

On the Drawbacks and Improvement of Legal System of Supervision on Securities Fraud in Cyberspace in China

LES INCONVÉNIENTS ET L'AMÉLIORATION DU SYSTÈME LÉGAL DE LA SURVEILLANCE SUR LES FRAUDES EN VALEURS MOBILIÈRES DANS LE CYBERESPACE EN CHINE

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Abstract: The law of internet securities fraud mainly concerns internet safety, securities offering, information disclosure and securities trading on internet, the imperfections of which mainly include the low level for legislation, short of fundamental legislation, imperfect special legislation, conflicts among traditional legislation, and short of rules of international coordination. The discreet measures for perfection should include promoting legislation level, establishing relevant provisions for cyberspace conduct and special law such as Electronic Securities Trading Law, and amending Securities Law to regulate the prominent securities fraud in cyberspace. At present, it is urgent for securities regulator to establish and perfect the relevant supervision rules.

Key words: Cyberspace; Securities Exchange; Securities Fraud; Legal Supervision

Résumé: La loi de la fraude en valeurs mobilières sur Internet concerne principalement la sécurité Internet, l'offres des titres, la divulgation de l'information et la transaction des titres sur internet, dont les imperfections incluent principalement un faible niveau de législation, une absence de législation fondamentale, une législation spéciale imparfaite, les conflits entre la législation traditionnelle, et une absence de règles de coordination internationale. Les mesures discrètes de la perfection devrait inclure la promotion du niveau de la législation, l'établissant des dispositions pertinentes pour la gestion de cyberspace et des lois spéciales telles que la Loi sur le commerce électronique des titres, et la modification de la Loi des titres

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pour réglementer la fraude en valeurs mobilières dans le cyberspace. À l'heure actuelle, il est urgent pour les régulateurs d'établir et de perfectionner les règles de surveillance appropriées.

Mots-Clés: cyberspace; taxes de transaction; fraudes en valeurs mobilières; surveillance légale

With the internet securities exchange becoming prevail and popular, securities fraud occurs endlessly. The basic legislation on supervising this kind of fraud is fairly important, especially in China, whose aim is a society governed by the rule of law. Yet China is still on the primary stage of a socialism market economy and relevant legislation and practical experience is insufficient, so comparing and referencing are significant. This article first refers to the practice of United States of America whose market economy is developed, then analyses the current situation of China, so as to put forward a conception which concerns the system of supervision, and, we hope, is beneficial for improvement on supervision on securities fraud in cyberspace in China.

1. UNITED STATES' LEGAL SYSTEM OF SUPERVISION ON SECURITIES FRAUD IN CYBERSPACE

United States of America has a perfect legal system of supervising securities fraud in cyberspace, although which is contained in the legal system of regulating internet securities exchange. In United States, the laws of governing the illegal act of internet securities (including fraud) have formed a system. (Zhong Wei, p37) Firstly, the foundations of supervision system are Securities Act in 1933, Investment Exchange Act in 1934, Investment Advisors Act and Investment Company Act in 1940. No matter how market participant trade by traditional approaches or internet, they must abide by these four laws. US Securities and Exchange Commission [SEC] issued many releases regulating internet securities exchange, all referred to those four laws. Secondly, internet securities exchange should abide by the laws concerning e-business, including United Computer Information Exchange Act, United E-exchange Act, The Globe And National Business E-signature Act. Thirdly, the series of laws that concern the special problems of internet securities exchange, of which Online Brokerage Keeping Aspace of Cyberspace, E-securities Exchange Act and Online Investment Protect Act are most famous. Online Brokerage Keeping Aspace of Cyberspace is a proposal document, published by SEC, this research announcement reflects the newsiest updates in America, offers some comments and suggestions in appropriateness, the best behavior criterion, market data, system capacity, investor education, online forums, right of privacy, portal net. This announcement also emphasizes regulator supervision online should apply the suitability doctrine. The suitability doctrine requests that broker's agency should offer invest advices to investor in accordance with their capacity. SEC published four requirements to internet broker-dealers: (1) ensure the quality of service in swift growth; (2) execute the trade instruction in a manner which is most effective to its clients; (3) offer client information with sufficient content and easiness to be understood; (4) advertisement in cyberspace should not mislead investors that will bring unrealistic expected earnings. (Liu Jinwei, 2004, p177) In 1999, US Congress passed the E-securities Exchange Act, which mainly asserted the legal effect of e-signature in the process of securities exchange. The law also settled the problem of e-information's belonging and security issue, this is a law which aimed at the singularity of securities exchange. US Congress drafted Online Investor Protection Act in 1999, whose aim is to establish information disclosure, new rule of bulletin and prevent exchange fraud. The second term of this law is a clause which concerns online exchange information bulletin, in which contains general rules and exception rules. So accordance to SEC's dictation, every online broker or dealer should publish SEC's rules on internet every season. This kind of information mainly referred to any system fault and online securities exchange block in the last trade quarter, the date of delayed event, sustainable time and some measures whose function are to avoid incidents. Exceptions are as follows: In specific circumstance, if SEC deems appropriate, they may exempt the aforesaid request from online broker or

dealer. Section 4 of this law provide that every broker, dealer, investment company and investment consultant must offer the information on investor education and anti-fraud to investors, the means for providing information may be a website connected with hyperlink or built by SEC, or other means required by SEC. According to Section 6 of this law, no more than one year after the law took effect, SEC should submit a market exchange research statement, in which should include whether fraud risk did exist during exchange activities.

American relevant legal system played a sound foundation for regulating securities fraud in cyberspace, which has important meaning for China building its own legal system of supervision on securities fraud in cyberspace.

2. THE LEGISLATION PRACTICE AND DRAWBACKS OF SUPERVISION ON SECURITIES FRAUD IN CYBERSPACE IN CHINA

2.1 The legislation status quo of supervision on securities fraud in cyberspace in China

Under the basic state policy of running the country according to law, it is necessary to supervise the illegal activities of securities exchange, which includes securities fraud in cyberspace. According to the current legislation situation of China, except for the basic law, namely Securities Law, other rules and regulations about securities exchange in cyberspace only can be seen in laws, administrative regulations, department regulations, judicial interpretation, and these can be categorized into four types as follows: (Qi Aimin, 2004, pp193-194)

First, the rules concerning internet security: E-signature Law, NPSC's Decision about Internet Security Protection, instituted by NPSC; PRC Computer Information System Security Protection Rules, Management Rules of Commercial Codes enacted by State Council; Computer Information Globe Security Protection Administrative Measures, Financial Institutes Computer Information System Security Protection Interim Rules, Computer Virus Protection Administrative Measures, published by Public Security Ministry; SPC's Interpretation about Application Law When Judging Cases of Perturbing Telecommunications Market Order, and so on.

Second, the rules concerning issuance and exchange of securities in cyberspace. Legislation do not allowed issuer to issue securities on internet directly. According to The Notice about New Public Company Which Giving Recommendation Through Internet published by CSRC on March 1, 2001, from March 1 2001, before firms initial public offerings, they must living the company recommendation to investor in cyberspace. CSRC also demanded issuer file the information that they put on internet forestall with CSRC and Shanghai Exchange or Shenzhen Exchange, so as to put on records.

Third, the rules concerning information disclosure. These rules mainly concerns the Notice about Public Company Disclosure Prospectus on Internet, set out by CSRC on January 20,2001, which provides special regulations on information disclosure of prospectus in cyberspace. According the regulations of information disclosure which made up by CSRC, public company must disclose annual report, interim report, and quarterly report in the fixed term and fixed website. The fixed websites for listed company in Shenzhen Stock Exchange and Shanghai Stock Exchange are www.sse.com and www.szse.cn respectively.

Fourth, the rules concerning securities exchange in cyberspace, these rules are mainly established by CSRC, they are Internet Securities Commission Provisional Administrative Measure, Security Company Internet Commission Business Authorization Procedure, and Security Company Administrative Measure.

3. THE DRAWBACKS OF LEGAL SYSTEM OF SECURITIES EXCHANGE IN CYBERSPACE

Compared with USA and other developed countries, the legal system of internet securities exchange of China has some drawbacks : (Qi Aimin, 2004, p194; Zhong Wei, 2007, p40)

Firstly, the level of legislation of internet securities exchange is too low. In China the legislations of internet securities exchange are administrative rules and regulations promulgated by State Council and CSRC, these administrative regulations and rules are not law and short of authoritativeness. These administrative regulations and rules are literally about market accessing and internet information security, most of which are prohibitive provisions and lack provision of right and duty. It is difficult for us to find definite provisions when we are judging the civil dispute of internet securities exchange.

Secondly, the basic law of internet securities exchange is still vacant, and short of core law. At present, the only basic law of internet securities exchange is the E-signature Law, while the Electronic Payment Law is still a blank space. Usually the latter provide for core content of relationships between rights and liabilities, but this kind of law is still vacant in China and the gap also leads investors hanging back. Due to the shortage of relevant legal provision, investors' legitimate rights and interests can not get technical support and legal safeguard.

Thirdly, the special laws of internet securities exchange are morbidity. Nowadays legislations special for regulating securities exchange in cyberspace are Internet Securities Commission Provisional Administrative Measure, Security Company Internet Commission Business Authorization Procedure, and Security Company Administrative Measure, which are all set out by CSRC in 2004. These regulations have positive actions in promoting the development of internet securities exchange. However, compared with international developed tendency of legislation, the regulations in China still have obvious defects, many crucial legal problems haven't been settled, such as the relationship between Security Company and investor, the relationship between security company and internet service providers, and the legal duty of parties. Further more, the management rules are too summary to insure the safety of internet securities exchange. Just as well, some security firms can not provide investors sufficient protection. In the process of concluding a contract, investors are discriminated and treated obviously unjust; in spite of limitations of technique and management, some security firms partially expanded the scale of business, which increases the risk of internet exchange.

Fourthly, the traditional laws of internet securities exchange haven't been revised, some conflicts exist among themselves. With the development of internet securities exchange, some laws no longer adapted practical need in China. Take Securities Law for example, although it regulated information disclosure, the legality of delivering information on internet is still not validated, the punishments of distributing rumours and other acts of disturbing market order in cyberspace are all unexercisable. Although Contract Law had admitted the legal effect of e-contract, and many settlements of internet securities exchange carried out by e-bill, Chinese Commercial Instrument Law hasn't accepted payment and settlement signed by e-signature, which all blocked the development of internet securities exchange.

Lastly, in China, owing to the temporary vacancy of relevant laws, international coordination of internet securities exchange getting into trouble. One of internet's characteristics is no boundary, which makes the international trade conveniently, however there is some diversity among different countries which will induce conflicts of laws if disputes occur. So it is necessary to set up a legal system of international coordination of securities exchange in cyberspace. Deficiency of relevant legislation not only hinders the international development, but also leads to legal conflicts in different countries. How to deal with the international coordination of internet securities exchange is a urgent problem in China. As the beginning of this article said, the legislation of securities fraud in cyberspace also has this problem in China.

4. IMPROVEMENT OF LEGAL SYSTEM OF SUPERVISION ON SECURITIES FRAUD IN CYBERSPACE IN CHINA

The measures of supervision for issuing and trading of securities in cyberspace in China are creating open and fair circumstance, and strictly governing information disclosure. At present, China hasn't formed a perfect system of supervision, not only short of system of supervision and basic law, but also lack experiences of defining criminal and punishing.

Improvement of regulations about securities fraud in cyberspace is the foundation of governing internet securities. China had better work out a law quickly, whose function is regulating the fraud of issuing and trading on internet, adjust relevant department laws, and supply the gap of securities fraud in cyberspace.

Firstly, we should promote the level of relevant regulations and turn the state rules and the department regulations into laws so as to enhance the authority of laws.

Secondly, we should establish legal system to regulate the basic actions in cyberspace. In China, there is only the E-signature Law, which concerning datagram, e-signature data authentication; we should enact E-payment Law to regulate the right, duty and responsibility among transaction parties. It is also necessary to publish Anti-Spam Act, by which we can regulate the action of distribution spam, make actors undertaking civil liability, and restraint actors controlling securities market and illegal soliciting investors through spam.

Thirdly, E-security Exchange Law, Online Investor Protection Law, and other special laws should be enacted. These laws should regulate the core problems of securities exchange in cyberspace, such as the relationship between security firm and investor, the relationship between security firm and internet service provider, and the legal duty of relevant parties.

Fourthly, Securities Law should be amended, in which we should add some regulations governing the outstanding problem of securities fraud in cyberspace, advance the pertinence of relevant rules. Except that, we should revise the regime of securities civil liability and litigation, the aim of which is to punish securities fraud and protect investors. In the process of revising, we must use the developed regimes of other countries for reference. We should set up a system of securities civil penalty and litigation in accordance with Chinese conditions. Regarding the specific form of penalty, we can mirror the experience of USA enforcement agency and judicial agency, adopt innovative legal measures, and set up the system of class action.

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