. Therefore, the duty of loyalty as contained in the fiduciary duty is a part of the "duty of bona fide manager," in other words, the "duty of bona fide manager" includes the duty of care and the duty of loyalty.[975] The concept of "bona fide manager" should be a concept corresponding to the "ordinary prudent man" as addressed in the Anglo-American law countries.[976] The "bona fide manager" is the duty of care standard generally referred to under the continental law

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[971] "The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust." See § 1. Prudent Investor Rule of Uniform Prudent Investor Act.

[972] "This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust." See Restat 3d of Trusts, § 90 (a).

[973] "In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so." See Restat 3d of Trusts, § 90 (b).

[974] See § 2. Standard of Care: Portfolio Strategy; Risk and Return Objectives of Uniform Prudent Investor Act.

[975] See Liang Shangshang, *Shareholder's Voting Right*, (Beijing: Law Press,2005), p.267-268.

[976] See Zhong Xiangchun, *Study on the Duty of Care of the Trustee of Business Trust in China*, (Beijing: China University of Political Science and Law Press, 2015), p.85.

system.[977] For example, among the Japanese Laws, the *Trust Law* and "*Trust Industry Law*" has not adopted the expression of "prudent" in the US law. Instead, they adopt the expression, the "the bona fide manager's duty of care," i.e., Article 29 of the *Trust Law* in Japan. The "the bona fide manager's duty of care" is also adopted in Taiwan. For example, Article 22 of the *Trust Law* of Taiwan provides that the trustee should adhere to the essence of trust, and handle the trust affairs based on "the bona fide manager's duty of care."[978] For another example, Article 22 of the *Trust Industry Law* of Taiwan stipulates that "the bona fide manager's duty of care" should be performed, and the duty of loyalty should be assumed in the handling of the trust business within the trust industry.[979] However, "the bona fide manager's duty of care" is an extremely "obscure concept," with its connotation being uncertain and denotation being open, this concept is only used by the legislation to point out a judgment direction for the Judges. As for how "far" the Judge can go along this direction, it is up to his or her discretion in each case.[980] Continental law countries should gradually change their proposition of "bona fide manager," and turn to adopt the "ordinary prudent man" standard, as it is easier to be understood by the public and the "duty of care standard" established for the trustees by using it as the basic concept is easier to be promoted.[981]

In the law of China, there is no direct adoption of the expression, "bona fide manager." However, the content of the duty of care bearable by the trustee has also included the obligation of being prudent while investing. For example, Article 25 of the *Trust Law* – The trustee must dedicate to its job responsibilities and perform the duty of being honest, credible, prudent, and effective in its management of the trust property. Article 9 of the *Investment Fund Law* stipulates that the fund trustee, while managing and using the fund property, should dedicate to its job responsibilities and perform the duty of being honest, credible, prudent, and diligent. In those contents, "prudence" mainly means being prudent in investment management. Therefore we have the viewpoint that holds that the expression, "duty of care," as found in China's *Trust Law* is directly cited from the Anglo-American trust laws.[982] In addition, Article 71 of the

[977] See Zhang Min, *A Study of the Trustee's Prudent Investment Obligation*, (Beijing: China Legal Publishing House, 2011), p.108.
[978] See Taiwan's Law Database , <https://lawsnote.com/law/57467a07b1056c1000ee8650> , latest visited on Nov. 20, 2019.
[979] See Taiwan's Law Database ,<https://lawsnote.com/law/574678a4b1056c1000ede725?t=3075129346> , latest visited on Nov. 20, 2019.
[980] See Liang Shangshang, *Shareholder's Voting Right,* (Beijing: Law Press,2005), p.267.
[981] See Zhong Xiangchun, *Study on the Duty of Care of the Trustee of Business Trust in China*, (Beijing: China University of Political Science and Law Press, 2015), p.85.
[982] See Zhang Min, *A Study of the Trustee's Prudent Investment Obligation*, (Beijing: China Legal Publishing House,

Investment Fund Law stipulates that the fund manager who uses fund property for securities investment, should adopt the asset portfolio method; Article 73 further provides that fund property should not be used for securities underwriting, for offering loans to other people or providing guarantee by violating rules or for engaging in investment or activities that require the assumption of unlimited liability.

In the law of China, "prudent investment," more often, only exists as a fundamental principle, which, unlike the trust laws under Anglo-American law system, has not formed corresponding specific standard and requirements[983] For instance, from the perspective of bona fide manager, the *Trust Law* in China, has stipulated the separated management and separated bookkeeping for trust property and inherent property (Article 29), and the management of trust affairs in person (Article 30).

In comparation, the US's "prudent investor rule," which focuses on the investment process, is a standard code of conduct, rather than a result-oriented standard rule for performance. Also, it focuses on being prudent in the investment as a whole, rather than individual investment acts. Despite the "prudent investor rule" is a default rule, rather than a compulsory statutory obligation, this rule has provided many considerations, which have great referential value and strong operability.

In addition, it is necessary to clarify the relation between "prudent investor rule" and "business judgment rule," both of which are rules used to judge whether the trustee has duly performed the duty of care in the basic structure of "principal-trustee." However, this thesis holds that we can not use the "business judgment rule," which is mainly applied in the company law field, for the judgment on the standard for the performance of the duty of care by the insurer of the investment-linked insurance. The former is mainly intended to balance between the company interests and director interests – the seeking of a balanced point between the managerial or operational faults and the legal liabilities bearable for such faults by the director or the manager. In other words, the "business judgment rule" is intended to provide a safe harbor for the director or the manager. If the director or the manager has performed the bonafide and reasonable duty of care in the business decision made for the company, even if such business decision is proved to be wrong at a later time, they should not be held liable.

2011), p.163.

[983] See Zhang Min, *A Study of the Trustee's Prudent Investment Obligation*, (Beijing: China Legal Publishing House, 2011), p.163.

The differences in the application of the two are not limited to this; the entrustment risks bearable by the "principals" are in a significant difference. In the context of company law, the director or the manager (the "trustee"), in general, has high operational risks, the principal (the "shareholder") thus is also assuming high risks or enjoying significant returns. In risk-bearing, the company law has also set forth many rules for the choice of the principal (the "shareholder"), i.e., "cumulative voting," "supervision by independent director or supervisor," "voting with feet," etc.

However, under the framework of principal (the "policyholder") – trustee (the "insurer") as found in the investment account of the investment-linked insurance, the rules outlined in company above the law can not be applied to the legal relation in the investment-linked insurance, i.e., the "exit and redemption rules" for the policyholder is not as convenient as that for the shareholder; more importantly, though the investment-linked insurance has strong securities attribute, still the product has the attribute of insurance guarantee. The stable life of the beneficiary may depend on the capital value of the investment account, so the trustee (the "insurer") still attaches importance to the safety of capital usage in investment management. Therefore, in terms of the legal relation of the investment account, the application of the "business judgment rule" to the judgment on the performance of the duty of care by the insurer is not appropriate.

6.5 Application of Other Rules and Exemptions to Rules

Except for the application of the abovementioned anti-fraud rules, the legal application of the investment-linked insurance also involves the application of many other rules, e.g., the competition and cooperation between rules and exemptions to rules.

6.5.1 Competition and Cooperation between Rules: Taking the Application of the Supervision Rules on the Conditions Setting for the Issuance of the Investment-linked Insurance

Investment-linked insurance, as a financial product, the issuer should have the qualifications for certain financial business. In other words, first of all, the issuance of investment-linked insurance should satisfy the conditions for the establishment of an insurance company. Article 68 of China's *Insurance Law* expressly stipulates that for

an insurance company to establish, it must meet the conditions including sustainable profitability (no serious crime over three years with net asset no less than 200 million yuan), qualified articles of incorporation, paid-in registered capital (no less than 200 million yuan),[984] professional management team, complete organizational structure and system, business premise, etc. The differences between the conditions required by existing laws on the establishment of an insurance company and the conditions required by the *Insurance Law* of 1995 and 2002 are that the latter has not expressly required the insurance company's capability of sustainable business operation, and also it is stipulated that the insurance regulatory and management institution should consider the development of insurance industry and the demand for fair competition when reviewing the application for an establishment.[985] Thus it can be seen that the conditions set forth in the existing *Insurance Law* on the establishment of an insurance company has, for one thing, reduced the consideration at the macro level on industrial background during the review, and for another thing, raised higher demand on sustainable profitability.

Under the line of thought, "substance over form," being followed for the application, if the investment account of the investment-linked insurance is essentially a kind of securities investment fund, which also means that the issuer of it should not only need to satisfy the requirements for the establishment of an insurance company, but also need to meet the requirements of the *Securities Investment Fund Law* for the fund manager. Article 13 of the existing *Securities Investment Fund Law* stipulates the following conditions on the establishment of a fund management company for the publicly offered fund: articles of incorporation, paid-in capital should not be less than 100 million, major shareholders have good performance in the business management, good internal governance structure, qualified business premise, qualified fund practitioners, etc.

Under the existing laws, there are relatively high thresholds for the establishment of both the insurance company and the fund management company, and the requirements for the former are even higher than that for the latter, e.g., the paid-in minimal registered capital and sustainable profitability. In other words, the issuance of the investment-linked insurance by the insurance company also can meet the conditions in the *Securities Investment Fund Law* for the establishment of the fund manager.

[984] See Article 68 of China's *Insurance Law.*
[985] See Article 71 of *Insurance Law* of 1995; Article 72 of *Insurance Law* of 2002.

Therefore, the business qualifications of the issuer of the investment-linked insurance should satisfy the requirements in Article 68 of the *Insurance Law*. This applies to US law as well. For example, Rule 14a-2 stipulates that if an insurance company is a joint-stock company with an asset size of at least 100 million US dollar, then it can be exempted from the application of the asset size requirement for an investment company, which is set forth in Rule 14 (a) of the *Investment Company Act*. Because for the issuance of the shares of separated accounts to the public, the assets of the insurance company should be able to satisfy the asset size requirement set forth in Rule 14 of the *Investment Company Act.*[986]

6.5.2 Exemptions to Rules: Taking Article 106 – the Supervision Rules on the Safety of Capital Usage as An Example for Analysis

Article 106 of the *Insurance Law* stipulates that the use of insurance funds has to be stable and in accordance with the safety principle, and should be limited to those forms of fund usage, including bank deposits, selling and buying negotiable securities, such as the stocks. For the so-called insurance fund, Article 16 of the *Insurance Law* has not made any provisions on it, nor has any specific provision on the proportion of the investment assets from the insurance fund, but stipulates that the CIRC should formulate particular management measures.

As has been discussed previously, the premium in the investment account of the investment-linked insurance is mainly used for investment rather than risk guarantee. The nature of the fund is entirely different from the traditional insurance fund. The insurer also does not need to assume the investment risk of the investment account, which shall be wholly assumed by the policyholder. This suggests that the fund in the investment account does not need to follow the safety principle for the use of the insurance funds. In other words, the application of this rule has been exempted. In fact, Article 20 of *Measures for the Administration of the Utilization of Insurance Funds* (No.1 [2018]) exempts the use of the fund of the investment-linked insurance, and stipulates that the assets allocation, investment management, etc. for investment-linked insurance are independent of other insurance funds, which also means that the use of the fund of the investment-linked insurance is exempted from the application of the

[986] See Wendell M. Faria, *Status of Insurance Companies and Insurance Company Separate Accounts Under the Investment Company Act*, Variable Annuities and Variable Life Insurance Regulation. ed. By Clifford E. Kirsch, (New York: Practising Law Institute, 2018), p.3-26.

rules for fund usage of traditional insurance.

Nevertheless, the exemption of the fund of the investment-linked insurance to the application of Article 106 of the *Insurance Law* does not mean the free from the supervision from public power. The use of the fund in the investment account should comply with the “style” of the investment account. For investment accounts with different styles, i.e., “positive growing investment account,” “investment account with robust income” and “aggressive investment account,” we should have different and specific investment strategies and limitations on the proportion of fund allocation, and further determines the different ratios of the fund respectively allocated to liquid assets, fixed income assets, assets with listed rights and interests, an investment plan for infrastructure, real estate related financial products and other financial assets.

For the use of the fund of the investment-linked insurance, currently, the major regulations are from the *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insurance (No. 32 [2015])* enacted by the CIRC in 2015. Article 4 of this *Notice* requires that the assets allocation in the investment account should have a reasonable value estimation method to satisfy the demand of the investment account for value estimation at a high frequency, and also the investment-linked insurance should have an open transaction market or though with no open transaction market available, but has expected stable income.[987] Also, for the liquidity management of the investment account, the CIRC requires that the investment balance of the liquid assets in the investment account should not be less than 5% of the account value; for investment plan for infrastructure, real estate related financial products and other financial assets, this figure should be 75%, and for any single item, this figure should be 50%.[988] Also, the corresponding liquidity management plan should be established. For example, at the initial period since the establishment of the investment account, when the percentage of redemption within ten working days exceeds 10% of the account value; during the liquidation of the investment account, the investment account can break

[987] See Article 4 of *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insurance (No. 32 [2015]).*
[988] See Article 6 of *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insurance* (No. 32 [2015]).

through the percentage limit set above for liquidity management, but should be adjusted to the prescribed limit within 30 working days.[989]

Besides, under the line of thought, "substance over form", based on the securities attribute of the investment account, there are also many exemptions when it comes to the application of the securities law. For example, rules in China's *Securities Law* on open transactions of the securities and on many others should also fall into the scope of the exemption.

6.6 Chapter Summary

This chapter discusses the return to the "application of the regulations in existing laws to ILI," as well as the improvement in this regard by mainly analyzing the rules represented by the anti-fraud rules.

In the application of the existing *Insurance Law*, the section that is chiefly analyzed is the good faith principle in this law. For example, in terms of the obligation to tell, Article 16 of this law – the performing subjects should not only include the policyholder but also include the insured. When handling the legal effect of the violation of the obligation to tell, "risk premium" and "investment premium" should be differentiated. The return of premium in the case of the traditional life insurance is analogized to such "risk premium," and the distinction among "deliberateness," "gross negligence," and "general negligence" should be made based on the subjective state of mind. The "either all or none" mode should be given up, and the legal effect of the performance of the obligation to tell should be evaluated according to the principle of the balance of consideration. In the event where the obligation to tell has not been performed, the legal effect, in case the contract is terminated, should only be limited to the non-return of the "risk premium," but the "investment premium" in the investment account should be returned as per the cash value in the account. As another example, for the performance of the obligation to explain, it is not appropriate to interpret the "clauses on self-bearing of investment risk" as found in ILI contract as the "exceptions." It is further judged on whether the insurer has duly performed the obligation to explain. For this, we should refer to relevant rules in foreign laws and interpret such "clauses on self-bearing of risk" as "important matters" of contract, which shall be regarded as a

[989] See Article 6 of *Notice of the China Insurance Regulatory Commission on Matters concerning Regulating the Investment Accounts of Investment-Linked Insurance* (No. 32[2015]).

factor for the evaluation of the insurer's performance of the obligation to explain.

In the anti-fraud sale of ILI, the suitability obligation, which requires the sale of this product to a group of customers with certain risk-bearing capacity, has played a significant institutional value. This is mainly served as a pre-contract obligation, and its performing subjects include the insurer, insurance agent, and insurance broker. For the identification of a breach of this obligation, the presumption of the fault should be adopted, and the insurer should bear the due performance of such obligation. However, in China, the hierarchical level of the regulations on the suitability obligation is low and is mainly stipulated in departmental regulations, notices, etc. In future, it should be stipulated in the basic laws and be deemed as a direct basis of the private right relief. In the performance of suitability obligation, comprehensive considerations should be given to many essential matters concerning a specific customer, including the occupation, age, bank savings, risk-bearing capacity, investment experience, etc. so as to judge the appropriateness of the product to the specific customer.

For ILI and its investment account, the rules on the disclosing subjects, the principle of disclosure, the content of disclosure, the method of disclosure, etc. are not as detail as the corresponding rules for the fund. The future improvement on the application should also follow or refer to the information disclosure rules for the securities investment funds. In terms of the contents of information disclosure, we may refer to relevant "Form Requirements" from the SEC in the US and provide the guidance and templates for the information disclosure of ILI and its investment account. We also have to attach importance to the "understandability and great importance" requirements for the information to be disclosed.

The fiduciary duty on the part of the insurer is interpreted and fulfilled by the good faith principle. In the performance of the duty of loyalty, information disclosure by the insurer should be strengthened for trades that involve a conflict of interest and for the collection of fees, including the managerial remuneration payable to the insurer. In terms of the performance of the duty of care, we should observe the "prudent investor rule" and refer to relevant rules in the US laws to specify the corresponding evaluation factors.

Because of the multiple legal attributes of ILI, the application of corresponding rules may involve many departmental laws or regulations, that is, *Insurance Law, Trust*

Law, Securities Investment Fund Law. It is unavoidable that there may be competition and cooperation between the application of those rules, as well as the exemptions, for example, the conditions for the issuance of ILI and the application of the rules on the use of the fund in the investment account.

Chapter Seven Rethinking Comparative Law: Differences between US and Chinese Law

Legal regulations and their mode in the context of US law are not a universally applicable model. The analysis of US law is not intended to simply copy its relevant provisions, because the numerous rules of each nation are not independent but rather cooperate with other rules to form a normative system. In addition, rules themselves are subject to the impact of multiple factors, including path dependence, the economy, culture, and gaming between political powers. Hence, it is necessary to explore the reasons for differences between US and Chinese law.

7.1 The Incentives of Financial Regulators

7.1.1 The Internal Incentives of Financial Regulators

7.1.1.1 The Role of "Helping Hand" in Financial Market

As we know, regulation is only part of the overall governance of institutions. Since the market has its shortcomings, it is necessary for the government to intervene and adjust the market as the visible hand to promote economic growth, protect investors, and make up for market shortcomings. "Public policymakers share the objective of designing a financial system which, to the fullest extent possible, maximizes social welfare. This assumption is consistent with the 'helping hand' perspective of policymaking, that views policymakers as, in effect, perfect rule-makers: driven by their altruism and public service ethos to identify and correct market failures."[990]

For example, in the US, both state and federal regulators have concluded that annuities in general present consumer protection issues and need particular regulatory attention.[991] In proposing Rule 151A, the SEC cited the need to protect investors, particularly older investors, from fraudulent and abusive practices related to the sale of indexed annuities.[992]

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990 John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.555.

991 See Baird Webel & Rena S. Miller, *Securities and Exchange Commission Rule 151A and Annuities: Issues and Legislation*, CRS Report for Congress, July 1, 2010, p.4.

992 See Baird Webel & Rena S. Miller, *Securities and Exchange Commission Rule 151A and Annuities: Issues and Legislation*, CRS Report for Congress, July 1, 2010, p.4.

The US's state regulators have also taken particular actions to protect consumers from abuses in annuity products.[993] To help harmonize states' oversight efforts, the NAIC's model laws and regulations include an "Annuities Disclosure Model Regulation" and a "Suitability in Annuity Transactions Model Regulation." [994]

In China, in order to protect policyholders, although CIRC considers the ILI as life insurance, the CIRC's regulations have adopted the logic of securities laws to ILI in the aspect of information disclosure. The CIRC issued the *Interim Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (No.6 [2002] of CIRC, issued on December 6, 2001), and the Chapter 2 of the No.6[2002] stipulates especially for the information disclosure of ILI.

7.1.1.2 The Role of "Grabbing Hand" in Reality

Andrei Shleifer and Robert W. Vishny, from the perspective of the "grabbing hand" of the government, believe that the government is innately seeking to maximize political benefits and often harms public welfare, and the goal of politicians is not to maximize social welfare but to pursue their own personal interests.[995] In other words, government administrative intervention does not fully serve the public interest. In reality, of course, policymakers may eschew such public-minded objectives in favour of their narrow self-interest because self-interested politicians may use their powers over the financial system to boost short-term growth with a view to gaining re-election.[996] For example, they may fuel booms by expanding credit, especially in the politically sensitive housing sector, via government-owned or government-sponsored financial institutions, implicit or explicit guarantees, the promotion of competition in the finance sector, and the relaxation of prudential regulation.[997]

7.1.2 The External Incentives of Financial Regulators

[993] See Baird Webel & Rena S. Miller, *Securities and Exchange Commission Rule 151A and Annuities: Issues and Legislation*, CRS Report for Congress, July 1, 2010, p.4.
[994] See Baird Webel & Rena S. Miller, *Securities and Exchange Commission Rule 151A and Annuities: Issues and Legislation*, CRS Report for Congress, July 1, 2010, p.4.
[995] See Andrei Shleifer & Robert W.Vishny, *The Grabbing Hand: Government Pathologies and Their Cures*, (Beijing: China Citic Press, Chinese translation edition, translated by Zhao Hongjun, 2004), p.3-4.
[996] See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.555.
[997] See VV Acharya, *Governments as Shadow Banks: The Looming Threat to Financial Stability*, 90 Texas Law Review 1745 (2012); John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.555-556.

Financial regulators making regulations are also affected by the following external incentives, in addition to the above internal incentives.

7.1.2.1 The external incentives of regulators in the US

First, the policymaking is influenced by constituencies. When legislators participate in the policymaking process, they are limited by expectations that can represent the preferences of voters and the public.[998] Different constituencies can be understood as competing with one another to influence the decisions of policymakers.[999] The formulation of economic policies is not based on a purely theoretical discussion. The important reason is that the formulation of policies represents voters of different interest groups. Generally speaking, rule-makers may use some policies to "butter up" voters in exchange for their ballot ticket. When voters consider voting for a certain political party, they will also consider the policy preferences and benefits that the corresponding party may bring to themselves.

Second, interest groups have a significant influence on policy formulation. Among interest groups, commercial forces are generally the most powerful groups, especially the financial industry. "The financial services industry is typically highly motivated, well organized, and possesses enormous reserves of financial, relationship, human, and political capital. Many other constituencies, meanwhile—including taxpayers and consumers of financial products and services—often have relatively weak incentives, heterogeneous interests, and few means of influencing the policy process."[1000]

Most interest groups have established their own Political Action Committee, which are responsible for political activities such as donations and lobbying, and their campaign donations are recognized and protected by the *Federal Election Campaign Act of 1974* and other laws in the US. On the one hand, seeking the support of interest groups is always related and obvious motivation.[1001] Political parties need a lot of capital to support their propaganda and political activities on the election; on the other hand, the democratic system of the United States provides a great space for the activities of interest groups.

[998] See Xun Wu, M. Ramesh, Michael Howlett, Scoot A. Fritzen, *The Public Policy Primer: Managing the Policy Process*, (Shanghai: Truth & Wisdom Press, Chinese translation edition, translated by Ye Lin, etc., 2016), p.54.
[999] John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.559.
[1000] John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.559.
[1001] See Cornelius M. Kerwin, *Rulemaking: How Government Agencies Write Law and Make Policy*, (Shanghai: Fudan University Press, Chinese translation edition, translated by Liujing, et.,2007), p.208.

The interest groups will make full use of their advantages (e.g., capital, information, etc.) to participate in political activities by donations. When political parties formulate industrial rules related to their interests, the interest groups output their policy preference, and further capture and influence the rule-making. Even if it is not during the election period, interest groups will still use their capital to carry out long-term lobbying work for political parties to obtain more policies that conform to their interests.

The financial industry has always been one of the largest sources of political donations in the United States. According to statistics from the Center for Responsive Politics, the following table shows the amount of donations made by the securities and insurance industries from 2008 to 2020, and shows a macroscopic growth trend. For example, the focus of the "Dodd-Frank Act" is to strengthen financial supervision. Before it was promulgated, the bill involves the interests of financial groups and political parties, and the financial interest groups opposed to strengthening financial supervision. During the 2008 election, they made donations and lobbied to influence the positions of political parties.

Table. the amount of donations made by the industries from 2008 to 2020[1002]

Industries	2008	2010	2012	2014	2016	2018	2020
Securities & Investment	$33,924,399	$19,707,496	$69,769,785	$40,166,620	$60,497,405	$49,540,066	$41,295,557
Insurance	$7,068,431	$4,315,588	$8,879,205	$5,775,361	$10,142,744	$7,439,969	$8,299,094

Meanwhile, interest group possesses a comparative organizational advantage and significant human capital—the information and expertise policymakers need to make informed policy decisions.[1003] Indeed, as the financial services industry has grown more complex, this last form of capital has become increasingly important, these endowments combine to give the financial services industry significant political capital which it can wield to influence the decisions of financial policymakers.[1004]

Third, a key constraint for regulators comes from elected politicians, who have the means and the incentives to affect their action.[1005] Elected officials can thus be

[1002] Data source come from the Center for Responsive Politics, < http://www.opensecrets.org/parties/indus.php?cmte=RPC&cycle=2020 >, latest visited on September 12, 2020.
[1003] See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.558.
[1004] See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.558.
[1005] John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA,

understood as performing a dual role: participating in the policy process as both lawmakers (supplying financial regulation) and as important constituents of regulatory agencies (demanding regulation which furthers their private interests—e.g., re-election).[1006]

Additionally, the formulation of regulations is also affected by factors such as costs and benefits, public opinion, and scholars. For example, the SEC estimated the total cost of preparing the new registration statements that would be required under Rule 151A for insurance companies at $82,500,000, based on 60,000 burden hours estimated of in-house work at $175 per hour and an additional $72,000,000 cost estimate for outside professionals' work.[1007]

Therefore, the formulation of policies is influenced by interest groups and political parties, and economic policies are the political result of combining the interests of political parties and interest groups. If different interest groups and political parties have different positions on the policy, the policy formulation is the result of the game of multi-party interests, and the political result of multi-party negotiation and compromise.

7.1.2.2 The external incentives of regulators in China

First, the pressure of regulatory competition in the financial industry. The regulation-making in China is still dominated by politics, especially the promotion of leaders of relevant departments. For example, after the 2008 financial crisis, in order to recover and promote the development of securities, insurance, and other financial industries, China's financial regulators had competition issues in their respective regulatory fields. They tried to promulgate a series of rules to promote the development of the industry for having more voice in the financial industry. For example, in2012, XIANG Junbo, the new chairman of the CIRC at that time, proposed a new regulatory strategy to resume the development of life insurance, which was called "releasing the front-end and tightening the back-end". Under this regulatory philosophy, the CIRC frequently-issued 13 administrative documents to expand the range of investment for insurance funds in 2012. For instance, in 2013, the CIRC issued *concerning the Pilot Program of the Asset*

2016), p.559.

[1006] John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.559.

[1007] See Baird Webel & Rena S. Miller, *Securities and Exchange Commission Rule 151A and Annuities: Issues and Legislation*, CRS Report for Congress, July 1, 2010, p.8.

Management Product Business of Insurance Asset Management Companies (No. 124 [2013] of CIRC, issued on February 4, 2013) to supporting the pilot program of the asset management product business of insurance asset management companies,[1008] which created a favorable policy environment for the development of investment-linked insurance.

Second, the law is the result of the balance of multiple interests, and some vested interest groups undoubtedly influence the formulation of regulations. For example, in the non-tradable share reform, many state-owned shares refused to transfer profits and rejected the non-tradable share reform plan. The ownership structure of listed companies in China divided into two kinds of shares: the Chinese governments owned non-tradeable shares and tradable shares before 2005, and the non-tradable shares. The two kinds of shares held by shareholders are based on different costs because tradable shares were purchased from the open stock market and were much higher than non-tradable shares, while they enjoy same rights (e.g., voting and cash flow rights). The structure triggered many adverse effects. For example, government ownership might complicate the usual principal–agent problem by introducing a multiple-principal problem as government owners could pursue objectives (e.g., maintaining employment levels) that are in conflict with minority shareholders (e.g., profit maximization).[1009] In order to solve this problem, the Chinese State Council tried to reduce its state-owned shares by issuing the *Interim Measures of the State Council on the Management of Reducing Held State Shares and Raising Social Security Funds* (No. 22 [2001] of the State Council) on 12 June, 2001. However, this measure was implemented too haste to a serious discussion in public, and it was opposed by many state-owned shares, so that the State Council hurriedly suspended the act on 22 October, 2001.

Additionally, policymakers usually consider other factors, such as the costs and benefits of the formulation of regulations and the possible reflections of public opinion.

7.1.3 Regulatory Failures: Taking Regulatory Competition as An Example

[1008] See *No. 124 [2013]* of the CIRC (Issued on February 4, 2013).
[1009] See Bing-Bing Jiang & James Laurenceson & Kam Ki Tang, *Share reform and the performance of China's listed companies*, 19 China Economic Review 489, 490(2008).

There are potential impacts of different regulatory failures: "hard" and "soft" regulatory capture, [1010] regulatory forbearance, [1011] welfare-reducing regulatory competition/arbitrage. [1012] For example, as for regulatory capture, one of channels involves transforming financial capital into political capital, e.g., between 1998 and 2008, the US financial services industry is estimated to have spent approximately $5.1 billion on political campaign contributions and lobbying expenses.[1013] As for variable products, the following analysis mainly takes regulatory competition as an example.

In the US, the ways in which the law is applied to variable annuities and variable life insurance are subject to regulatory competition between the federal government and the states. Eventually, a pattern forms where variable annuities are jointly regulated. Thus, at the federal level, provisions in securities laws (i.e., registration and information disclosure rules) should be followed, but should also be subject to state ordinances. However, in China, the CIRC oversees the ILI. There is no joint regulation to ILI, nor is there any influence from power struggles between regulators. China's regulatory competition manifests that the financial homogeneity products subject to the rules of different regulators, under the principle of "classified management and classified supervision".

In US law, although the *McCarran Ferguson Act of 1945* established the regulation pattern for insurance, the federal government has never stopped trying to seek unified regulatory power over insurance. Since insurance companies have become the chief source of revenue in numerous states, and because such financial contribution can affect a specific state's legislation, some insurance companies take steps to resist or collaborate in order to maintain their monopoly within a state, which necessitates the need for federal involvement. [1014] Furthermore, the federal government maintains an interest in the regulation of insurance because of the following: the insurance industry's import role in state economies; how changes in the insurance market affect interstate commerce;

[1010] The concept of regulatory capture proceeds from the view that regulation is a valuable service—imposing various costs (such as direct and indirect taxes) and conferring various benefits (in the form of implicit and explicit subsidies), which regulated industries can acquire for their private benefit. See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.560.

[1011] Regulators engage in forbearance for a number of different reasons. For example, they may legitimately believe that—given additional time—a distressed financial institution will be able to resolve its problems without resort to public regulatory intervention. See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.564.

[1012] See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.560.

[1013] See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.560.

[1014] See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1044 (1973).

periodic crises (e.g., many insurance companies went bankrupt in the 1980s, which aroused suspicions regarding the effectiveness of state regulation); and insurance companies' control of a large number of resources.[1015] However, the *McCarran Ferguson Act of 1945* expressly dictates that the federal government is not allowed to impede or supersede the provisions outlined in states' insurance laws.[1016] Therefore, federal intervention lacks a corresponding basis in the face of pressure from states and the insurance companies in those states. During the Great Depression, states were able to oversee insurance in a valid way.[1017] Despite this, the federal government did not stop trying to influence state insurance laws (e.g., implementing crop and flood insurance with immunity to state ordinances, setting up mandatory standards, etc.).[1018] Along with the emergence of variable annuities—products with an evident investment nature—the debate over whether states should refer to the *Insurance Act* or the *Federal Securities Act* to manage them has, once again, demonstrated the gaming of power between the federal government and the states regarding the regulation of insurance.

On the one hand, from the US government's perspective, variable annuities—when compared to insurance—are more similar to investment securities,[1019] and are regulated by different regulators. "Sometimes several regulators are better than one. The solitary regulator becomes risk averse; he or she tries to guard against all imaginable negative outcomes, creating a crushing compliance burden. In the financial industries, where the Fed shares regulatory jurisdiction with the Comptroller of the Currency, the Securities and Exchange Commission, and other authorities, we tended to keep one another in check."[1020]

On the other hand, variable products issued under the name of insurance, have had the attribute of risk guarantees ever since they were created, and states have managed them. In terms of insurance products, ordinances differ across states. Undoubtedly, this

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[1015] See Robert W. Klein, *An Overview of the Insurance Industry and Its Regulation*, p. 15 (2009). Available at https://www.researchgate.net/publication/228341618_An_Overview_of_the_Insurance_Industry_and_Its_Regulation (last visited on Nov. 26, 2018).

[1016] See 15 U.S.C. § 1012 (b). "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business…"

[1017] See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1045 (1973).

[1018] See Robert W. Klein, *An Overview of the Insurance Industry and Its Regulation*, p. 16 (2009). Available at https://www.researchgate.net/publication/228341618_An_Overview_of_the_Insurance_Industry_and_Its_Regulation (last visited on Oct. 24, 2018).

[1019] See Arthur H. Haussermann, *The Security in Variable Annuities*, 1956 Ins. L.J. 382, 392 (1956).

[1020] Alan Greenspan, *The Age of Turbulence: Adventures in A New World*, (New York: The Penguin Press, 2007), p.375.

will increase insurance companies' operation and regulation expenses. Further, the excessive cost of regulation has weakened the US financial market's relative competitive advantage. For example, insurance companies (which operate across states) make multiple declarations about—and carry out myriad examinations of—their insurance products while facing the same state regulations time and again. Consequently, its efficiency has been reduced.[1021] This has also been noted in US law. For instance, the model regulation (passed by the NAIC) was intended to unify state insurance ordinances, eliminate repeat laws, and establish a unified regulatory mode. However, unified rules mainly emerge in the form of the model regulation and are not mandatory.

The multi-layered management, conflict, and regulatory coordination in US law are more evident than in China. From the angle of financial reform, for example, in terms of protecting consumers, before the subprime crisis in 2008, several federal agencies (e.g., the Federal Reserve, the Federal Deposit Insurance Corporation, the Federal Trade Commission, the SEC, etc.) were responsible for protecting and overseeing consumers. This was a deeply flawed system, as such a scattered supervisory structure made it difficult to coordinate policymaking and carry out the duty to protect consumers; when many regulatory agencies are responsible for the same thing at the same time, ironically, no agency is responsible.[1022] After the subprime crisis, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* was passed in 2010. Further, the *Consumer Financial Protection Bureau* was created to protect consumers exclusively; it is committed to implementing the *Federal Financial Consumer Act* to ensure the fairness, transparency, and competitiveness of the financial market.[1023] The Consumer Financial Protection Bureau has reinforced functions that were previously allocated to different regulatory agencies, and has shown independence without interference from other agencies regarding these aspects (e.g., the appointment and removal of personnel, sources of funds, and making rules).[1024]

[1021] See Luo Peixin, *A Reflection on the Dilemma of American Financial Supervision Law and Policy*, 3 China Legal Science 91, 95 (2009).

[1022] See Wen Shuying, *The Reform and Experience of American Financial Consumer Protection Mechanism*, 1 The Chinese Journal of American Studies 105, 109 (2015).

[1023] "The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive." See Section 1021(a) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

[1024] See Wen Shuying, *The Reform and Experience of American Financial Consumer Protection Mechanism*, 1 The Chinese Journal of American Studies 105, 115 (2015).

"Regulatory competition" and other problems exist in China because of the lack of unified regulation. A typical case is the existence of a phenomenon whereby different ordinances are established for homogenous products among all collective financial management products. In other words, there are various regulatory provisions and requirements for the homogeneous financial products (See below Table).

Table. The different supervisions for the homogeneous financial products

Products	Investment-linked insurance	Securities investment fund	Trust plan of assembled funds	Management plan of collective asset	Banks' financial management product
Issuer	Insurance company	Fund company	Trust company	Securities company	Commercial bank
Authorities	CIRC	CSRC	CBRC	CSRC	CBRC
Registration Requirements	Examination, approval, and filing	Examination, approval, and filing	Examination, approval, and filing	Filing	Filing
Restriction on the number of people	No Restriction	No restriction on the public issue; No more than 200 in the private issue	No more than 50[1025]	No more than 200 in the private issue	No more than 200 in the private issue
Investment scope	Liquidity assets shall not be less than 5%, infrastructure, real estate, and other financial funds shall not exceed 75%, etc.	Compliance with prudent business principle, and invest the standardization of securities and their derivatives, etc.	Standardized or non-standardized assets and have a clear investment scope and proportion	No restriction; but it should not be used for investments that may bear unlimited liability.	No restriction; but they mainly invest bond assets such as treasury bonds and corporate credit bonds.
Following investor	Allowing	No rule	No rule	Following the investment by the own capital	Prohibition
Guaranteed income	Prohibition	Prohibition	Prohibition	Prohibition	Prohibition
Duties of trustee	No rule	Safety custody, execution of investment instructions, supervision of investment operations, etc.	Safety custody, execution of investment instructions, etc.	Safety custody, execution of investment instructions, supervision of investment, etc.	Safety custody, execution of investment instructions, supervision of investment operations, etc.
References[1026]	No. 32 [2015] of CIRC; No.3 [2009] of CIRC.	No. 84 [2012] of CSRC; No.19 [2004] of CSRC	No.1 [2009] of CBRC	No. 93 of CSRC	No. 6 [2018] of CBRC; No. 5 [2011] of CBRC

In another example, conflicts in regulations, low efficiency, and "free riders" are found in the context of scattered financial consumer protection authorities, established under the supervision of the General Headquarters of the People's Bank of China, the CSRC, the CIRC, and the CBRC. As for these issues, China's primary approaches are now considered steps taken at the "soft law level," such as the "joint conference mechanism" between departments. However, there is no "hard law" based on a

[1025] The number of the natural persons involved in a single trust plan may not exceed 50, while the number of natural persons with a single entrustment of more than 3 million yuan and qualified institutional investors is not restricted. See Article 5 of *Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds* (No.1 [2009] of CBRC).

[1026] See *Notice on Matters concerning Regulating the Investment Accounts for Investment-Linked Insurance* (No. 32 [2015] of CIRC); *Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (No.3 [2009] of CIRC); *Measures for the Administration of Securities Investment Fund Management Companies* (No. 84 [2012] of CSRC); *Measures for the Administration of Information Disclosure of Securities Investment Fund* (No.19 [2004] of CSRC); *Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds* (No.1 [2009] of CBRC); *Measures for the Administration of the Customer Asset Management Business of Securities Companies* (No. 93 of CSRC); *Measures for the Supervision and Administration of the Wealth Management Business of Commercial Banks* (No. 6 [2018] of CBRC); *Measures for the Administration of the Sale of Wealth Management Products of Commercial Banks* (No. 5 [2011] of CBRC).

coordination mechanism, an indicator of the "basic law level." Hence, when there is no related legislation at a higher level, the less coordinated "boundaries" of the powers held by various regulatory bodies allow them to make their own rules, creating many overlapping ordinances with different standards. As for the ILI, there is the problem of a "regulatory hole" whereby oversight of the ILI is limited to a single law passed by the CIRC. This has resulted in a lack of regulations on the ILI's securities attribute. In addition, the CIRC does not handle the relationship between financial product innovation and the strengthening of rules. For example, early on, when the ILI was introduced, it was considered an epoch-making innovative product that ought to be affirmed, encouraged, and advocated for the sake of its development. However, in recent years, in light of the idea that "insurance has to be insurance," regulators have once again conveyed "a defective product" and "a star product." This shift in attitude towards regulation is linked to China's contemporary regulatory policies, which stress the prevention of financial risk and that "insurance products have to be insurance." However, regarding the ILI, this line of thinking—in terms of reverting to the oversight of traditional insurance—has significant defects, thereby hindering progress when it comes to applying securities laws to the ILI.

As for regulatory failures, there are five institutional arrangements and two strategies that can be used to constrain them. The five institutional arrangements are transparency requirements, independent oversight, precommitment mechanisms, compensation, and liability.[1027] The first strategy is to harness the relevant agents' concern for their reputation within the community of those who genuinely care about the quality of financial regulation—be they market participants focused on the long term, disinterested observers, or public-interest-minded policymakers. The second strategy is to ensure supervisory agents' substantive independence from politics.[1028]

7.2 The Reasons for Differences between US and Chinese Law

7.2.1 How Different Financial Regulators Affect the Application of the ILI

[1027] See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.566.
[1028] See John Armour, Dan Awrey, etc., *Principles of Financial Regulation*, (New York: Oxford University Press USA, 2016), p.566.

Public regulatory authorities have tremendous impact on how rules are applied to financial products. Variable products have a large difference regarding the application of such laws (i.e., securities regulations in both China and the US). The direct reason is the different attitudes of financial regulators in the two countries towards implementing the provisions of securities regulations. In the US, the Securities and Exchange Commission (SEC) actively promotes the execution of securities regulations to variable products. However, in China, neither the China Insurance Regulatory Commission (CIRC) nor the China Securities Regulatory Commission (CSRC) has promoted the application of securities regulations to the ILI.

In the US, the SEC has played a prominent role in the legal use of variable products. The SEC was founded pursuant to the *Securities Exchange Act of 1934,* as a subordinate entity of the US Federal Government responsible for supervising and managing securities. The SEC has always maintained a clear, firm stance on determining the legal nature of variable annuities; that is, the SEC holds that variable annuities are securities regulated by the SEC.[1029]

On the one hand, the SEC actively fosters the execution of securities laws to variable annuities. For example, in the aforementioned VALIC and UBLIC cases, the SEC filed all of the lawsuits as the plaintiff against VALIC and UBLIC, the defendants; these companies had to register with—and disclose information to—the SEC in accordance with the *Securities Act of 1933* and the *Investment Company Act of 1940*. Otherwise, they would not be allowed to sell annuities in dispute. After the VALIC and UBLIC cases, the US incorporated such products (like variable annuities) into the regulatory scope of the *Securities Act*,[1030] and after the Prudential case, the US once again included separated accounts in the regulatory scope of the *Investment Company Act*.[1031] In these cases, the SEC played a crucial role in bringing about a regulation, featuring "substance over form" for variable annuities and variable life insurance.

In contrast, the SEC has identified some incorrect regulations in laws on products. For example, in the US, the SEC has made many exemptions when applying the *Investment Company Act of 1940* to separated accounts. The reason is that except for some

[1029] See SEC, *Annuities*, available at https://www.sec.gov/fast-answers/answersannuityhtm.html (last visited on Oct. 20, 2018).
[1030] See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 65 (1959); *SEC v. United Ben. Life Ins. Co.*, 387 U.S. 202, 202 (1967).
[1031] See *Prudential Ins. Co. of America v. SEC*, 326 F.2d 383 (1964).

details of variable annuities and variable life insurance, the SEC used to manage separated accounts as if they were periodic payment plans. This included passing various special laws since separated accounts have many differences regarding these aspects, such as the issuer, dividends, and subscriptions.[1032] The SEC admitted that it was not correct in overseeing variable products as if they were periodic payment plans. In 1992, in its report *Protecting Investors: A Half Century of Investment Company Regulation*, the SEC noted that there are significant differences between variable life insurance contracts and periodic payment plans in the following ways. First, regarding interests acquired by the contract owner, the two have different pricing and distribution requirements. Periodic payment plans merely provide a means to buy securities through installments, whereas variable insurance is a combination of insurance and investments, with no explicit substitution. Although the initial cost is high, the beneficiary can acquire an insurance guarantee.[1033] Second, in terms of administrative services, variable contracts offer a more flexible way to pay fees.[1034] Third, concerning the capital structure of sponsoring companies, most often, a periodic payment plan involves thinly capitalized entities, whereas the insurance company's capital base is more reliable than the typical plan sponsor.[1035] Fourth, before 1940 there were no laws on periodic payment plans. Instead, each US state executed its state-level ordinances—such as solvency laws[1036]—which expected insurance companies to be stronger financial entities than typical plan sponsors. Hence, based on the abovementioned differences, it is not appropriate to perceive variable contracts as periodic payment plans in terms of their regulation.[1037]

In contrast, no financial regulators in China recognize or advance the securities nature of the ILI. The CIRC dominates the development of the ILI (which has obvious elements of securities) and oversees it, rather than the CSRC. Since there is nothing about the ILI in Chinese law, its operation depends entirely on CIRC's regulations, even though it was founded almost 30 years ago, and China's *Insurance Law* was revised in 2002,

[1032] A "periodic payment plan certificate means (A) any certificate, investment contract, or other security providing for a series of periodic payments by the holder, and representing an undivided interest in certain specified securities or in a unit or fund of securities purchased wholly or partly with the proceeds of such payments and (B) any security, the issuer of which is also issuing securities of the character described in clause (A), and the holder of which has substantially the same rights and privileges as those which holders of securities of the character described in clause (A) have upon completing the periodic payments for which such securities provide." See 15 U.S.C. 80a-2(a)(27).
[1033] See SEC 1992 Report, "*Protecting investors: A half century of investment company regulation,*" pp. 390-391.
[1034] See SEC 1992 Report, "*Protecting investors: A half century of investment company regulation,*" pp. 391-392.
[1035] See SEC 1992 Report, "*Protecting investors: A half century of investment company regulation,*" pp. 392-393.
[1036] See SEC 1992 Report, "*Protecting investors: A half century of investment company regulation,*" pp. 393.
[1037] See SEC 1992 Report, "*Protecting investors: A half century of investment company regulation,*" pp. 390-393.

2009, and 2015. Initially, the CIRC introduced the ILI as a new life insurance product, and first enacted *Interim Measures for the Management of ILI* in 2000. Since then, novel personal insurance has been incorporated into the CIRC's regulatory scope; a regulatory path whereby the CIRC manages the ILI has thus formed. In the process of applying laws—despite that ordinance passed by the CIRC cover the ILI's information disclosure rules—the ILI's securities character and the implementation of securities law remain unspecified. Second, although the CSRC was founded in 1993, it was not until 1998 (when it became part of the Securities Commission under the supervision of the State Council) that a centralized, unified, and nationwide system to regulate securities emerged. After that, the CSRC needed time to consolidate; therefore, it was difficult for the CSRC to consider this new financial product. Moreover, investment-related issues of the then-new personal insurance did not appear in practice.[1038] Hence, at the beginning, the CSRC lost its ability to control several products (e.g., the ILI). Later on, although the CSRC realized the ILI's securities nature, given that the CSRC and CIRC were organizations at the same level, the CSRC was not being positive about regulatory authorities relating to products represented by the ILI; nor was the CSRC willing to break up its relationship with the CIRC or to promulgate the ILI's rules arbitrarily on this matter. Therefore, in China's regulatory environment, accurate definitions (which regulators should create) and recognition of the ILI product's nature (which regulators should grant) are lacking.

Hence, the case whereby the US mistakenly regarded variable annuities as periodic payment plans, and the indeterminate/conflicting provisions set forth by the CIRC regarding the ILI, show that the successful regulation of new financial products depends on regulators effectively understanding—and defining—them.

7.2.2 Different Sources for Rules and Relief Mechanisms

In the US, ordinances on variable products are quite abundant. Not only are there rulings from case law or those enacted by the SEC and different states; there are also rules created by influential self-regulatory organizations, such as the NAIC. In China, in terms of the ILI's rules, only the CIRC has established regulations, without forming any special rules at the basic law level from case law, or from self-regulatory organizations. This demonstrates the relief characteristic of "attaching importance to administrative measures,

[1038] See Luo Yu, *Investment-linked Insurance: Securities?* 6 Financial Law Forum 85, 91 (2003).

but making light of judicial measures." The main reasons are that the degree of liberalization in China's financial market is relatively low, and there are quite a lot of administrative interventions and controls; these features stem from the planned economy of the past.

In the US, in addition to case law, as well as SEC and state rules, the ordinances of self-regulatory organizations are also sources of law. For instance, the NAIC—a voluntary association of state insurance commissioners—has played an essential role in centralization (expanding upon its initial advisory and model law drafting functions), and has come to resemble a federal agency in many respects.[1039] For example, for variable annuities, the NAIC issued the *Variable Annuity Model Regulation*. According to this ordinance, a variable annuity is "a policy or contract that provides for annuity benefits that vary according to the investment experience of a separated account or accounts maintained by the insurer as to the policy or contract."[1040] Yet for separated accounts, Section 4 stipulates that "with respect to a separated account registered with the Securities and Exchange Commission as a unit investment trust, exercise voting rights in connection with securities of a regulated investment company registered under the Investment Company Act of 1940"[1041] and "establish for the account a committee, board or other body, whose members may or may not be otherwise affiliated with the company and may be elected to membership by the vote of persons having interests in the account ratably as determined by the company."[1042]

In contrast, the rules of self-regulatory organizations are not prominent, and the content of administrative intervention is obvious in China. For example, Chapter 7 of the *Insurance Law* contains a chapter specifically for legal liability. As for civil liability, the law broadly states that whomever causes damage to others by violating the regulation shall bear civil liability.[1043] Criminal liability is also generally expressed[1044]; it is similar to the *Securities Law* among the types of legal liability presented in Chapter 13 of the law, and—except for Articles 219 (criminal liability) and 220 (civil liability)—all other

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[1039] See Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 Florida State University Law Review 625, 628 (1999).
[1040] Variable Annuity Model Regulation, Section 2 (B) (2007).
[1041] See Variable Annuity Model Regulation, Section 4 (D)(1)(a) (2007).
[1042] See Variable Annuity Model Regulation, Section 4 (D)(1)(b) (2007).
[1043] See Article 175 of *Insurance Law of the People's Republic of China.*
[1044] It stipulates that "whoever is suspected of a crime by violating this Law shall be held criminally liable according to the law." See Article 179 of *Insurance Law of the People's Republic of China.*

clauses are provisions on administrative liability and other penalties. Thus, for both the *Insurance Law* and *Securities Law*, their legal responsibility systems all consist of civil, administrative, and criminal liability, dominated by provisions on administrative liability. In addition, China's system on the ILI's rules only contains administrative regulations created by the CIRC, without rules from any self-regulatory organizations. The cause of this legal situation is related to the context whereby the law in China stresses administrative intervention, except for the lack of a response from basic laws.

In China, financial regulatory organizations are often referred to as "management level" entities because not only are they regulators; they also have many other roles (e.g., protecting the market). In this sense, the scope of their function is even broader than that of regulators in US law (e.g., the SEC). In China, administrative power allows for clear control of the market through all-around interventions (e.g., market access, trading order, and market stability). For example, the CSRC does not nurture its corresponding autonomous organization along with the market's maturity, but rather allocates resources tendentiously by "taking charge of all things," implying a management idea that places no trust in the market, just like the paternalistic path.[1045] In another instance, in China, the government creates—and invests in—many financial institutions, so the government is simply the market's direct stakeholder and participant. Consequently, there is a superior-subordinate administrative relationship between regulators and these financial institutions; regulators might also implicitly guarantee their continuous operation.[1046] To some degree, this can be viewed as a characteristic of China's formerly planned economy, which was first implemented when contemporary China was founded. In that context, administrative interventions—not the market—dominated the distribution of resources. The reform and opening-up policy, introduced in the 1980s, marked the start of China's exploration of the market economy and its transformation from a planned economy to a market-based one. However, the perfection of the market mechanism cannot be completed overnight. Hence, today, financial laws are still subject to the impact of the planned economy's management model (including "path dependence" for the system), which closely aligns such laws with national policy, allowing for a clear policy orientation.

[1045] See Li Siqi, *Criticism and Reconsideration about Chinese Securities Supersory Doctrine*, 2 Economic Law Review 314, 318 (2009).
[1046] See Huang Tao, *Legal Approach for Financial Market in China to Shift from "Institutional Regulation" to "Functional Regulation" – Focus on the Improvement of the Supervision Rules for Financial Products,* 7 Law Science 105, 110 (2011).

The academic term "regulation" does not yet adequately express the relationship between the government and the market. The fact that the regulators of China's securities market are deeply involved in it has blurred their role as "regulators," especially when we consider the point in time when finance began to develop in China. This involved "super-government corporations" (i.e., the government controls everything) in the planned economy, as well as the progressive characteristic of institutional change. Thus, we cannot expect to see a "government-market" relationship in China in a short period of time, which is what we have witnessed in developed countries. [1047]

Therefore, the feature of strong administrative intervention is evident in China's system of rules. Not only must administrative organizations provide the leadership and advancement necessary to amend basic laws; in addition, they dominate the enactment and regulation of rules in the financial field. China's system, which contains administrative controls—thereby allowing for brief, timely responses to issues that draw the public's attention—is efficient, and its performance is clear. The rules' rationality depends on the administrative organizations' stance, which can easily cause problems. The issue about the regulation of the ILI is closely tied to the "campaign oriented financial governance paradigm," which is currently being observed in China.[1048] Hence, they have not dealt well with the relationship between the development of the ILI and its regulation. China's financial regulatory authorities favor direct administrative intervention and responses, as these practices have apparent short-term effects. However, the country's governance pattern is more likely to exhibit phenomena such as "selective law enforcement" and "shoot the bird which takes the lead"—which treat the symptom but not the underlying problem. Even more worrisome is that huge intervention in the short term is of a strongly "punitive nature," whereby it is extremely easy to break the law.

Quite often, "financial movement governance" is accompanied by punitive thinking, which prefers heavier, serious punishments. For the same irregularities, graver punishments will be imposed if they are compared with the same under normal circumstances. This "movement governance" is a choice of the "rule of man" instead of the "rule of law."[1049]

[1047] See Huang Tao, *Why the Court is Not So Important: An Observation of China's Stock Market,* 9 Law and Social Sciences 63, 68 (2012).

[1048] Notice of the Liaoning Regulatory Bureau of the China Insurance Regulatory Commission in carrying out self-inspections and corrections regarding the insurance intermediary market in 2010, No. 47 (2010), etc.

[1049] See Zheng Yang, etc., *The Practice of Global Functional Supervision and the Exploration of China's*

Certainly, the market is not omnipotent. The biggest lesson learned from the 2008 subprime crisis is that when pursuing financial liberalization, it is easy to overlook regulations on the risks and trade of new financial products; as such, regulations must keep pace with innovation.[1050] This is especially the case for the US, and is not an obvious situation in China, where financial institutions persuade the government or regulatory authorities to gradually loosen financial control by relying on their powerful influence. They seek their own interests on the pretext of innovation. In this process, they advance the legislation, amendment, and abolishment of laws, which results in deviations from legal rights and obligations setting off alarm bells are for observers.[1051] By contrast, China seems to be moving towards the other extreme; the relationship between financial product innovation and regulation has not been handled appropriately. This is shown whereby financial innovation might be "strangled" in the process of strengthening regulation. Namely, it is not possible to solve the problem of "laissez-faire may bring chaos, but regulations may suppress its development."

The differences between the abovementioned Chinese and American rules further suggest that, with regard to the means of relief, China is more in favor of public relief if it is compared with the US. Generally speaking, legal relief can be divided into "private litigation" and "public enforcement," where the former implies using the judicial system to halt illegal acts, and the latter involves employing "government regulation" to do the same. China places more emphasis on relief where administrative power prevails, and attaches "importance to administrative measures, but [makes] light of judicial measures." This is due to multiple reasons. Except for the country's imperfect legal system, many other causes contribute to this situation. For instance, the market mechanism has not matured enough, and the public has grown tired of filing lawsuits, especially due to the impact of the country's system of rules, which is dominated by administrative ordinances. Scholars have pointed out that this is political resource mobilization—rather than a regulation activity performed by regulators in accordance with the law—which, as an

Comprehensive Financial Supervision (Shanghai: Shanghai People Press, 2016), p. 93.

[1050] See Sun Tianqi & Zhang Xiaodong, *The US Subprime Mortgage Crisis: Legal Inducement, Legislative Solution, and Its Enlightenment to China*, 2 Studies in Law and Business 133, 140 (2009).

[1051] See Sun Tianqi & Zhang Xiaodong, *The US Subprime Mortgage Crisis: Legal Inducement, Legislative Solution, and Its Enlightenment to China*, 2 Studies in Law and Business 133, 140 (2009).

alternative mechanism, has assumed the function of protecting investors' rights and interests when the judicial approach has failed to achieve the desired effect.[1052]

In the US, compared to the *Securities Exchange Act of 1934*, the NAIC *Model Law* has a different focus in terms of anti-fraud provisions. The chief differences are that the *Model Law* focuses on relief provided by the public power given to administrative regulations. For anti-fraud acts, an administrative penalty is imposed, or a criminal lawsuit is filed. The *Securities Exchange Act* places more importance on the private relief offered in civil actions, which means that victims can initiate private lawsuits by themselves, thus safeguarding their rights and interests. This regulation context has hampered the application of state laws, making it difficult to easily obtain civil relief. Federal law protects policyholders' interests as a kind of private enforcement. For example, insurers are responsible for the content of a product's description because purchasers often make choices based on the promises stated on a product. However, the State of New York's insurance law does not consider a product's description to be part of an insurance policy's content, even though advertising materials (such as a product's description) may contain misleading content.[1053] If state insurance laws are made fully applicable to variable annuities, then policyholders' investment interests cannot be protected by relevant systems (e.g., information disclosure systems).

By contrast, China pays more attention to public enforcement than private litigation. For example, in terms of relief, Chinese citizens primarily make formal complaints to financial regulators, but there are no specific provisions for the procedure, time limit, or channel in relation to filing a complaint. Hence, people in China may likely encounter "stonewalling" and may have "a perfunctory attitude."

Although some of the normative documents created by the CIRC include purposes such as strengthening the protection of policyholders' lawful rights and interests, the insured, and beneficiaries, these rules are limited to administrative relationships, with a focus on the supervision of public power. Yet, there is a lack of civil relief that is pertinent to investment interests.

To surrender ILI, it is easy to be characterized as a "group event" with political

[1052] See Huang Tao, *Why the Court is Not So Important: An Observation of China's Stock Market,* 9 Law and Social Sciences 63, 63 (2012).
[1053] See 29 N.Y. Jur. Insurance § 638 (1963); Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1029 (1973).

sensitivity. For example, according to *Guiding Opinions on Ascertaining Personal Insurance Companies' Liability for Misleading Sales* (CIRC No. 99 [2012]), when a personal insurance company has misleading sales (e.g., an administrative punishment) and needs to be held accountable, the company receives a "regulative letter" from the appropriate regulatory authority whenever there is any "regulative conversation."[1054] Significant, mass unexpected incidents are defined and further divided into three levels of responses.[1055] In dealing with such cases, based on the responsibility of government superiors or the pursuit of their own interests, political logic will certainly overwhelm judicial logic.[1056] In general, the supervision of public power cannot be considered a kind of relief to protect investment interests under the ILI. Civil relief—which relies on the "self-interest" of the parties involved, and the effects brought about by such relief—is more beneficial for protecting the interests of policyholders (or "investors") when compared to pure administrative protection.

7.2.3 Different Effects on "Separate Operation and Classified Supervision" in Applying Laws in China and the US

There are vast differences between Chinese and American law on variable products because the principle of separate operation has diverse outcomes in each country's respective legal system. The "separate operation and classified supervision" is still being implemented at the level of China's basic finance ordinances. Grounded in this principle, the securities law cannot be applied to the ILI directly. If the securities law is to be applied to products represented by the ILI, that principle must be amended at the basic law level; otherwise, the court and regulators cannot directly execute the securities law. However, in the context of US law, this principle is not considered a barrier to applying securities law to variable products.

The *Glass-Steagall Act of 1933* gave rise to traditional separate supervision of the financial industry based on lessons learned from the economic crisis of 1929–1933. This Act called for no operations across financial sectors, and implemented "separate operation

[1054] See Article 3 of *Guiding Opinions on Ascertaining Personal Insurance Companies' Liability for Misleading Sales* (CIRC No.99 [2012]).
[1055] See Article 4 of *Guiding Opinions on Ascertaining Personal Insurance Companies' Liability for Misleading Sales* (CIRC No.99 [2012]).
[1056] See Huang Tao, *Why the Court is Not So Important: An Observation of China's Stock Market,* 9 Law and Social Sciences 63, 101 (2012).

and divided supervision."[1057] Later on, because mixed financial operations became inevitable throughout the country's financial development, this principle was abolished, and the US government created a financial system featuring mixed operations through *the Gramm-Leach-Bliley Act of 1999*. Hence, from the 1930s to the end of the 1990s, the US financial industry was in a state of "separate operation." A number of cases with far-reaching influence (e.g., the VALIC and BULIC cases) took place during this period, and thus established the practice of applying securities law to variable products. This indicates that, in the US, "separate operation" does not hinder people from applying securities law to variable products.

In China, the principle of "separate operation and classified supervision" is the key barrier to applying securities law to the ILI. This principle is explicitly specified in Article 43 of the *Law of the People's Republic of China on Commercial Banks* of 1995, Article 8 of the *Insurance Law of 1995*, Article 6 of the *Securities Law of 1999,* and Article 7 of the *Measures for the Administration of Trust Companies of 2007*. China follows statutory law, which carries binding force regarding both law-executors and law-abiding people. Thus, "being separate" not only creates restraints on authorities in terms of managing financial institutions and regulators but also fixes the "field" between regulators and the ones being regulated, in addition to barriers that emerge when trying to apply the law.

The purpose of fostering "separate operation and divided supervision" in China is mostly to set up a "firewall isolation mechanism" for financial risk, thus allowing for potentially partial risks to be controlled within individual institutions and avoiding "infiltration and infection" between them. This practice is a direct reference from the US.[1058] In China, this principle makes apparent distinctions, without any overlapping part between financial products regarding the application of laws; so does supervision by the authorities in a way that each individual supervises his or her own business, without interference from others. If a financial product is deemed an insurance product, only the *Insurance Law* and its supervision rules can apply to it. This is the same for securities. To apply the *Trust Law*, it is limited to nominal trust products; if a financial product

[1057] See Glass-Steagall Act, sections 16, 20, 21, and 32.

[1058] The *Glass-Steagall Act* instituted separate operation and supervision in the financial industry. See Glass-Steagall Act, sections 16, 20, 21, and 32. The Act requires banks to operate separately from securities because of concerns that bankers may be too powerful in influencing political security in the US. See Xing Huiqiang, *Expansion and Boundary of the Definition of Securities in the Securities Law of China*, 1 China Legal Science 244, 251 (2019).

essentially adopts the structure of a trust, but its name has not been expressed as a "trust," then the *Trust Law* shall remain inapplicable.[1059]

Under this regulatory system (namely institutional regulations), regulators do not tend to exercise their power towards businesses or products, but rather towards financial institutions themselves. For example, as far as the CBRC is concerned, as long as business activities are conducted by commercial banks, they will be included within its scope of regulatory power, irrespective of the nature of the specific business or product of the commercial bank involved, be it a deposit, loan, security, or insurance.[1060]

Before 1994, financial institutions in China were dominated by banks in fields such as securities, insurance, and trusts. Hence, they were in a mode of mixed operations. However, at the end of 1993, the State Council enacted the *Decision of the State Council on Reform of the Financial System* and chose to abolish the old, mixed operations system. Instead, the State Council adopted the "principle of separate operation and classified supervision," which the legislation expressly confirmed. The background for establishing "separate operation and classified supervision" in the financial industry primarily emerged in the 1990s. In the early period, when the financial market was created, there were many risks in the financial world (e.g., the "three illegal dealings": the illegal pooling of funds, the founding of financial institutions, and the handling of financial business). Financial regulatory institutions had not been completely set up and were still in the process of consolidation; so their regulation capabilities were inadequate. The principle of separate operation and classified supervision was then installed based on the aforementioned considerations; this was reasonable at the time because, under this principle, regulators' regulatory activities were almost entirely focused on financial institutions. As long as the type of financial institution, the business it was engaged in, and the financial products it provided were certain, this would produce a clear division of responsibilities among regulators, and bore the characteristic of high efficiency.[1061]

[1059] The application of securities investment fund law may involve *Securities Investment Fund Law, Securities Law,* and *Trust Law*.

[1060] See Huang Tao, *Legal Approach for Financial Markets in China to Shift from "Institutional Regulation" to "Functional Regulation" – Focus on the Improvement of the Supervision Rules for Financial Products,* 7 Law Science 105, 109 (2011).

[1061] See Huang Tao, *Legal Approach for Financial Market in China to Shift from "Institutional Regulation" to "Functional Regulation" – Focus on the Improvement of the Supervision Rules for Financial Products,* 7 Law Science 105, 110 (2011).

Along with the ongoing innovation of financial products—especially when different financial institutions launch diverse prevailing financial management products—regulators continuously try to adjust or break the "principle of separate management" (i.e., different rules are stipulated for various financial management products). The disadvantages of traditional institutional regulations are being exposed and cannot keep up with demand. Mixed operations represent the new development trend in the financial industry.[1062] The root cause of the financial crisis does not lie in separated or mixed operations, but is rather due to the lack of preventions against risk mechanisms.[1063] Although laws in China "stick" to the "principle of separate operation and classified supervision," there is still a tendency to become "unbound." For example, in China's *Commercial Banks Law (2003 Amendment)*, the *Insurance Law (2009 Amendment),* and the *Securities Law (2013 Amendment)*, there are miscellaneous provisions on "separate operation and classified supervision" ("except as otherwise stipulated by the state"). Hence, such a principle is no longer strictly required in basic law. However, there is still no ruling that clearly specifies the "exception," so "separate operation and classified supervision" is an important reason for the differences between the application of the law in China and the US.

7.2.4 Differences in Horizontal Regulation and the "Scope of Securities"

The difference in the "scope of securities" between China and the US determines whether securities law can be applied to variable products. Only a substantial definition and a broad "scope of securities" would allow securities law to be applied to more financial investment products. In China, *Securities Law* cannot be applied to composite financial products. The definition of the "scope of securities" by China's *Securities Law* is too narrow. Before the 2019 amendment to the *Securities Law*, Article 2 constrained the objects to be regulated by law to a limited number of securities (e.g., stocks, corporation bonds, and other securities that are lawfully recognized by the State Council; government bonds; shares of securities investment funds; securities derivatives, etc.). This gave rise to a situation whereby many financial investment products could not be applied to the *Securities Law*. By contrast, the definition of securities in the US *Securities*

[1062] See Wang Heli, *Research on the Prospect of China's Financial Mixed Operations*, 9 Journal of Financial Research 188, 188 (2008).
[1063] See Qin Guolou, *Comparative Analysis and Empirical Study on Financial Comprehensive Operation and Separate Operation,* 9 Journal of Finance 57, 63 (2003).

Act of 1933 is broad. It lists more than 30 types of securities, and case law was used to produce the Howey test to define substantial securities.[1064] Although the *Dodd-Frank Wall Street Reform and Consumer Protection Act* does not contain any general definition of financial products/services, Section 1002 (15) of the law lists specific kinds of financial products/services. Judging from the typical integrated financial laws in foreign countries, financial laws in nations like the US tend to adopt integrated financial ordinances. This legislative tendency is a kind of reform meant to combat the defects of traditionally separated regulation, as well as to strengthen laws for financial consumers through function and conduct-oriented regulations, thus realizing integrated legislation on financial instruments/services. However, financial integration law is only discussed in theory, and has not been put into legal practice in China.

China's law still has a gap compared to US law in terms of progress of the Integrated Financial Law and the scope to be regulated by the securities law. Then, the question arises as to why China chose a limited number of securities, rather than a substantial definition of securities when drafting its *Securities Law*. The main reason is that when the *Securities Law* was passed in 1995, the securities market in China was still in its early stages. The *Securities Law* was not yet fully in line with the same laws in then-advanced countries like the US. Instead, the stipulation of relevant provisions needed to be considered on the basis of requirements later on, when the securities market in China would mature and have certain experiences. For this reason, regarding legislation in the interim period, legislators in China made a prudent choice based on China's actual needs and conditions, which was to enumerate finitely in the Securities Law.[1065] In addition, if legislators had tried to include substantial securities in the law, a long-term debate could have ensured. Hence, the enactment of the whole law would be delayed.[1066]

However, with the development of the securities market in China, this "interim" legislation has become incompatible with present needs, and limits other types of securities found in practice.[1067] Therefore, China amended the *Securities Law* on December 28, 2019. China expanded the former scope of securities by adding "depositary

[1064] See Park McGinty, *What Is a Security*, 1993 Wis. L. Rev. 1033, 1052 (1993).
[1065] See Li Fei, *How to Determine the Adjustment Scope of Securities Law in China*, 2 China Legal Science 25, 25-28 (1999).
[1066] See Li Fei, *How to Determine the Adjustment Scope of Securities Law in China*, 2 China Legal Science 25, 25-28 (1999).
[1067] See Wu Zhipan, *Reflection and Prospect of the Scope of Application of Securities Law in China*, 6 Studies In Law and Business 13, 13-16 (2003).

receipts," "asset-backed securities," and "asset management products." However, "asset-backed securities" and "asset management products" are not being regulated directly by the *Securities Law*, but are otherwise specified by the State Council. In this law, the scope of asset management products is not defined, but if we examine Article 2 of the *Guiding Opinions on Regulating the Asset Management Businesses of Financial Institutions (CBIC No. [2018] 106)*, an asset management business involves accepting the entrustment from investors by financial institutions (e.g., banks, trusts, securities, funds, futures or insurance management institutions) and financial asset investment companies to render financial services through investing and managing investors' property. In this sense, financial management products (including bank financial management products and the ILI) fall within the meaning of "asset management products." Nevertheless, because of the requirements and division of the investors of asset management products in the abovementioned text, asset management products mostly refer to asset management plans issued by various financial institutions, excluding the ILI. Therefore, in the long run, China, as a written law country, should comply with the trend of financial integration law.

7.2.5 Different Law Systems

At present, the global legal system primarily consists of the continental and Anglo-American legal systems. The chief difference is that the former entails statute law prepared by a legislature (e.g., Germany, Japan, and France); the latter involves case law produced by judicial organs (e.g., the UK and the US).

The differences between the two legal systems can be found in case status (whether precedent will be followed), the concept being observed in compiling laws (code), the judicial litigation system ("inquisitorial" or "adversary procedure"), and the classification of laws and terms ("public or private law" and "common or equity law").[1068] Nevertheless, the two legal systems tend to blend with each other. For example, because of the continuous sharp rise in the number of precedents, the law has become cumbersome and hard to grasp, so it is necessary to compile "case rules" into a "restatement" through a clearly set systematic structure. In other words, the basis of the unification of American private law—the "Restatement of the Law"—is similar to the "code" in the continental

[1068] See Zhang Wenxian, *Jurisprudence*, (Beijing: Higher Education Press, 2007), p. 200.

law system.[1069] In another instance, as far as China is concerned, the "Guiding Cases" released by the Supreme People's Court has, to some extent, brought the actual effect of legal precedent on similar cases into play, which can make up for the inadequacies of statute law.[1070] Despite this, the two legal systems still have fundamental differences when it comes to creating laws and applying them.

In terms of applying rulings to variable annuities in the US, there are conflicts between state insurance laws and the *Federal Securities Act*. Before the VALIC case, only state insurance laws applied to variable annuities; there were also concerns about the lack of sufficient protections for these products' investment interests. After the VALIC case, the US Supreme Court determined them to be securities and included them in the scope of regulations of the *Securities Act*. In the process of realizing the regulation on variable annuities through the *Securities Act*, the US government did not try to amend existing laws, but rather to promote the SEC and the Supreme Court's ruling. After this, amendments were made to existing federal or state insurance laws. For example, the *Securities Act* of Hawaii classifies variable annuities as securities.[1071] Therefore, variable annuities—as innovation for financial products (when given flexibility under case law)—to a great extent, can help respond to newly launched economic activities related to financial commercial transactions in an effective and timely manner.

The continental legal system does not have the flexibility of Anglo-American case law. The application of the law to variable products depends on amendments made to it. For example, Japan still regards variable life insurance products as insurance, but stipulates the "quasi application of the *Financial Instruments and Exchange Act*" in Article 300-2 of the *Insurance Business Act*. In Japanese law, the abovementioned legislation approved the Securities Attribute of Variable Life Insurance, and the provisions in the *Financial Instruments and Exchange Act* can be directly applied to it.

In Taiwan, rules on securities have not been introduced to the ILI. Consumer protections can be realized through fiduciary, suitability, and other duties set forth in the *Financial Consumers Protection Act*. However, when statute law has not been amended

[1069] See Zweigert Konrad & Kotz Hein, *General Theory of Comparative Law* (Beijing: Law Press, Chinese translation edition, translated by Pan Handian, etc., 2003), p. 367.

[1070] The legislatures of all states in the US have the right not only to make their statutes, but also to develop their laws in different directions through rulings. See Zweigert Konrad & Kotz Hein, *General Theory of Comparative Law*, (Beijing: Law Press, Chinese translation edition, translated by Pan Handian, etc., 2003), p. 366.

[1071] Hawaii Revised Statutes Section 485A-102: "Security" means a note, stock, treasury stock, security future, or variable annuity contract.

or no corresponding law has been created, interpretative theory—a theory with uncountable defects in the context of China's "big civil law thinking" (the direct adoption of civil law without provisions of commercial law)—is the only approach to apply the law to variable products.

In continental law countries, the starting point for applying commercial legal relations is the search for corresponding provisions in private law. Modern commercial codes all claim that priority should be given to commercial codes/customs in order to regulate the commercial field. Where there are no such provisions, the law shall be applied through civil codes.[1072] In China, the relationship between civil and commercial laws is more often considered as a connection between ordinary and special law. Commercial law is a special realm of civil law, so where it is not provided in commercial law, relevant provisions in civil law are applied.[1073] Currently, basic law "gives no response" to the legal implementation of the ILI in China. However, in the context of "big civil law," this has adversely affected the application of pertinent laws, which is something worth discussing.[1074] In other words, it will inevitably cause ignorance of the laws on commercial relationships, as well as ignorance of the use of the "civil law approach" to handle commercial relationships. Not only will this hinder the effective regulation of commercial relationships; civil law itself will be damaged.[1075] In practice, to pass a judgment, the Court—while invoking provisions in civil law—either curbs commercial practices based on the logic of the provisions in civil law, or reaches a compromise and lets the commercial practices involved remain unchecked by those provisions.[1076]

In China, as previously discussed, given our understanding of traditional civil and commercial relations, if we apply (by analogy) Article 124 of the *Contract Law* to financial management relationships in investment accounts,[1077] we end up with an inaccurate application of the law in these aspects, including the distribution of fault and

[1072] See Galgano Francesco, *Lex Mercatoria*, (Beijing: Commercial Press, Chinese translation edition, translated by Jia Wanting, 2017), p. 3.
[1073] See Li Shishi, *Interpretation of General Principles of Civil Law of the People's Republic of China*, (Beijing: Law Press, 2017), pp. 2-3.
[1074] It is very difficult to apply the law in China's commercial judicial practices, such as there being "no law available," "inappropriate existing laws," or the "inconvenience of invoking existing law." See Wang Jianwen, *Application of Law in China's Commercial Judicial Practices: Difficulties and Solutions*, 5 Modern Law Science 141, 141 (2010).
[1075] See Shi Tiantao, *Rediscovery of Commercial Relations and Mission of Current Commercial Law*, 6 Tsinghua University Law Journal 136, 138 (2017).
[1076] See Zheng Yu, *Logic of Civil Law, Thinking of Commercial Law and Application of Law*, 4 Law Review 82, 91 (2018).
[1077] See Gao Minshang, *Some Legal Issues in the Trial of Entrusted Financial Management Cases in the Securities, Futures, and Treasury Bond Markets*, 6 People's Judicature 27, 28 (2006).

the burden of proof. In another instance, for fraudulent acts committed by policyholders, except for the application of "insurance law," there are two approaches: contract and tort law. According to the former, fraudulent acts committed by policyholders do not meet the constitutive element of liability for a breach of contract. The liability for damage against a contracting fault cannot provide relief to the insurer, whereas the difficulties and cost of producing evidence have led to the conclusion that tort law cannot be the optimal regulatory approach for fraudulent acts committed by policyholders.[1078]

7.3 The Causes of Differences between the US's Law and Chinese Law: From the Path-dependence Perspective

7.3.1 The Basic Views on Path Dependence

Along with the advancement of economic globalization, the competition between and impact of financial laws in various countries are not only reflected by the financial products in their markets, but are also shown by their respective application of those laws and their rules on investment protection. For example, for the protection of the investment interests of the ILI, though both the securities law and insurance law can serve the role of protecting investment interests, the "approach" under Securities Act (the US) is more reasonable, and providing more powerful protection to the investors than the same under Insurance Law (in China). It is easy to doubt about is that at a macro level, the logic in the regulation by financial law has been acknowledged and observed by many countries (see Chapter 2). As a "catch-up country", especially in the financial field, China is a country that is actively engaging in transplanting rules from American laws, e.g., the "separate operation and separate supervision". Why didn't China learn the practice under the US laws in a way which is most beneficial to the protection of the investment interests or with the highest efficiency in the multiple amendments made to Securities Law or Insurance Law? In other words, except for the aforementioned reasons, what are the profound reasons that result in the differences between China and the US in terms of the application of the laws on ILI?

Namely, the differences between provisions in Chinese laws and provisions in the US laws in terms of the law application for ILI can be explained by path dependence

[1078] See Wu Yiwen, *Legal Regulation Path of Fraud During Insurance Contracting on Party of Insureds*, 5 Law Review 59, 59 (2019).

theory, including the path dependence in the change of the legal system and the inefficient state, "lock-in" is thus formed in the transplantation of law due to path dependence. Path dependence was first proposed in the field of economics, but in the meantime, it is also the powerful theory used to explain legal reforms and institutional changes, especially in the field of corporate governance.[1079]

In a path-dependent framework, legitimation explanations maintain that, once a given institution is contingently selected, the institution will be reinforced through processes of increasing legitimation, even if other previously available institutions would have been more legitimate.[1080] What these various mechanisms of reproduction (including functional, power, and legitimation) have in common is that they "maybe so causally efficacious that they 'lock-in' a given institutional pattern, making it extremely difficult to abolish".[1081] For example, "existing legal rules might have an efficiency advantage because institutions and structures might have already developed to address needs and problems arising under these rules. In such a case, replacing the existing rules might make the existing institutional and professional infrastructure obsolete or ill fitting and require new investments."[1082]

There are three possible efficiency outcomes when a dynamic process exhibits sensitive dependence on initial conditions: (1) initial actions, (2) imperfect information, and (3) "sensitive dependence on initial conditions leads to an outcome that is inefficient".[1083]

Additionally, Roe divides three forms of path dependence: weak-form path dependence, semi-strong form path dependence, and strong-form path dependence.[1084]

As discussed above, the US applies securities laws to variable life insurance, which is in line with the logic of financial law. However, it is not the optimal choice under the American environment. In the US, the variable life insurance inevitably implies multi-

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[1079] For example, there are two sources of path dependence in corporate ownership and governance: structure-driven path dependence and rule-driven path dependence. See Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 Stan. L. Rev. 127 (1999).

[1080] See James Mahoney, *Path Dependence in Historical Sociology*, 29 Theory and Society 507, 523 (2000).

[1081] See James Mahoney, *Path Dependence in Historical Sociology*, 29 Theory and Society 507, 515 (2000); Taylor C. Boas, *Conceptualizing Continuity and Change: The Composite-Standard Model of Path Dependence*, 19 Journal of Theoretical Politics 33, 46 (2007).

[1082] See Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 Stan. L. Rev. 127, 156 (1999).

[1083] See S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. Econ. & Org. 205, 206-207 (1995).

[1084] See Mark J. Roe, *Chaos and Evolution in Law and Economics,* 109 Harv. L. Rev. 641, 647-652 (1996).

layered supervision, which will involve insurance/securities regulatory authorities. In this context, it is easy to see the advantage of having multiple ordinances, such as more people to think and more eyes to provide supervision. This is helpful to mitigating the mistakes in regulatory decision-making when compared to single regulations with centralized decision-making. Historically, multi-layered oversight has boosted the US financial industry's prosperity and development.[1085] However, there are also some drawbacks. For instance, the existing system—which consists of both federal and state laws—has caused many problems such as high regulatory costs, low efficiency, the coexistence of overlapping rules, blank regulations, "competition for being inferior," and "regulatory arbitrage."[1086]

By contrast, the legal application of ILI is unreasonable and inefficient in China (chapter 2), which differs the corresponding in the US. The causes of the phenomenon can be further analyzed from the following aspects.

7.3.2 Initial Conditions for the Current Chinese Laws

According to the theory proposed by Liebowitz and Margolis, the first-degree path dependence refers to a circumstance where our initial acts fix us to a certain path, which is also one of the optimal paths, at least not an inefficient one. This path dependence only explains how the initial choice may have an impact on the present system. [1087] That is to say, initial actions, perhaps insignificant ones, do put us on a path that cannot be left without some cost, but that path happens to be optimal (although not necessarily uniquely optimal).[1088] Although the way of "law transplantation" for Chinese laws is evident, the original effects of many rules have not been fully brought into play; one important reason is that they are being restricted by the initial conditions of the Chinese laws. Those initial conditions are different from those for US laws.

7.3.2.1 Economic Institution: the Characteristic of Administrative Intervention Is Evident Rather Than A Typical Market Economy Country

[1085] See Luo Peixin, *A Reflection on the Dilemma of American Financial Supervision Law and Policy*, 3 China Legal Science 91, 94 (2009).
[1086] See Luo Peixin, *A Reflection on the Dilemma of American Financial Supervision Law and Policy*, 3 China Legal Science 91, 91 (2009).
[1087] See S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. Econ. & Org. 205, 206-207 (1995); Deng Feng, *Path Dependence of Chinese Corporate Governance*, 1 Peking University Law Journal 58, 61(2008).
[1088] See S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History,* 11 J. L. Econ. & Org. 205, 206 (1995).

As we all know, the United States has inherited the culture and policies of British mercantilism. After the founding of the United States in 1776, it has built a mature civil society through the formulation and implementation of the Constitution. The United States has implemented the market economy since the founding of the country, and there have been no apparent twists and turns for more than 200 years. Its market economy started early, developed rapidly, and formed a relatively complete market economy system.

However, the current economy in China started its development since 1978, within such a short period of development, the characteristic of government intervention left by the planned economy is quite apparent, which is unlike the long and matured development for the market economy in the US.

To begin with, it is necessary to provide a brief economic history of China. The People's Republic of China was founded in 1949. It was a new China that was rebuilt on the ruins left by the war. As a socialist country, the new China was facing threats from capitalist countries represented by the US. The outbreak of the Korean War has also aggravated the turmoil in the pattern of geopolitics. At that time, the object the country was trying to learn from was the Soviet Union, and the economic policy being adopted was the "planned economy", e.g., the first five-year plan established in 1953, in which the strategy of giving priority to the development of heavy industry was chosen. Since the founding of new China, the experience of Soviet Union was being advocated and the planned economy was also confirmed based on the background at that time. In the context of the national blockade, with enduring impoverishment and long-standing debility, the advancement of industrialization in new China could not be initiated using market economy. The new Chinese government had to rely on its political mobilization power and resource integration capability to consolidate the newly established political power by implementing the planned economy in light of the limited national conditions. There was no doubt that this was reasonable at that time, and also the first five-year plan was over fulfilled ahead of time. However, the drawbacks of this planned economy featuring strong intervention were also quite apparent since it was fully subject to the political impact. From 1967 to 1977, China entered into the turbulent period of the Great Cultural Revolution, which brought the Chinese economy almost to a standstill. After 1978, China started to reflect on the faults committed in the past and adopted the reform and opening-

up policy and then confirmed the implementation of the strategy of the market economy in the early 1990s.

The current economy in China started its development only since 1978, whereas the exploration of the laws and regulations in China was also started only since the 1980s. With just around 40 years of development, three characteristics are quite striking when it comes to the establishment of corresponding legal rules.

First, the United States emphasizes the absolute rights of personal property and the dominant position of private interests. In China, it is a fundamental economic system adopted by China in its primary stage of socialism that the public ownership shall be the mainstay and multiple forms of ownership shall be developed side by side. Even at the beginning of the 1990s when China started to implement the market economy, the main market players in China were still state-owned enterprises rather than private enterprises. Therefore, when making the laws, more often the initial thinking was to serve the state-owned enterprise. For example, at the very beginning when enacting the Company Law, it was to serve the need of the state-owned enterprises for a reform of their company system.

Second, the establishment and implementation of laws still rely on the government for a lead on their implementation and advancement, while the strength from the folks is negligible. The important reason for this is that the country is under the impact of the previous planned economy lasting over a long period. Besides that, it also requires a strong intervention from the government to realize the economic recovery and law-making after 1978. Therefore, in China, the resource allocation led by administrative power is still quite apparent, whereas the capability of the market to participate in the governance from the outside is quite weak. Due to the lack of legal supply in many respects, economic development and social governance are strongly dependent on policies issued by China's government.

Third, as for the legal environment, China started its exploration of legal construction in the 1980s, and the characteristic of law transplantation was obvious. This was because there were no perfect legal rules in place after the founding of new China in 1949 and the country needed to learn the advanced legal system from foreign countries, especially for China at that time, many things, as well as the legal rules, were new to the

country and there was no referable experience. In this sense, law transplantation was no doubt the right choice for China.

At present, the commercial laws which are being implemented by China was enacted just in the 1990s and only by taking the path of "law transplantation". When confirming the object to be transplanted, the laws in Taiwan were mainly learned. This was because the external environments for laws in Taiwan and laws in the Chinese Mainland were identical. Many laws in Taiwan were learned from foreign countries (like Japan), and the implementation effect could be observed directly. For example, the Company Law enacted in 1993 had learned a lot of legal provisions from Taiwan. The Company Law, which was amended in 2005, still followed the path of "law transplantation", but it was more apparent transplantation of the provisions under the Anglo-American law system. The development route for Securities Law and Company Law is by and large similar, which is also a development mode dominated by "law transplantation".[1089] This applies to the Insurance Law as well. The insurance legislation in China restarted at the beginning of its reform and opening up, the *Regulations of the People's Republic of China on Contracts of Property Insurance* and the *Interim Regulations on the Management of Insurance Companies*, enacted by the State Council in 1983 and 1985 respectively, still followed the system of separated legislation for the "Insurance Contract Law" and "Insurance Business Law". Nevertheless, when making the *Insurance Law of the People's Republic of China* in 1995, it was under the influence of the same in Taiwan, the two laws were combined and also broken away from the tradition of the continental law system.[1090]

Comparing with the US, the initial conditions for the enactment of the aforementioned Chinese laws are different from the same in the US. The US has not experienced the planned economy, so the administrative intervention is not significant if compared with China. For instance, China mainly adopts an examination and approval system for the issuance of financial products, whereas a registration system is adopted primarily in the US. For example, the registration with SEC is not an approval process for it is not a recognition of the qualifications and capacity of a specific financial institution, but an indication that those institutions, upon registered, should observe the business rules set forth in the Securities Act and accept its regulation, especially the

[1089] See Zhou Tianshu, *The Development Model of Chinese Corporate Governance: A Path-Dependent Perspective*, 4 China Legal Science 99, 102-103(2013).

[1090] See Fan Qirong, *Reflection and Prospect of China's Insurance Legislation,* 6 Studies in Law and Business 63, 64 (2011).

regulation in progress and after the event. Also, because the economic development in the US is mature and many financial laws and regulations were originally created by itself, so it has always been regarded as a country to be learned from, and the characteristic of "law transplantation" from other countries is not quite apparent.

The differences mentioned above in the backgrounds of the economic development in China and the US can reasonably explain why the advancement and implementation of laws in China have shown a significant factor of intervention by the administration power, and there is no complete development of the market rules.

For example, government ownership with an absolute advantage is still being kept in the financial system of China; these initial conditions result in a fact that the change of financial system also shows a characteristic of compulsory system change under strong leadership of the government. The central government in China has vested its financial system with many political functions. Take the bank as an example, the state-owned banks become "blood transfusion machines" for the state-owned enterprise and pressure reducers for social stability. In the securities market, this is shown by many political tasks they have assumed, including transferring the risks of the state-owned enterprises, reducing the financial pressure of the country, financing for state-owned enterprises, replenishing the capital, as well as solving both the difficulties being faced by those state-owned enterprises and the employment issues.[1091]

For another example, the insurance legislation in China is under the impact of the concept that attaches importance to the legislation about insurance regulation, but with less focus on the legislation about insurance contract, there are only 60 articles about the Insurance Contract Law (from Article 9 to Article 68), which is really being "congenitally deficient", consequently, their role of offering effective regulation over the insurance contract can not be brought into play. When the *Insurance Law* was amended for the first time in 2002, being guided by the thought to deliver on the promise made by China when joining the WTO and to strengthen the regulation and management of insurance, only the part of the law on insurance business was amended, but no essential amendment was made to the part of the law on an insurance contract.[1092] In terms of the *Company Law*,

[1091] See Zhang Jianwei, *Law and Finance: Path Dependence and the Reform of Financial Law*, 10 Academic Monthly 96, 102(2005).

[1092] See Fan Qirong, *Reflection and Prospect of China's Insurance Legislation,* 6 Studies in Law and Business 63, 65 (2011).

the use of registered capital to regulate company property, the strict restriction on the purpose of a company and the reliance on company registration system, etc. refer to a *Company Law* described as being regulatory and paternalistic. Regulations containing authorizations account for a major part of the US laws. The focus is on fiduciary duty and the corporate financing and the control of the corporation by the management level are deemed as the major core regulations, thus to establish a Company Law with a complete separation of two rights.[1093]

In addition, China is a country with thousands of years of history. Throughout its long history, China has mainly passed through the feudal society where the economic characteristic was self-sufficient, stressing a mode of production based on each family unit and with the only purpose of satisfying the family need rather than commodity transaction. Meanwhile, the policy of "stressing agriculture and restraining commerce" was being implemented in ancient China, resulting in the absence of a relax environment under which the commerce was being developed in China. So the traditional economic system in China was usually built on family relations with blood ties, whereas what had been stressed by western countries was an effective allocation of capitals and resources that ignores the identities.[1094] This difference in backgrounds may be apparent in corporate governance. For example, in many companies in China, the paternalism is being followed inside with a high concentration of decision-making power. Such a company mainly relies on blood ties, family ties and friendship to realize internal incentives and restraints, so it is hard for a talent hired from the outside to be appointed to an important position.[1095] This phenomenon also can be found in insurance companies and fund companies where effective internal governance and supervision are missing. In US law, in terms of corporate governance, the characteristic of blood ties is not as apparent as the same in China.

7.3.2.2 Social Institution: the Policy of "Maintaining Stability Is of Top Priority"

From the early 1980s, Deng Xiaoping (the one who put forward the "reform and opening-up policy" in China, also the second top leader of China) reiterated the absolute

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[1093] See Deng Feng, *Path Dependence of Chinese Corporate Governance*, 1 Peking University Law Journal 58, 63-64(2008).
[1094] See Zhou Tianshu, *The Development Model of Chinese Corporate Governance: A Path-Dependent Perspective*, 4 China Legal Science 99, 102 (2013).
[1095] See Chen Wenjin & Chen Lixin, *The Cultural Path Dependence of Corporate Governance and Its Creative Choice*, 5 Journal of Gansu Institute of Political Science and Law 33, 37(2006).

need to maintain a domestic political situation which is stable and solidary. On February 26th, 1989, Deng Xiaoping pointed out that for all issues in China, the top priority over everything else is the need for stability, without a stable environment, nothing can be achieved, and even the achievements obtained can be lost.[1096] This is a view on social stability, which advocates the reliance on the enforcement power of the state to maintain social stability.[1097] Stability, in general, broadly refers to stabilities at all levels of the society, among which the one that ranks top is political stability, as specially stressed by Deng Xiaoping. [1098] Therefore, based on the policy – maintaining stability is a top priority over everything else, for the reform on the legal system, as well as for the settlement of relevant disputes, whether it is stable and will not result in social instability, have become the basis to be considered by the legislators and government, thus to adopt a legislative attitude which is quite conservative.

For example, according to the lawmakers' consideration, China's *Securities Law* in 1999 could not be fully in line with the same in advanced countries like the US. Instead, the stipulation of relevant provisions should be considered based on the needs when the securities market in China is matured and has specific experiences. For this reason, as the legislation at the interim period, the legislators in China made a prudent choice based on China's actual needs and conditions, which is to enumerate finitely in the *Securities Law* at that time.[1099]

Additionally, under the policy of "stability overriding everything", the Judicial system emphasizes the mediation system rather than the legal litigation system in China. As the roles of China's courts, "the people's courts are not only a building force of the harmonious society but also a protection force of the harmonious society, and shoulder significant historical missions during the course of building a socialist harmonious society."[1100]

[1096] See Deng Xiaoping, *Selected Works of Deng Xiaoping*, (Beijing: People's Publishing House, 1993), p.284.
[1097] See Pang Xialan & Liu xiangying, *Analysis on "Stability Overwhelming the Wholeness"——A Perspective of Social Conflict Theory,* 9 Journal of University of Science and Technology Beijing (Social Sciences Editi on) 14, 14(2006).
[1098] See Wang Yilin & Wang Yu, *On the Principle of Political Economy in the Statement that Stability Is of Overriding Importance*, 4 Journal of Jishou University (Social Sciences Edition) 40, 42 (2010).
[1099] See Li Fei, *How to Determine the Adjustment Scope of Securities Law in China*, 2 China Legal Science 25, 25-28(1999).
[1100] See *Several Opinions of the Supreme People's Court on Further Displaying the Positive Roles of Litigation Mediation in the Building of a Socialist Harmonious Society*, No. 9 [2007] of the Supreme People's Court.

7.3.2.3 Informal Institutions: Collectivism Is Being Advocated Rather Than Individualism

The effectiveness of a system does not depend on rational design, because to determine the merits and demerits of a system, not only do we have to judge on the rational system structure, but also the thing we need more than anything else is to see if it is adaptive to a cultural environment.[1101] What has been reflected by legal provisions is the legal culture behind it. For example, in China, the civil law culture is about ethical culture, and ethical norms mainly show the norm of civil law.[1102] The rights and obligations as contained in current rules are based on the good ethics and morality formed in China over a long period, which are further defined as legal relations.[1103]

"The Confucian ideal of the social structure rests on the 'Five Relationships.' Formulated by classical Chinese philosophers, this concept states that there should be affection between father and son, righteousness between ruler and minister, attention to separate functions between husband and wife, proper order between old and young, and faithfulness between friends."[1104]

In China, the culture with far-reaching influence is the Confucian culture. Although Confucian culture has many advantages (e.g., advocating self-cultivation), what to be discussed here is the impact brought by the drawbacks of Confucian culture to the legal system in China. The drawbacks of the Confucian culture are mainly the following. Firstly, the main standpoint of Confucian culture is to advocate the rule of virtue rather than the rule of law. This practice of overstressing the rule of virtue but ignoring the rule of law has caused a lack of laws across the whole society. Therefore, once there is a dispute, people do not resort to lawsuit but to seek private mediation instead. This has even created the culture of having a hatred feeling towards lawsuit. For example, at the spiritual level, the Confucian culture maintains an attitude of belittling and rejecting towards the profit-seeking behaviors of merchants, which gives rise to the fact that the officials at the bureaucratic stratum, who received the education by Confucian classics, also maintain an indifferent attitude towards the trial of and ruling on commercial cases.[1105] Secondly, the

[1101] See Chen Wenjin & Chen Lixin, *The Cultural Path Dependence of Corporate Governance and Its Creative Choice*, 5 Journal of Gansu Institute of Political Science and Law 33, 33(2006).
[1102] See Zhao Wanyi, *Ethical Analysis of Civil Law*, (Beijing: Law Press, 2012), pp.3-5.
[1103] See Chenwei, *Law of Family and Succession*, (Beijing: Law Press, 2002), p.11.
[1104] See Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform,* 22 Berkeley J. Int'l L. 195,215 (2004).
[1105] See Zhou Tianshu, *The Development Model of Chinese Corporate Governance: A Path-Dependent Perspective*,

idea, anyone who excels in learning can be an official, as advocated by the Confucianists, lead to the prevailing thought of acting like an official in the traditional society of China. For example, in the corporate governance of China, many administrators regard their statuses in the company as being officials, rather than being operators and managerial people. Thirdly, the Confucianists overstress the paternalism. For example, "internal control" is quite serious in many Chinese companies. Fourthly, the Confucianism advocates collectivism, which overstresses the obedience of individual to collective. This contributes to the fact that the legal system in China does not give individuals and their private rights due importance.

The impact brought by a cultural background featuring collectivism to the law application for ILI is that the disputes arising out of the ILI do not resort to legal approaches, such as lawsuits, for settlements. For instance, as it is found through investigation from 542 interviewees, the most effective way to settle a dispute is to "negotiate with the business staffs of the financial institution (28%)"; the next one is to resort to administrative approaches – "report to the People's Bank, CSRC, CIRC, etc. (27.86%) "; third, "call the service number of the financial institution (27.49%)"; fourth, "report to the media (22.69%)"; fifth, "lawsuits (22.14%)", and what follow are to "report to the association of consumers"(13.47%); or "resort to an arbitration (11.81%)".[1106]

In terms of the Anglo-American laws, the culture that has been inherited by them is the "Anglo-Saxon culture", the core of which is the value of individualism. An explanation of the economy from this perspective is to focus the observation and analysis of individual acts and preference, rather than observing many people with different consciousnesses as a whole. The act of studying economic activities will not have any fundamental significance unless it is started from each individual.[1107] For example, this characteristic of individualism is also one of the reasons that contribute to the highly decentralized distribution of shareholder rights in American enterprises. For those relevant subjects that either can not or are not willing to pay the regulatory cost separately, it is natural that they will seek an external market-oriented regulation pattern. Also the relatively complete and sound market system and the legal system allows this to happen.

4 China Legal Science 99, 102 (2013).

[1106] See Xing Huiqiang, *Research on the Diversified Resolution Mechanism of Financial Consumption Disputes*, (Beijing: China Finance Press, 2012), p.204.

[1107] See Chen Wenjin & Chen Lixin, *The Cultural Path Dependence of Corporate Governance and Its Creative Choice*, 5 Journal of Gansu Institute of Political Science and Law 33, 34(2006).

Therefore, the externally monitored governance automatically becomes the governance pattern adopted by the UK or US companies.[1108]

7.3.3 The Initial Conditions of ILI

Why do American variable products cause legal disputes? The initial reasons are as follows. In Section 3(a) of the US's *Securities Act of 1933*, it has expressly stipulated that the insurance contract, life insurance with fixed policy period, and annuity are exempted from the application of the Securities Act.[1109] In Subsection 17 of Section 2(a) of the country's *Investment Company Act of 1940*, it has stipulated that the insurance companies are state-governed companies whose significant businesses are to underwrite risk and to provide reinsurance.[1110] However, the McCarran Act provides that the business of insurance shall be subject to state regulation and that no act of Congress shall be construed to invalidate, impair, or supercede state regulation.[1111] The authority for the regulation over the issuance of securities and the investment contract other than the insurance is in the hands of the SEC at the federal level.[1112] Under this mode of regulation, in the 1950s, variable annuity in combination with insurance guarantee and investment & finance management functions appeared in the US market. This variable annuity was a mixture of insurance and securities, so it remained unclear as to whether or not its legal attributes fell into the category of securities or still fell into the category of insurance, disputes also arose as a result.

By contrast, China's ILI began in late 1999. Why is the ILI locked in as "insurance" at the beginning? Under the above initial conditions, we can further analyze the initial conditions of ILI.

First, the insurance market needed some new products to activate the market in the 1990s.

As to variable life insurance of America, it was devised to be a hedge against inflation,[1113] while the emergence of China's ILI is affected by interest rate, residents'

[1108] See Chen Wenjin & Chen Lixin, *The Cultural Path Dependence of Corporate Governance and Its Creative Choice*, 5 Journal of Gansu Institute of Political Science and Law 33, 35(2006).
[1109] See 15 U.S.C. § 77c(8) (1964).
[1110] See 15 U.S.C. § 80a-2(a)(17) (1964).
[1111] See C. Lee Jr. Cook, *The Legal Barriers to the Variable Annuity*, 1958 U. Ill. L.F. 466, 468 (1958).
[1112] See Robert H. Jerry II & Douglas R. Richmond, *Understanding Insurance Law*, LexisNexis,2012, p.28.
[1113] See Tamar Frankel, *Regulation of Variable Life Insurance*, 48 Notre Dame Law 1017, 1017-1091 (1973).

investment habits, inflation, rate of return, etc.,[1114] and one of the primary factors is the rapidly dropped interest rate in the 1990s. It is well known that China transformed from a planned economy to a socialist market economy in the late 1980s and the early 1990s, and began the fast development of the economy. However, the insurance industry faced the puzzledom of development in the 1990s. According to the official figures, China's one-year deposit rate fell from 10.98% in 1993 to 2.25% in 1999, whereas the domestic insurance industry did not realize this slump in time and still kept the previous high rate of return for endowment insurance products at that time, resulting in a hot-selling life insurance in 1996-1997.[1115]Subsequently, the industry-recognized this phenomenon and began to lower the rate in 1997, but it lost consumers' attraction to endowment insurance products with lower interest rate and led to a decline in the total sales of life insurance. The industry tried their efforts to change the situation. For example, they would return the income of the interest rate spread to policyholders when the rate goes up, while the companies retained the risk of the rate if the rate goes down.[1116] The fact proved their efforts failed because it violated the allocation of risk in a market economy, and they were unwilling to assume this risk afterward. As a result, the industry began to exploit some new insurance products, and the first ILI was introduced as new life insurance to solve this economic dilemma.

Second, the CIRC always pays a vital role in the development and supervision of ILI. CIRC initiated the introduction of ILI. Why does the CIRC lead the introduction of such a product? The CIRC is not only a regulator but also a developer to promote the insurance market in China. Due to the inadequate development of China's economy, the government adopts a strong intervention to achieve rapid economic development, which is affected by the long-term implementation of the planned economy in China.

As discussed earlier, the development of ILI is deeply affected by not only the stock market but also the regulations. In China, the supervision of this product is totally dependent on the administrative rules issued by the CIRC. The CIRC, established on November 18, 1998, is a direct subordinate agency of China's State Council. It is

[1114] See Wen Gu, *Empirical analysis and prospects of investment-linked insurance in China*, 12 Shanghai Insurance 46, 46-48(2008).
[1115] See Chang Ding & Li Hanxiong, *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), p.12.
[1116] See Chang Ding & Li Hanxiong, *The Fundamentals and Supervision of Investment-linked & Universal Life Insurance*, (Beijing: Chinese financial & Economic Press, 2009), p.12.

responsible for performing administrative functions, supervising and managing the national insurance market to maintain the legal and steady operation of the insurance industry according to the authorization of the State Council and the Article 9, 133 and 134 of *Insurance Law* in China.[1117]

Initially, the CIRC enthusiastically greeted with the introduction of ILI. Not long after the introduction of ILI, the CIRC promptly issued the *Interim Measures for investment-linked Insurance Management* (No. 26 [2000] of CIRC) on 21 February 2000 and expected the insurance will be smoothly developed and suitable for the improvement of the Chinese economy in the Article 1 of the No. 26.[1118] Under this regulation, the CIRC not only clearly defined the product as a new kind of life insurance and stipulated mandatory items to the information disclosure of the investment account,[1119] but also required that selling ILI must be approved in advance by CIRC pursuant to Article 2, 5 and 6 of the No.26.[1120] In other words, the CIRC successfully announced the regulatory power of ILI has fallen into its business.

Third, ILI is introduced by insurance companies rather than securities companies. In China, several major insurance companies, such as China Life Insurance Company and China Pacific Insurance Company, were state-owned enterprises (funded by the government). These companies can not be simply considered as market entities, because they are funded by the government. For example, the managers of these companies are treated as a kind of civil servant in fact. Therefore, the role of insurance companies is not only to make profits in the market but also to shoulder the responsibility for the development of the insurance market. In this context, insurance companies introduced ILI and sold it as "insurance", which is also intended to promote the development of the insurance market in the 1990s.

Fourth, although the CSRC was established in 1993, and the time was easier than the CIRC's establishment, the CSRC was not the solely regulatory agency of the securities industry. In the 1990s, there was another regulator called the "Securities Commission of the State Council" (SCSC) to supervise China's securities market. It also was a directly subordinate agency of the State Council at that time. The SCSC's regulatory power was

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[1117] See Article 9, 133 and 134 of the *Insurance Law of People's Republic of China*; also see the official website of CIRC, < http://bxjg.circ.gov.cn/web/site0/tab5170/ >, accessed on 7 November, 2018.
[1118] See Article 1 of *Interim Measures for Investment Link Insurance Management,* CIRC No 26 [2000].
[1119] See Article 2 of *Interim Measures for Investment Link Insurance Management,* CIRC No 26 [2000].
[1120] See Article 5 and 6 of *Interim Measures for Investment Link Insurance Management,* CIRC No 26 [2000].

focused on macro-management of the securities market, while the CSRC was an enforcement agency of the SCSC, although both CSRC and SCSC had similar roles and authorities as the securities' regulators. However, the State Council of China decided to combine the two regulators and place the regulatory power of Shanghai and Shenzhen Stock Exchanges under the scope of the CSRC in 1997. The State Council further merged the SCSC into the CSRC in 1998. After these reforms, the power of the CSRC has been significantly strengthened and centralized to the supervision of China's stock market. Namely, it basically formed a nationally unified regulator in 1998. However, there were also many affairs, staff and power that need to be integrated for some time due to this institutional reform. Furthermore, there were some serious illegal actions in the stock market at that time, such as insider trading, which consumed most of CSRC's time and energy. Particularly, there were no obvious problems with ILI around 2000 under the name of life insurance. As a result, the CSRC overlooked and did not pay attention to the status of this insurance. Although the CSRC has realized the security's status of ILI later, it is still unwilling to try its efforts to supervise the product, because it is unwise for the relationship between CIRC and CSRC to become hostile towards for the product.[1121]More importantly, with the development of ILI, it has paid an important role in the insurance industry and it has brought huge political benefits to the CIRC so that the CIRC would not easily to give up the regulatory power to ILI. Accordingly, ILI is supervised by the CIRC all along, not the CSRC in China.

Finally, under the policy of "stability overriding everything", China's government adopted a very cautious attitude to commercial law in the 1990s. For example, China's Securities Law began to be implemented in 1999. At that time, the law only has two kinds of securities - stocks and corporate bonds, and the funds were excluded. Thus, it was impossible for ILI to be included in the scope of "securities" at that time. Meanwhile, due to the policy of "stability overriding everything", many of the rules also tend to focus on social stability. For example, for the surrender of ILI, it is easy to be characterized as a "group event" with political sensitivity. In the *Guiding Opinions on Ascertaining Personal Insurance Companies' Liability for Misleading Sales* (CIRC No.99 [2012]), the circumstances under which a personal insurance company should be held liable in case it is found to have misleading sales, e.g., administrative punishment, a "regulative letter"

[1121] See Luo Yu, *Investment-linked insurance: security?* 6 Financial Law Forum 85, 91(2003).

received from the regulatory authority or whenever there is any "regulative conversation".[1122] Besides, significant mass unexpected incidents are defined and further divided into three levels of response.[1123] In dealing with such cases, based on the responsibility to the government superiors or the pursuit of their own interests, the political logic will certainly overwhelm the judicial logic.[1124] In general, the supervision on public power can not be deemed as all relief to realize the protection of investment interests under ILI. The civil relives, which rely on the focus of "self-interest" by the party concerned and the effects brought by such relieves, are more beneficial to the protection of the interests of the policyholders (or the "investors") if compared with the pure administrative protection.

7.3.4 The Second-degree Path Dependence of ILI

The second-degree path dependence is caused by imperfect information, given the assumed limitations on knowledge.[1125] "In this case, it is possible that efficient decisions may not always appear to be efficient in retrospect. Here the inferiority of a chosen path is unknowable at the time a choice was made, but it is later recognized that some alternative path would have yielded greater wealth."[1126] In such a situation, sensitive dependence on initial conditions leads to outcomes that are regrettable and costly to change.[1127] Meanwhile, in order to avoid paying too much cost, people may be satisfied with the existing suboptimal path instead of pursuing the optimal path.[1128]

In the process of legal transplantation, China's financial laws show imperfect information, the second-degree path dependence. For example, in the process of legislation of the company law and insurance law in the 1990s, Chinese Mainland basically learned and copied Taiwan's company law and insurance law. This is obviously

[1122] See Article 3 of *Guiding Opinions on Ascertaining Personal Insurance Companies' Liability for Misleading Sales* (CIRC No.99 [2012]).
[1123] See Article 4 of *Guiding Opinions on Ascertaining Personal Insurance Companies' Liability for Misleading Sales* (CIRC No.99 [2012]).
[1124] See Huang Tao, *Why the Court is Not So Important: An Observation of China's Stock Market,* 9 Law and Social Sciences 63, 101 (2012).
[1125] See S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. Econ. & Org. 205, 207 (1995).
[1126] S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. Econ. & Org. 205, 207 (1995).
[1127] S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. Econ. & Org. 205, 207 (1995).
[1128] See S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. Econ. & Org. 205, 206-207 (1995); Deng Feng, *Path Dependence of Chinese Corporate Governance*, 1 Peking University Law Journal 58, 61(2008).

due to insufficient knowledge supply, and Taiwan is a good model for reference because both have many similar outside legal environments.[1129] As for ILI, there is also the second-degree path dependence.

ILI is introduced from abroad, but it is lacked adequate information and knowledge on its securities attributes. ILI covers the properties of conventional life insurance and securities as a hybrid financial product. However, the element of security in the ILI has always been overlooked by CIRC. In fact, the hybrid product has focused more attention on the investment function, an essential feature to security rather than life insurance. The investment-risk of ILI does not transfer to insures in the concept of traditional insurance. Historically, "insurance" has provided against these risks by guaranteeing a substantial fixed-dollar benefit.[1130] At the technical level, the guarantee is achieved by the pooling of mortality and the actuarial techniques, such as the theories of probability, the law of large number, etc. Legally, there exists a consideration that policyholders pay the insurance premium to insurers under an insurance contract and the insurer pays insurance benefits when the insured dies or reaches a specified age pursuant to the Article 2 of China's *Insurance Law*.[1131] Namely, the insurer shall assume the mortality and investment risk, not policyholder and the insured. The absence of a substantial guarantee, and the corresponding lack of investment risk-taking by the insurer, is inconsistent with "insurance".[1132] As early as 1959, the US's supreme court held in the case of VALIC that "the issuer of a 'variable annuity' contract that has no element of fixed return does not assume any investment risk, which is inherent in the concepts of 'insurance' and 'annuity'".[1133] The US's supreme court also quoted this point in the case of UBLIC in 1967.[1134] Afterwards, whether risk-taking by the insurer is transferred or not has become a primary factor to decide the status of a variable product.

In addition, there is also imperfect information on the legal application of ILI. For example, it is not emphasized the "caveat vendor". Caveat emptor, as an obvious principle

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[1129] See Deng Feng, *Path Dependence of Chinese Corporate Governance*, 1 Peking University Law Journal 58, 64 (2008); Fan Qirong, *Reflection and Prospect of China's Insurance Legislation,* 6 Studies in Law and Business 63, 64 (2011).
[1130] See Milton P. Kroll, Gary O. Cohen, *Insurance—Security Identity Crisis*, 46 George Washington Law Review 790, 794 (1978).
[1131] See Article 2 of *Insurance Law of the People's Republic of China*.
[1132] Milton P. Kroll, Gary O. Cohen, *Insurance—Security Identity Crisis*, 46 George Washington Law Review 790, 794 (1978).
[1133] See *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65, 65 (1959).
[1134] See *SEC v. United Benefit Life Insurance Co*., 387 U.S. 202, 210 (1967).

for the allocation of transaction risk in a market economy, is formed based on the transaction relationship found in the simple selling and buying of commodities in which there exists no apparent information asymmetry between both parties of the transaction. The principle is then further established and consolidated in a reasonable manner in the tide of western liberalism and individual rationalism, both of which are found in modern times. However, in a modern commodity transaction, the complicated financial products have resulted in the emergence of apparent inequality in terms of the actual economic status of both parties and the capabilities in negotiating, which eventually is inappropriate to the hypothesis based on the traditional transaction. In judicial practice, the application of caveat emptor to ILI should be turned to the consideration of "caveat vendor first and then caveat emptor", and the importance should be attached to the considerations of both fiduciary duties and suitability doctrine on the sellers of ILI.

7.3.5 The Third-degree Path Dependence of ILI

"In third-degree path dependence, sensitive dependence on initial conditions leads to an outcome that is inefficient-but in this case the outcome is also remediable. That is, there exists or existed some feasible arrangement for recognizing and achieving a preferred outcome, but that outcome is not obtained".[1135]

The legal application of ILI exists the first-degree path dependence. It also has the second-degree path dependence because there is a lack of understanding of its securities attributes when it is introduced in China. ILI is regarded as an "insurance product" and regulated by insurance law in China. However, as discussed above, it is an unreasonable way if ILI is only applied to insurance law, and lead to inefficient complementarities for investors protection. In other words, the information disclosure system and private enforcement of securities law are replaced by the rules of CIRC and public enforcement. Moreover, the judicial disputes caused by investment fraud are mainly in accordance with the rules of insurance law and civil law. That is the third-degree path dependence for the legal application of ILI.

7.3.5.1 Information Disclosure: CIRC Rules Instead of Securities Law

[1135] S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. Econ. & Org. 205, 207 (1995).

The CIRC's regulations in relation to ILI are ineffective and provide weak guidance to the insurance industry, participate in the information disclosure. Although the operation and underlying structure of the investment account resemble mutual funds, the information disclosure of the investment account is far less abundant and detailed than funds in the items and extent of information. For example, the total number of ILI prospectus usually is 44 pages, less than 6,000 words, while a fund prospectus has a total of 112 pages, up to 81,000 words.[1136] The account only includes five parts: basic characteristics, asset allocation goals and principles, investment tools, portfolio restrictions and investment risks, and each part is relatively simple and rough, while the fund has detailed descriptions on product participation, investment management, asset custody and disposal, asset valuation, fees and taxes, net worth announcement, and risk disclosure etc.[1137] The main reason why the disclosures are different between an investment account and fund is that the CIRC's mandatory requirements are in principle and lack specific standards about ILI. For instance, although ILI shall be disclosed the investment strategies, one of the most important information for decision of purchasing, pursuant to the Article 18 if *Measures for the Administration of the Disclosure of Information on New-Type Personal Insurance Products* (No.3 [2009]), it lacks specific items and standards, such as proportion of various assets in the portfolio, trading decision-making mechanisms, investment procedures, net worth announcement, and other aspects. Furthermore, CIRC stipulates the principle of "the product brochures are objective, true, and without any major omission" pursuant to Article 11 of the No.3 [2009], but it does not define what "any major omission" is. Namely, it lacks the materiality standards of information disclosure for ILI. As a result, it cannot provide an efficient guidance to the insurance industry, and it is easy to cause the problem that the disclosure avoids the important and dwell on the trivial with regard to ILI as for insurers. If there are too much trivial information in their presentations, it could can be misled to consumer's decision.

7.3.5.2 Legal Remedies: Public Enforcement Instead of Private Enforcement

Two features in the investment contract give rise to the need for protection under securities acts: control and management of the investment is in the hands of someone

[1136] Yan Tao, *Comparative Analysis of Investment-linked Insurance and Fund Information Disclosure*, 9 Insurance studies 88, 90 (2010).
[1137] See Yan Tao, *Comparative Analysis of Investment-linked Insurance and Fund Information Disclosure*, 9 Insurance studies 88, 90 (2010).

other than the investor; the risk is borne by the investor.[1138] As discussed previously, the policyholders bear the investment risk and the insurers manage and control the investment in an ILI. Therefore, the investment protection of the product can arise to the application of China's securities law. However, this is not the case at all.

The CIRC's regulations only adjust the administrative legal relation (the vertical relation) between the insurance industry and the CIRC, not the civil legal relation (the lateral relation) between insurers and policyholders. Namely, it only relies on the public enforcement by CIRC if the industry violates the regulations of information disclosure. Nevertheless, there are some problems to the CIRC's public enforcement. First, the types of the administrative liability are relatively simple and rough, and the illegal cost is very low. Article 28 of the Order No.6 [2002] stipulates where an insurance company fails to conduct a follow-up this regulation, it would be punished including "ordering to correct", "canceling the qualifications of the responsible persons", "suspending to sell this kind of product", etc. In 2009, CIRC stipulates the specific range of administrative fine, for instance, a company would be imposed a fine of not less than one nor more than three times the amount of illegal income, not exceeding 30,000 yuan if the company violates the regulation pursuant to Article 34 of the Order No.3 [2009]. Thus, these regulations do not provide the components of administrative liability, and illegal behavior will thrive so long as the cost of breaking the regulations is low. It also is easy to form the selective enforcement if the CIRC does not strictly to execute the own issued regulations, and the CIRC would like to focus on the illegal behaviors resulted in certain social influence and overlook other illegal behaviors.

As to private enforcement, it is even more absent in the regulatory system. ILI does not apply to securities law, and it impossible for a policyholder to initiate private litigation under securities law because the CIRC is unwilling to admit its property of security, even though it has substantial features to the property of security in the regulations. It also means private enforcement cannot be realized in terms of the dominant part of security. On the other hand, there is no special legal article for ILI and the product only applies to the Articles in relation to conventional life insurance in the *Insurance Law*. Policyholder only initiates private action pursuant to the conventional legal framework of life insurance

[1138] See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts,* 51 B.U. L. Rev. 177, 214 (1971).

in Insurance Law. However, if ILI is considered as life insurance products completely, the product, as a hybrid product, faces new legal challenges (Chapter 2).

Accordingly, the above weak enforcement will directly lead to inadequate and poor protection of the purchaser's rights, although both Article 1 of *Insurance Law* and Article 1 of *Securities Law* have the legislative intent to protect the interest of policyholders (investors) in China. As it turns out, there have occurred several incidents of large-scale collective surrender for the weak and poor protection, such as the "Ping An Surrender Event" in 2002 and the "Hai Kang Surrender Event" in 2008, etc.

7.3.5.3 The Application of Anti-fraud Rules under Civil Law and Insurance Law

At present, the information fraud of ILI is handled pursuant to the provisions of Civil Law or Insurance Law in China. However, it can be known that irrespective of the insurance law approach or the general civil fraud approach. None of them have covered the regulation logic for the securities attribute of the ILI, which has resulted in insufficient relief for investment interests. It is crucial to respect the legal attributes of the ILI product itself, as well as the specific characteristics of its legal relation.[1139]

For example, in China, as it is previously discussed, under our understanding about the traditional civil and commercial relations, if we apply by analogy Article 124 of the *Contract Law* to the financial management relationship in the investment account,[1140] we will have inaccurate law application in those aspects including the distribution of fault, burden of proof, etc. For another example, for the fraudulent acts committed by the policyholder, except for the application of "insurance law", there have two approaches: the contract law and the tort law. For the former, fraudulent acts committed by the policyholder do not constitute the constitutive element of the liability for breach of contract, the liability for damage against contracting fault can not provide relief to the insurer, whereas the difficulties and cost in producing evidence has determined that the tort law can not be the optimal regulation approach for the fraudulent acts committed by the policyholder.[1141]

[1139] Both civil law and commercial law belong to private law. The commercial law is not a special law of civil law, but a special law of private law. See Shi Tiantao, *Rediscovery of Commercial Relations and Mission of Current Commercial Law*, 6 Tsinghua University Law Journal 136, 136 (2017).
[1140] See Gao Shangmin, *Some Legal Issues in the Trial of Entrusted Financial Management Cases in the Securities, Futures, and Treasury Bond Markets*, 6 People's Judicature 27, 28(2006).
[1141] See Wu Yiwen, *Legal Regulation Path of Fraud During Insurance Contracting on Party of Insureds*, 5 Law Review59, 59 (2019).

Article 58 of the *General Principles of the Civil Law of China (2009)* determines the act performed by a person against his or her true intentions as a result of cheating, coercion or exploitation of his unfavorable position by the other party as null and void. However, this is stipulated by the *General Provisions of the Civil Law of the People's Republic of China (2017)* and the *Contract Law* as a "revocable legal act." In case there is any conflict between laws in identical legal hierarchy, based on the principle that "new law should be superior to the old law," Article 147-151 of the *General Provisions of the Civil Law of the People's Republic of China (2017)* and Article 54 of the *Contract Law* should be deemed as the basis of our analysis. It can be known that the constitutive element of civil fraud is the following: First, fraudulent act; the performing subjects of this fraudulent act are not limited to the parties concerned. Although Article 54 of the *Contract Law* limits the application of its provisions on fraud to the parties to a contract, Article 149 of the *General Provisions of the Civil Law of the People's Republic of China (2017)* also stipulates the provisions on the fraudulent acts committed by a third party. Second, the actor has the subjective intention; Third, causal relation, meaning that the civil fraudulent act, in general, shall refer to the circumstance where one party to a contract deliberately makes false statement or conceals important facts, which lets the trading counterpart have a wrongful understanding based on which to sign a contract.

The "good faith principle," as expressly stipulated in Article 5 of the *Insurance Law* of China, is, in fact, a requirement that the parties to a contract should not have committed any fraudulent act. The CIRC also has strict control over the sales of insurance products. In the *Notice about Entrusting the Banks for the sale of the Investment-linked Insurance and the Universal Insurance Products (No. [2004]22 of CIRC),* it was provided that the information disclosure material and publicity materials should be printed and managed collectively by the parent company of the insurance company or its authorized branch company, the affiliated agencies and its working personnel, who are selling the product on agency terms are prohibited from printing or changing publicity materials arbitrarily.[1142] In Article 5 of the *Management Measures for the Disclosure of the Information on New Personal Insurance Products* (No. 3 of 2009), it was expressly stipulated that the insurance company should be responsible for the objectiveness and authenticity of the information disclosed by it, may not omit any important information,

[1142] See Article 3 of *Notice about Entrusting the Banks for the sale of the Investment-linked Insurance and the Universal Insurance Products (No. [2004]22 of CIRC).*

and may not defraud, mislead, and conceal information from insurance applicants, insureds, beneficiaries, and the general public. However, we should say that those anti-fraud provisions are only principles without specific judgment standard, especially the case when it involves any fraud, the policyholder only relies on the *Insurance Law* or general civil relief provisions for private law relief, which will block the channel through which the policyholder receives relief. Because the general relief channel provided in the contract law should still be followed for the legal consequence of the fraud in the context of the insurance law – subjective state of the defrauder, causal relation, etc. have to be proved.

7.3.6 Remediable Possibilities to the Inefficiency of ILI's Application

Although the CIRC issued several regulations on ILI, those are incomplete, weak, and ineffective regulation for the ILI. By contrast, securities law provides more reasonable and logical ways to private enforcement of ILI as well as investors protection. As for this situation, the legal application of ILI has formed a strong path dependence in China, which seems to have been locked in a specific equilibrium. Does it mean that the starting point is the ending point? In other words, how to walk out this kind of constant path dependence?

As the statutory law, the most thorough way to solve the problems mentioned above in the application of ILI is undoubtedly to amend the law in China. However, this way is complicated.

To begin with, it is necessary to consider the sunk cost. "The sunk cost effect is manifested in a greater tendency to continue an endeavor once an investment in money, effort, or the time has been made. Evidence that the psychological justification for this behavior is predicated on the desire not to appear wasteful is presented."[1143] Once costs are sunk in equipment with no good alternative use, continuance often is efficient.[1144] After the introduction of ILI, the CIRC has invested a lot of time and energy to formulate ILI rules and has formed the equilibrium state in China. If the current rule system of ILI is abandoned, it means to re-determine the application path of the securities law. It will inevitably reinvest a lot of costs. Secondly, ILI involves a power game among financial

[1143] Arkes, Hal R. & Blumer, Catherine, *The Psychology of Sunk Cost*, 35 Organizational Behavior & Human Decision Processes 124, 124 (1985).
[1144] Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 Stan. L. Rev. 127,139 (1999).

regulators. If the securities law is applied to ILI, it means the redistribution of supervisory power in China. Thirdly, ILI is advertised and treated as an insurance product, making the public form this understanding of ILI. It is also challenging to reshape the public's knowledge of ILI.

Although the current application of ILI is unreasonable and it is difficult to solve this problem through legislative amendments, the following ways and new trends may ease the irrationality of the legal application of ILI.

First, although China is a statutory country, there is no case law system. However, the Supreme Court of China is not only a judicial institution but also acts as a legislative institution in fact. This is different from other countries (e.g., US). China's legislative institution is the National People's Congress. The institution works at the National People's Congress in March every year. Since the meeting time is only two weeks, and various major national events will be reviewed within two weeks, there is not much time left to review the draft legislation. Based on this situation, many incomplete laws have appeared in China. According to Article 104 of *Legislation Law of the People's Republic of China*, the interpretations on specific application of law in trial as developed by the Supreme People's Court shall primarily involve the specific clauses of laws and conform to the objectives, principles, and original meaning of legislation. Therefore, the Supreme People's Court usually has issued some judicial interpretations to promptly respond to some issues that have not been resolved by the fundamental law. [1145] The National People's Congress has also acquiesced to the Supreme Court's practice, so the Supreme People's Court of China is also a kind of legislature institution.

In 2019, the Supreme People's Court issued *the Minutes of the National Courts' Civil and Commercial Trial Work Conference*. This document stipulates the suitability obligations, information disclosure, and fiduciary duty to financial products. Although the *Conference Minutes* are not judicial interpretations and cannot be cited as a basis for adjudication, people's courts may reason according to the relevant provisions of the *Conference Minutes* when specifically analyzing the reasons for the application of law in the "The court is of the view" section of adjudicative instruments.[1146] This means that

[1145] However, although the Supreme People's Court is authorized by the legislation to make statutory judicial interpretations, the authority of such interpretation is by far unclear, which has caused many problems. See Wang Cheng, *Study on the Interpretations of Supreme People's Court in China*, 28 Peking University Law Journal 263, 279 (2016).
[1146] See Section 5 of *Minutes of the National Courts' Civil and Commercial Trial Work Conference*, No. 254 [2019] of the Supreme People's Court.

financial products can be regulated at a substantive level. Moreover, in 2010, the Supreme People's Court established a "case guidance" system， which learned the "precedent" of the common law. Namely, where a case being tried by a people's court at any level is similar to a guiding case issued by the Supreme People's Court in terms of basic facts and application of law, a judgment shall be rendered by reference to the key points of judgment in the relevant guiding case.[1147]

Second, China is reforming financial institutions. The traditional regulatory mechanism cannot satisfy the supervision for the hybrid product, and the supervision should be changed from "institutional regulation" to "functional regulation" in China. Fortunately, the Chinese government has realized this situation. The "functional regulation" was made explicit in 2017 the National Financial Working Conference, and financial regulators has reformed that combined the CIRC and the CBRC to the CBIRC in March 2018. And, we expect the new reform will help to solve the problems in the future, which has discussed more in the "Section 5.3.1 of Chapter 5".

Third, there exist the learning effect. "Modern, complex technologies often display increasing returns to adoption in that the more they are adopted, the more experience is gained with them, and the more they are improved. When two or more increasing-return technologies 'compete' then, for a 'market' of potential adopters, insignificant events may by chance give one of them an initial advantage in adoptions. This technology may then improve more than the others, so it may appeal to a wider proportion of potential adopters. It may therefore become further adopted and further improved." In Chapter 7, we discussed some development trends in financial regulation. At present, many officials and scholars in China are advocating the way of learning the horizontal regulation for financial products. In judicial practice, some courts also endow insurers and other financial institutions with fiduciary duty through the "principle of good faith". As the proposition of "horizontal regulation of financial products" is gradually recognized in China, it is possible in the future to legislate to change the current unreasonable application of ILI.

7.4 Chapter Summary

[1147] See Article 9 of *Detailed Rules for the Implementation of the Provisions of the Supreme People's Court on Case Guidance*, No. 130 [2015] of the Supreme People's Court.

This chapter discusses the incentives of financial regulators and the reasons for the differences between US and Chinese law.

As for the incentives of financial regulators, regulators pay the role of "helping hand" in the financial market and the role of "grabbing hand" in reality. In the US, constituencies, interest groups, and elected politicians, etc., have a significant influence on policy formulation. In China, financial regulators often consider the pressure of regulatory competition in the financial industry, vested interest groups, the possible reflections of public opinion, etc.

The following main factors cause the differences between US and Chinese law.

(1) Different financial regulators may have different effects on the progress of applying the ILI's rules. In Chinese law, neither the CIRC nor the CSRC has advocated for advancing the application of securities law to the ILI. The SEC in the US has been pushing for the application of securities law to variable products.

(2) Financial regulation backgrounds are different. In US law, there are regulation conflicts between the federal government and the states, whereas in Chinese law, centralism is adopted, so there are no clear conflicts between local and central regulation powers. Instead, "soft law" is relied upon to resolve regulation conflicts between regulatory authorities.

(3) There are unique sources of the rules and differences in relief characteristics. In US law, the sources of rules are diversified. Not only are there rules from case law; there are also are plenty of rules from self-regulatory organizations in the financial market. Chinese financial law is dominated by administrative rules, and also exhibits a relief characteristic of "attaching importance to administrative measures, but making light of judicial ones."

(4) The financial regulation principle of "separate operation and classified supervision" has different impacts on applying the law in China and in the US. In China, this principle is established at the basic law level, and hence has a clear, powerful binding force. This hinders people from applying the securities law to financial investment products. In contrast, in the US, this principle does not serve as a natural barrier to applying securities law to variable products.

(5) Regarding the different "scopes of securities" for the regulation of securities law in China and the US, US law has a substantial definition of securities. Hence, its *Securities Act* has a "broader scope" of securities, while China's *Securities Law* has a limited regulating scope and cannot include new financial products.

(6) The differences in the application of rules between Chinese and US law may be due to different legal systems. In the US, case law is an important source of law. Courts can make specific explanations and judgments based on certain circumstances, as well as the essence of legal provisions when dealing with particular cases. Hence, relatively speaking, based on the flexibility of case law, the US is able to respond in a timely way to relevant issues. China, a country that follows statutory law, does not have the same flexibility. The application of the law in China is subject to the principle of "separate operation and classified supervision," and it is very difficult to make amendments at the basic law level.

These differences between the US and Chinese law are subject to the impact of multiple factors from the path-dependence perspective, including the following:

(1) It varies in terms of the degree of maturity of the free market. The market economy in the US was established earlier and matured. The market has played a dominant role in allocating resources, and the self-regulatory organizations and rules created by resources are abundant. When the New China was founded, a planned economy was implemented. China did not start to develop a market economy until the early 1990s. China's market economy remained undeveloped for a long time and became subject to the impact of management under the planned economy. The clear administrative interventions are still evident, indicating that China's intervention in the market is more intense than in the US.

(2) The degree of the perfection of the law varies. In the US, the rules are relatively complete. Modern financial law came into being after the economic crisis of 1929–1933 (e.g., the *Securities Act of 1933*). Such laws have been developed to this day. With nearly 90 years of continuous improvement, the rules are relatively sound. China began to build its financial law system in the early 1990s (e.g., the Insurance Law was not passed until 1995, and the *Securities Law* was not enacted until 1999). Its laws were formulated within a historical context and from a relatively conservative standpoint. Although these laws

complied with conditions at the time and were reasonable, a lot of social and economic changes have taken place since then, hence many rules do not conform to actual circumstances.

(3) In terms of rule-making or financial reform, China places more importance on "social stability" than the US. At the macro level, China places more emphasis on the implementation of policy, since "maintaining stability is of top priority." The country has made steady progress on law-making, law-executing, and law-amending, so it usually tends to make a slight amendment instead of taking a radical approach. Hence, because of these differences, regarding the extent of the development of China's market economy and the country's degree of freedom and completeness of rules, certain gaps are revealed when the same circumstances are compared to the US context. For these gaps, China is trying to improve its laws.

It is time for legislation.[1148]

[1148] This is just like Professor Tamar Frankel's representative work on the analysis of variable products has the conclusion that "It is time for legislation". This thesis also has the conclusion. See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. Rev. 177, 401 (1971).

Chapter Eight Conclusion

8.1 Major Conclusions

ILI is a financial product that covers multiple fields, including insurance, securities, and trusts. It is also considered as maintenance and innovation of traditional financial products. In the constitutive elements of this product, “the provision of either death or life insurance guarantee” is identical to that of traditional life insurance. However, in aspects such as the “specially established independent investment account” and “complete assumption of the investment risk,” they are different from the traditional life insurance but identical with the financial management products such as the securities investment fund.

Under the legal background of “separate operation and classified management,” ILI, as a hybrid financial product, is easy to elicit the inadequate application of securities law and trust law. For example, in insurance law, the obligation that the insurer has for the policyholder is limited to the insurance product’s contractual obligations such as the payment of premium, but does not include the fiduciary duty bearable by it in the role of asset trustee. This will easily cause insufficient protection of the investment interests of the policyholder, and not comply with the regulation logic of modern financial law. Because of financial laws such as insurance and securities, different rules are set mainly based on the differences in risk allocation between direct and indirect financing. For example, in terms of the protection of the purchaser of the financial products, insurance law mainly sets strict limits on those aspects, including the solvency of the insurer and the safe use of funds, to ensure that the insurer can realize their promise made to the policyholder. Securities law provides the information basis, based on which the investors can make independent decisions and bear the risks by themselves through the establishment of a system of rules that focus on information disclosure.

In the US laws, VALIC and UBLIC cases are among the cases that have revealed that the “the bearing of investment risk” and “investor protection” are the main factors that differ the traditional insurance product from the traditional securities products. This paper has further analyzed the different functional directions and constitutive elements

between insurance and securities. It can therefore be found, that despite ILI having a traditional life insurance factor, its major characteristic is still the securities attribute. However, the law application carried out based on the dominant factor identified for ILI products has resulted in the lack of or irrational application of provisions in insurance law or securities law, so the law application should be carried out in accordance with the line of thought, "substance over form" and on the basis of the actual rights and obligations under the contract, instead of being entangled with its legal nature and form among traditional financial products. The US laws relating to it have also experienced the change from "dominant factor" to "substance over form." For example, in many States of the US, the variable life insurance is prescribed not only in the *Insurance Act* as insurance but also in the *Securities Act* as securities. In the Japanese law, the variable insurance is regarded as the insurance product, but *mutatis mutandis* application of the *Financial Instruments and Exchange Act* is allowed. In Taiwan, also through special legislation, the *Financial Consumers Protection Act* was enacted to strengthen the protection of the purchasers of composite financial products. All roads lead to Rome. All those comparative laws have reflected the same fact that for the composite products, such as for ILI, the "substance over form" approach should be adopted for its regulation.

Considering "substance over form," at the private law application level, the investment account is the carrier of the securities attribute of ILI, and it also accounts for the major part of the right-obligation relation between the policyholder and the insurer. The legal relation — entrusted financial management in the investment account — is not a nominate contract under the existing law. The content of the commission contract, as enacted under traditional civil law, cannot tally with the actual right-obligation relation in the investment account. In the interpretation theory, the "entrusted financial management relation" and "traditional life insurance relation", as being contained in the ILI, should be deemed as a kind of simultaneous contract, and adopt the "analogical theory" to apply by analogy the provisions in the *Securities Investment Fund Law* and the *Trust Law.* Also, by the nature of the investment account, it complies with the constitutive elements for fund and is in fact an investment fund that is open, contractual, and publicly offered. In the US laws, particularly in Prudential cases, the separated account had been expressly specified as a kind of fund, and the *Investment Company Act of 1940* was applicable to it. At the same time, based on the cost considerations for different types of funds, for example, operational costs, managerial costs, etc. at present, in judicial practice in the US, separated

accounts are mainly registered with the SEC as a unit investment trust, which is again being operated in accordance with the trust principle and contract and the obligation of the trustee is stressed. For that reason, in terms of the private law relationships in the investment account, the rights and interests, such as the beneficiary right of the policyholder, and the obligation bearable by the insurer in the role of assets manager, including fiduciary duty, suitability obligation, the obligation to provide information, and the obligation to explain, are mainly stressed.

In terms of the regulation of ILI, except for the reason the ILI itself was introduced as a new life insurance product, the right to regulate ILI by the CIRC was formed as the unified regulatory power being owned by the CSRC and is relatively late. Among the regulatory rules of the ILI, the CIRC mainly adopts a line of thought, similar to that adopted by the Securities Investment Fund, as well as strict regulation on sale and purchaser fitness management. However, the CIRC did not properly handle the relation between the development and the regulation of the ILI as there are many conflicting contents and contradictions, as well as the existence of such problems as "selective law enforcement." The rising and practice of functional and conduct regulations in foreign countries have great significance in giving enlightenment to the improvement of the regulation on ILI. Although the "look-through regulation" can lay a certain foundation for the implementation of functional regulation, it cannot replace functional regulation.

In the improvement of the application of specific rules of the ILI, for example, the "anti-fraud" rules, there are mainly the following conclusions: For the application of the "obligation to tell" stated in the insurance law, the subjects of this obligation not only include the policyholder, but should also include the insured. In the event where the "obligation to tell" has been violated, the different legal consequences between "risk premium" and "investment premium" should be distinguished. It is not appropriate to follow the legal effect of "exception clauses" in identifying the "provisions on self-bearing of investment risks," as being contained in the ILI contract, rather, it should be done by giving the standard of "important matters" in relation to the "obligation to explain" as it does in an insurance. For the provisions on suitability obligation, the subjects of this obligation are not limited to the insurer, but also include the insurance agent and insurance broker. In terms of the rules on information disclosure, relevant provisions on the securities investment fund can be referred to for improvement. Importance should be

attached to the understandability and materiality of the information disclosed. The fiduciary duty bearable by the insurer should be interpreted and fulfilled based on the good faith principle. For the performance of the duty of loyalty, the insurer should pay attention and prudence to the matters, including the trades, involving the conflict of interests, management remuneration, etc., and the fairness and openness of the corresponding transaction should be stressed. For the performance of the duty of care, the "prudent investor" should be referred to as the standard.

For the inclined protection of the financial consumers and the improvement of the law application, it does not mean to follow the practice of Taiwan to enact a special *Financial Consumers Protection Act*, but to implement and put into practice the idea of inclined protection for the financial consumers in law application, thus to realize essential fairness for law application. For example, the performance of suitability obligations is the main content of "caveat venditor" and the premise and basis of "caveat emptor" in the fields of promoting and selling high-risk financial products. As an additional example, the bearing of the fiduciary duty should not be limited by "nominal trust," and the definition of "trust" under trust law should also adopt a substantial definition, especially in the "non-nominal trust", the fiduciary duty bearable by financial institutions represented by the insurer as the roles of assets managers or trustees. Additionally, it is valuable to adopt integrated financial law and introduce the term, "financial investment commodity," and make an abstract definition of it in China to realize the horizontal regulation on financial instruments.

Finally, it is necessary to summarize the main causes of differences between China and American law because comparative research is an important content in this thesis.

Table. the causes of the difference between Chinese and the US's law

<table>
<tr><th>Items</th><th>the US</th><th>China</th><th>Notes</th></tr>
<tr><td>Regulatory background</td><td>The SEC regulates securities, and states regulate insurance</td><td>CIRC regulates insurance, and CSRC regulates securities</td><td>More details in the section 2.2.1</td></tr>
<tr><td>The status of ILI</td><td>Securities at the federal level</td><td>Insurance</td><td rowspan="4">More details in chapter three</td></tr>
<tr><td>Regulator</td><td>SEC and states</td><td>CBIRC (CIRC)</td></tr>
<tr><td>The approach of legal application</td><td>Substance over form</td><td>Form over Substance</td></tr>
<tr><td>Causes</td><td colspan="2">In the US, the Securities Law of 1933 lists more than 30 types of securities and adopts the Howey Test to define securities, which makes the definition of securities more inclusive of financial investment products. Additionally, SEC is</td></tr>
</table>

<table>
<tr><td colspan="2"></td><td colspan="2">a strong regulatory agency. It will take litigation or other means to determine the legal attributes of possible securities products and bring them into its regulatory scope.
In China, the CIRC introduces ILI as new life insurance and brings it into the scope of supervision. Meanwhile, under the institutional supervision system, the CSRC has no power to intervene in the regulatory scope of CIRC, and the ILI cannot be applied to the securities law. In addition, the securities law only lists several typical securities, for example, stocks, but does not adopt the substantive definition of securities, so the scope of securities is limited.</td><td></td></tr>
<tr><td rowspan="3">Investment Account or Separate Account</td><td>Status</td><td>Investment Company, and usually registered as a unit investment trust in practice.</td><td>Laws and regulations do not respond to and define the account, but in theory, they are essentially securities investment funds.</td><td rowspan="3">More details in section 4.3</td></tr>
<tr><td>Governance structure</td><td colspan="2">Regardless of whether the separated account is registered as an open-end management company or a unit investment trust at SEC, the idea of share-holder democracy has all been reflected in the rules on internal governance, and the basic concept of mutual restrictions on rights have been implemented and put into practice. Moreover, in the US, the asset manager of the separated account has an explicit fiduciary duty. Comparing them with the US laws, China lacks corresponding rules (including basic laws and departmental rules or regulations) on the internal governance of the investment account of ILI and the fiduciary duty of the assets manager.</td></tr>
<tr><td>Causes</td><td colspan="2">The investment company law of American law is corresponding to China's securities investment fund law. The scope of the investment company in the United States is broad, and there are many types. China is mainly limited to contractual investment funds.</td></tr>
<tr><td rowspan="6">Key contents of regulation</td><td rowspan="2">Suitability obligation</td><td>FINRA Rule 2090 "know your customer", etc.</td><td>There is no provision in the insurance law, but it is stipulated in the CIRC rules and Article 88 of the Securities Law.</td><td rowspan="2">More details in section 6.2.2</td></tr>
<tr><td colspan="2">CIRC stipulates the suitability obligation in China, but the provision is limited to the administrative supervision system, and there are obstacles in the private law relief. The suitability obligation in American law can be regarded as a private law obligation. In terms of content, the content of CIRC is relatively macro, and there is no specific judgment factor.</td></tr>
<tr><td>Information disclosure</td><td>SEC Rule "Form N-3" and "Form N-4", etc.</td><td>The CIRC has regulations on information disclosure, but it cannot apply the detailed information disclosure in the Securities Law.</td><td>More details in section 6.3</td></tr>
<tr><td rowspan="2">Fiduciary duty</td><td>It is stipulated in the Investment Company Act and other laws.</td><td>There is no fiduciary duty in insurance law, which is stipulated in the Trust Law.</td><td rowspan="2">More details in section 6.4</td></tr>
<tr><td colspan="2">The insurer's fiduciary duty as an asset manager needs to be interpreted according to the principle of good faith. As for the performance standard of fiduciary duty, there is no detailed standard, for example, the US's prudent investor standard.</td></tr>
<tr><td>Causes</td><td colspan="2">Under the system of "separate operation and classified supervision" in China, the ILI cannot directly apply the suitability obligations, information disclosure, and fiduciary obligations in the Securities Investment Fund Law.</td><td></td></tr>
<tr><td colspan="5">Summary: It can be seen through the above comparison that American law is a well-established system. The main reasons are as follows: 1. There are differences in the role of regulators in the application of rules. SEC plays a key role in promoting the application of securities law to variable annuity and other products; 2. The power game between the states and the federal government is obvious in the US, while the power game of China's regulatory authorities is not significant; 3. Many rules of</td></tr>
</table>

the US are formulated by market self-regulatory organizations and have great influence like NAIC, while the role of self-regulatory organizations in China is not prominent, and dominated by administrative regulations; 4. China, as a written law country, implements “separate operation and classified supervision,” which makes ILI a hybrid product, not able to cross the application of financial law; 5. Because of China’s current scope of securities and the institutional supervision, the CSRC has no power to regulate ILI, rather than the functional supervision in the US law; 6. As a written law country, China has a natural lag compared with the flexibility of the United States as a case law country. There are efficiency differences in legislative response between the two. Additionally, those differences are not merely restricted to the law itself, but respectively will also subject to the restrictions and influences from several aspects, including politics, economy, society, culture, etc.

8.2 The Shortcomings of This Dissertation

The ILI, as a new composite financial product, involves many issues of its legal application, and it is directly related to almost all financial laws, such as insurance laws, securities laws, and trust laws, etc., which lead to certain difficulties in the study, especially for the lack of studies under current theories. The Chinese literature that can be directly referred to is scarce, which further adds to the study difficulties in this thesis. Therefore, it is still unavoidable that the discussions on some points remains shallow, although this thesis tries to have a more in-depth study of it.

Furthermore, the US started earlier in its discussion on this issue. However, the variable annuity and variable life insurance also involve many other fields, and the laws that are directly applicable to them include the ones at both the Federal and State levels – the *Securities Act of 1933*, *Securities Exchange Act of 1934, Investment Company Act of 1940*, and *Investment Advisers Act of 1940*, as well as the Blue Sky Laws and Insurance Laws of various States. The legal system is more complicated than the same in China. The author of this thesis has not received any systematic training on US laws, so there may be drawbacks in the study of the US laws.

In terms of the methodology, ILI was introduced as a new life insurance product, so if further research can be carried out by conducting mathematical model analysis on the product structure itself from different perspectives, including economics, etc., then we will have a better grasp of the essence of the economic structure of ILI. However, a further drawback of the thesis is the difficulty of analyzing it from this perspective due to the personal limitations of the author.

Although there are some shortcomings in this dissertation, it has taken more than

two years to analyze the issues and the corresponding literature. The author is more than willing to put this thesis in the role of "throw out a brick to attract a jade," and expects that more follow-up research could further discuss ILI and other financial hybrid products, making the current legislation more appropriate, reasonable, and effective.

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