THE BANKING LITIGATION LAW REVIEW

Editor
Christa Band

THE LAWREVIEWS

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TAIWAN

Patrick Marros Chu, Salina Chen, Joyce W Chen and Chi Lee[1]

I SIGNIFICANT RECENT CASES

i Taichung District Court civil judgment 103-Su-Zi-3271 (2016)

The plaintiff, a corporate investor, alleged that the defendant, a commercial bank, violated relevant selling restrictions when selling certain target redemption forward foreign-exchange-related derivative financial products (TRFs) to the plaintiff, and argued that the transaction should be void. The plaintiff further asserted that the defendant failed to perform a suitability test on the plaintiff regarding the TRFs and committed fraud; therefore, the plaintiff should have the right to cancel the transaction. The Taichung District Court ruled in favour of the defendant. The court held that the TRFs are not covered by the selling restriction and a bank can legally sell such product in Taiwan through its offshore banking unit (OBU). The court further ruled that the defendant had provided sufficient disclosure documentation to the plaintiff, including presentation decks, the product terms and conditions, and certain risk-alert documents to the plaintiff, and the plaintiff was fully aware of the risk to the transaction. The court also held that the defendant had duly performed suitability analysis on the plaintiff's risk endurance level. In sum, the transaction between the plaintiff and the defendant was legally effective, and the defendant was not liable for the investment loss suffered by the plaintiff.

ii Supreme Court civil judgment 102-Tai-Shan-Zi-1189 (2013)

The Taiwan High Court held that a bank failed to fulfil its duty of disclosure to an investor because the disclosure documents were complex and difficult to read. The Taiwan High Court also held that the investor's signature on the disclosure document alone cannot prove that the bank had properly disclosed the investment risk to the investor. The Supreme Court of Taiwan vacated the Taiwan High Court's decision and remanded the case for further investigation of evidence on whether the bank fulfilled its duty of disclosure. The remanded case was subsequently resolved through mediation.

Since the establishment of the Financial Ombudsman Institution after the promulgation of the Financial Consumer Protection Act in 2011 (the FCP Act), most of the banking disputes involving financial consumers in Taiwan that were traditionally decided by courts through litigation are now resolved by the Financial Ombudsman Institution.[2] The Taichung District Court judgment described in subsection i, *supra*, is one of the few disputes resolved

1 Patrick Marros Chu is a partner, Salina Chen is an associate partner, Joyce W Chen is a senior attorney and Chi Lee is an attorney at Lee and Li, Attorneys-at-Law.

2 See Section II.iii, *infra*.

through civil litigation in recent years. Many other cases were resolved through settlement or mediation, such as the Supreme Court judgment outlined above. The FCP Act does not apply to banking disputes involving offshore branches, OBUs, qualified institutional investors, or persons or entities with a certain level of assets or professional investment intelligence prescribed by the competent authority from time to time.

II RECENT LEGISLATIVE DEVELOPMENTS

i General regulatory scheme of financial institutions

The regulations of financial institutions in Taiwan are generally imposed by the Financial Supervisory Committee. The sale of financial products is generally regulated under the Banking Act with regard to the sales by banks, and the Securities Exchange Act with regard to the sales by securities firms. There are also other relevant regulations authorised by the two aforementioned acts, such as the Regulations Governing Foreign Exchange Business of Banking Enterprises, the Regulations Governing Foreign Exchange Business of Securities Enterprises, the Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business, and the various orders and opinion letters issued by the competent authorities from time to time.

In general, a financial institution is required to submit a proposed financial product, such as a fund or a bond, to the regulatory authorities for their review. The purpose of such submission is to ensure that the financial product is properly designed and the relevant information is properly disclosed in the transaction documents. Approvals by the regulatory authorities must be obtained before the financial institution can sell the product to a customer. Nevertheless, a structured product is usually sold through the structure of 'specific monetary trust' in Taiwan and the trust agreement governing the transaction of the structured product is generally deemed a private contractual relationship between the financial institution and the investor. An investor entrusts his or her money to a domestic financial institution, which in turn invests the entrusted money in an offshore structured product based on the trust agreement. As such, unlike funds or bonds, the regulatory authorities are not required to review these products prior to the transaction. Prior to the 2008 financial crisis, a wide variety of structured products were therefore sold to many investors without adequate regulatory review or approval.[3]

Given the commonly-used investment structure mentioned above, the financial institutions are also governed by the Trust Law as trustees of the trust properties. Pursuant to the Trust Law, a trustee should manage the trust matter with the due care of a 'prudent administrator.'[4] When a trustee fails to manage the trust matter with such due care thereby causing the settlor any damages, the trustee is liable to the trust property for such damage.[5]

ii Additional regulatory requirements in response to the financial crisis

In light of the 2008 financial crisis and in response to the call from the public for more stringent regulations, the Regulations Governing Offshore Structured Products were promulgated, which target a specific category of financial products, namely, the offshore

3 Li-Chung Lee, 'Analysis on financial product sale disputes and cases', *Taiwan Bar Journal*, 2009.8, at 25–27.

4 Trust Law, Section 22.

5 Id., Section 22.

structured products. The Regulations set forth the requirements for the sale of offshore structured products, including, among others, the requirements for Chinese disclosure documents,[6] the obligation of the financial institutions to explain to the investors whether the product is principal guaranteed,[7] and the obligation of the financial institutions to read out the disclosure documents to the investors and to record such conversation.[8] Although the regulations provide rather detailed guidelines regarding the sales by financial institutions, they do not cover the general regulations of other financial products.

During 2014 and 2015, many small to medium-sized corporations in Taiwan invested in the TRFs (as defined in Section I.i, *supra*) and suffered serious losses. In response to these cases, the Financial Supervisory Committee further set forth a series of regulations on 'complex, high-risk derivative financial products' (e.g., the Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business). These regulations provide a detailed definition on what kind of products constitute 'complex, high-risk derivative financial products'. In general, the products with higher risk and higher leverage will more likely fall into this category, which also includes offshore structured products.[9]

iii Financial Consumer Protection Act Enacted in 2011

In response to the need for a more stringent regulatory scheme on a wide array of financial products, the FCP Act was promulgated in 2011. The FCP Act has two major regulatory purposes. It aims to provide general regulations covering more categories of financial products, and replaces the prior rules that were scattered in several different laws and regulations. Additionally, the FCP Act also sets forth a new mechanism for the financial disputes resolution procedures.

The FCP Act applies to disputes between a financial institution and a financial consumer with regard to provision of financial products and services.[10] The financial institutions regulated under the FCP Act do not include offshore branches and OBUs.[11] The FCP Act also specifically narrows its application to 'financial consumer' and excludes its application to investors such as qualified institutional investors and persons or entities with a certain level of assets or professional investment intelligence prescribed by the competent authority from time to time.[12]

The major aspects of the FCP Act include, among others, the due care obligation of a financial institution when selling financial products or providing services; the truthfulness obligation of a financial institution when soliciting customers, promoting products and advertising; the obligation of disclosure; the obligation of evaluation of suitability of certain products to a consumer; and the responsibility of the financial institution for failure to fulfil

6 Regulations Governing Offshore Structured Products, Section 9.

7 Id., Section 23.

8 Id., Section 22.

9 Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business, Section 2.

10 FCP Act, Section 5.

11 Financial Supervisory Committee Letter Jin-Guan-Fa-Zi No. 1010070279.

12 FCP Act, Section 4.

these obligations. The FCP Act specifically provides that a financial institution should bear the duty of due care of a 'prudent administrator' to an investor when providing financial products or services.[13]

Furthermore, the Financial Ombudsman Institution was established under the FCP Act in 2012. The Financial Ombudsman Institution is the major focus of the new alternative dispute resolution mechanism. Under the new mechanism, when a financial consumer dispute arises, the financial consumer reports first to the financial institution with which the consumer has a dispute. If the solution proposed by the financial institution is not satisfactory to the consumer or if the financial institution fails to review the case, the consumer can then apply to the Financial Ombudsman Institution for an 'ombudsman case'.[14] The ombudsman case will be reviewed by an ombudsman committee.[15] If the applicant accepts the decision of the ombudsman committee, the financial institution should also accept the decision if (1) it is under the amount prescribed by the competent authority or (2) the applicant is willing to reduce the amount of the case to a figure below the prescribed amount.[16] The applicant can then apply to the court for the court to approve the decision of the ombudsman committee.[17] A decision approved by the court has the same legal effect as a court judgment.

Since its establishment, the Financial Ombudsman Institution has reviewed hundreds of cases. During 2014, 2015 and 2016, the Institution reviewed 227, 235 and 278 cases respectively with regard to banks, and 31, 37and 38 cases respectively with regard to securities firms.[18]

III SOURCES OF LITIGATION

The major source of banking litigation in Taiwan is between financial institutions and individual investors in the financial product retailing market. In the litigations regarding investment product retailing, the most common causes of action include:

a failure in the formation of contract;
b failure of a financial institution in fulfilling its duty of disclosure;
c failure of a financial institution in evaluating customer suitability in investing in a specific product;
d failure of a financial institution in fulfilling the post-transaction duty of disclosure; and
e violation of sales limitations.[19]

Each of the categories is further elaborated on in this section, while (b) and (d) will be addressed together as the general duty of disclosure of financial institutions.

13 FCP Act, Section 7.
14 FCP Act, Section 13.
15 FCP Act, Section 17.
16 FCP Act, Section 29.
17 FCP Act, Section 30.
18 www.foi.org.tw/Article.aspx?Lang=1&Arti=1806&Role=1. (Last visited on 19 April 2017).
19 See Chen, Christopher Chao-hung, 'Legal Risk and Investor Protection for Retail Investment Products: An Empirical Study of Lawsuits Regarding Mutual Funds and Structured Notes in Taiwan', *Chengchi Law Review*, 2014.2, at 153.

i Formation of contract

Entering into a contract through an agent

One of the common disputes that arises between a financial institution and an investor is whether the agent of the investor has the authority to enter into a contract on behalf of the investor. Based on banking practice in Taiwan, it is very common for an investor, as a principal, to delegate to an agent by giving the agent the investor's name chop (which has the same legal effect as a signature in Taiwan) and, sometimes, the identification document.

In a case before the Taiwan High Court in 2011, the investor delegated his spouse as an agent, by giving his spouse his name chop, to renew his deposit contract with a bank. The spouse instead purchased a structured product on behalf of the investor. The investor subsequently accepted the interest distribution of the structured product without any objection.[20] The issue then was whether the agent had the authority to purchase a structured product for the investor, and whether the investor recognised such authority by accepting the interest distribution. The court ruled that (1) although it is common for spouses to have each other's name chop for daily transactions in Taiwan, the renewal of a deposit and the purchase of a structured product have different investment risks in nature, and (2) the bank failed to verify with the principal regarding the agent's scope of authority, which the bank could have known had it simply contacted the investor for verification; therefore, the fact that the agent possessed a name chop was insufficient to prove that the agent had the requisite authority.[21] The fact that the spouse entered into a structured product contract without authority, therefore, rendered such contract invalid. Furthermore, even though the investor subsequently accepted the distribution payment without any objection, the investor did not explicitly recognise or promise to be bound by the spouse's action.[22] However, it is worth noting that the majority of the Taiwanese courts used to hold the opinion that the presentation of a name chop can establish that the agent has effective presence of authority as long as the agent also presents other forms of documentation in addition to a name chop, such as a checkbook or a receipt.[23] Given the above, it remains uncertain as to whether a financial institution is under the burden of further verifying the authority of an agent or can simply rely on the presentation of the name chop of the investor.

Delivery of investment documents

The investors asserted in some cases that the financial institutions failed to deliver proper documentation when entering into the investment contracts with the investors. A court held that failure of the financial institution to deliver proper documentation should be deemed non-performance of the contract.[24] However, it is of the view that so long as the financial institutions have duly delivered the Chinese offering circulars or disclosure documents, the fact that the original English offering circulars or disclosure documents were not delivered to the investors would not affect the formation of a contract.[25]

20 See Taiwan High Court civil judgment 100-Shan-Zi-202 (2011).

21 Id.

22 Id.

23 See Supreme Court civil judgment 44-Tai-Shan-Zi-1428 (1955). See also Supreme Court civil judgment 56-Tai-Shan-Zi-2156 (1967). See Wu, Jiin-Yu, 'The exclusion of the principles responsibility for apparent agency', *Taiwan Law Journal*, 2013.12, at 189.

24 See Taipei District Court civil judgment 98-Zon-Su-Zi-195 (2009).

25 See Taiwan High Court civil judgment 98-Shan-Yi-Zi-672 (2009).

Cancellation of contract

In some situations, a court will allow the investor to exercise its right to cancel the investment contract, such as in cases of fraud. In a case before the Taipei District Court, a financial institution failed to properly specify in the contract or to explain to an investor the exact items, amounts and calculations of the fees and commissions. By withholding important information such as the existence of relevant service fees payable by the investor, the financial institution was deemed to have withheld information and committed a fraud, and the investor would be entitled to the right to cancel the investment contract.[26]

ii Duty of disclosure of financial institutions

Disclosure upon sales

A financial institution is generally obligated to disclose certain essential information during the process of transaction as a seller of a financial product. The duty and scope of disclosure of a financial institution upon selling financial products are generally regulated by the Financial Supervisory Commission in its various administrative orders. Nevertheless, before the promulgation of the Regulations Governing Offshore Structured Products in 2009, the specific disclosure obligation of financial institutions on the sale of structured products was less regulated than other financial products.

One of the major issues here is whether the signature of the investor on the disclosure documents is sufficient to prove that the financial institution has properly delivered such disclosure documents to the investor or fulfilled its disclosure obligation. Most courts are of the view that if the investor signed a document with sufficient disclosure of investment information, the signature itself is sufficient to prove that the financial institution has fulfilled its disclosure obligation prior to and upon the transaction, such as in Taiwan High Court civil judgment 98-Zon-Shan-Zi-288.[27] On the other hand, in another case, the court ruled that if the investor in fact signed the disclosure document under the instruction of the sales representative, the signature cannot serve as the evidence that the sales representative has fulfilled the financial institution's disclosure obligation.[28] In a more extreme case, the Taiwan High Court held that the signature alone is insufficient to prove that the financial institution has fulfilled the obligation of disclosure.[29] However, very few courts have adopted such view.

Another common argument made by the investors is that the transaction documents are too complicated in form and in written language, and are difficult or impossible for the investors to understand. In a case before the Taiwan High Court Taichung Branch, the Court ruled that so long as the documents clearly specified the investment risks, and alerted the investors to such risks, the fact that some parts of the documents are complicated did not prevent the investor from understanding the investment risks.[30] Another case before the Taiwan High Court, however, ruled that if the layouts of the transaction documents were too difficult to read and comprehend, the delivery of such document was not sufficient to prove that the financial institution had fulfilled its disclosure obligation.[31]

26 See Taipei District Court civil judgment 97-Su-Zi-5116 (2009).

27 See Taiwan High Court civil judgment 98-Zon-Shan-Zi-288 (2010).

28 See Taiwan High Court Tainan Branch civil judgment 99-Shan-Yi-Zi-157 (2011).

29 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

30 See Taiwan High Court Taichung Branch civil judgment 99-Shan-Zi-26 (2010).

31 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

Another issue that frequently surfaced during litigation is the scope of the duty of disclosure, namely, how much information a financial institution is obligated to disclose. In the same case before the Taiwan High Court, the financial institution that failed to disclose to the investor about the nature of the product as a structured product without principal guarantee, as well as other risks, was held by the court to have violated the financial institution's duty of disclosure to the investor.[32] In another case, the court held that the financial institution had made sufficient disclosure by providing the disclosure document that specifies the structure of the product, the annual return rate calculation and the risk alert regarding potential loss at the event of early redemption.[33]

In addition to the general disclosure obligation as the seller, in an investment structure of specific monetary trust as mentioned in Section II.i, *supra*, the financial institution, as a trustee, is also obligated to act in accordance with the due care of a 'prudent administrator'.[34] The courts generally held that a financial institution should bear such obligation at the time of entering into a specific monetary trust agreement. A financial institution that fails to provide sufficient disclosure when selling structured products violates the due care of a prudent administrator and should be liable for the damages suffered by the investor, as the settlor.[35]

Continuing duty of disclosure

The financial institutions' continuing duty of disclosure, or post-transaction duty of disclosure, is usually raised in trust cases. The background of such issue is that when the 2008 financial crisis gradually unfolded, many financial institutions failed to alert the existing investors regarding the change of risks in their investments. A financial institution, as a trustee in a specific monetary trust, is generally obligated to report necessary information of the trust property to an investor, as the settlor, such as the change in value of the trust property.[36]

Nevertheless, the courts remain split as to whether the financial institution has the general obligation of continuing disclosure of potential risks after it enters into a transaction. In the Taiwan High Court civil judgment 99-Zon-Shan-Zi-45, the court decided that the financial institution should inform the investor of the subsequent material change of the product risk.[37] However, another court is of the view that there are too many factors affecting the change of product risk and, therefore, the burden of notification should not be placed on the financial institution that sold the products.[38]

It is worth noting that the plaintiffs in a substantial portion of cases in structured bond disputes raised the argument based on financial institutions' continuing duty of disclosure.[39] Nevertheless, the FCP Act does not elaborate on or provide clarification regarding financial institutions' continuing duty of disclosure to the consumers.[40] It is anticipated that the

32 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

33 See Taiwan High Court Tainan Branch civil judgment 99-Jin-Shan-Yi-Zi-1 (2011).

34 Trust Law, Section 22.

35 See Taiwan High Court civil judgment 98-Shan-Yi-Zi-299 (2010).

36 Trust Law, Section 31.

37 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

38 See Taiwan High Court civil judgment 98-Zon-Shan-Zi-463 (2010).

39 *Supra* note 21, at 153–4.

40 Id. at 154.

disputes in the future, to be resolved either through litigation or through the Financial Ombudsman Institution, will still focus on the continuing duty of disclosure, considering the lack of clear regulations and judicial guidance.

iii Consumer suitability

Prior to 2009, there were no laws or regulations that clearly set forth a financial institution's duty to evaluate or monitor a consumer's suitability in investment in terms of risk-bearing ability other than the financial institution's internal policies. It is usually argued by the financial institutions that they have fulfilled their duty to evaluate a consumer's suitability in investing in certain products by conducting an internal review.

In a case before the Taipei District Court, the consumer filed a claim arguing that the sales representative of the bank was aware of the fact that the target product was substantially riskier than the products suitable for the plaintiff according to the suitability test, which was evidenced by the investment plan prepared by the sales representative.[41] The court ruled that, even if the product at issue is not suitable for the consumer's risk-bearing ability, so long as the sales representative clearly explained the investment risks to the consumer and the consumer made his or her own decision to invest, the bank had sufficiently fulfilled its duty.

Similarly, in a case before the Taiwan High Court, the court also recognised that so long as the investor agreed to make such investment with written consent, the bank should be deemed to have fulfilled its duty to assess the investor's suitability with regard to such product.[42]

In sum, the courts have generally held that the financial institutions have no obligation to actively refrain from selling financial products that are beyond a consumer's risk-bearing ability,[43] and generally yielded to the parties' freedom of contract.

With that said, for offshore structured products, the Securities and Futures Commission has promulgated the Regulations Governing Offshore Structured Products in 2009, pursuant to which financial institutions are prohibited from entering into transactions with non-professional investors regarding certain products and products beyond the investor's risk-bearing ability.[44] It should be noted that such regulations are still different from a general obligation to refrain from a transaction, and apply only to the transactions of offshore structured products.

Additionally, the courts sometimes make *de novo* decisions in evaluating an investor's suitability. However, in such cases, the courts rarely find an investor lacking suitability. For example, in one of the cases, the court ruled that so long as an investor has prior investment experiences in the stock market or the fund market, it is generally sufficient to conclude that such investor is suitable to invest in a structured bond.[45]

iv Selling restrictions

The offering circulars of structured notes generally contain selling restrictions, including a clause stating that 'the Notes may not be sold or offered in the Republic of China ('R.O.C.')

41 See Taipei District Court civil judgment 99-Jin-Jian-Shan-Zi-5 (2010).

42 See Taiwan High Court civil judgment 98-Shan-Yi-Zi-1021 (2010).

43 Chu, Te-fang, 'Should a selling institution refrain from transaction when a customer decides to purchase the financial product above one's risk level?', *Taiwan Law Journal*, 2011.4, at 196.

44 Regulations Governing Offshore Structured Products, Section 21.

45 See Taichung District Court civil judgment 98-Su-Zi-1060 (2009).

and may only be offered or sold to R.O.C. resident investors from outside Taiwan in such manner as in compliance with Taiwan securities laws and regulations applicable to such cross-border activities.'[46] Many investors relied on such language to claim that the financial institutions violated the selling restriction of specific products.

Most of the courts are of the view that the selling restriction should be construed as forbidding the notes from being sold or offered publicly and directly to Taiwanese investors. The common practice of the banks was to sell the structured notes through a specified monetary trust, in which the financial institutions are the direct investors and theoretically the products were not sold to the Taiwanese investors. From a legal point of view, the individual investors were the settlors of these trusts, instead of the direct investors of the structured notes. As such, the financial institutions did not violate such restriction of the offering circular under the investment structure through specified monetary trusts.[47]

The minority view of the courts is that, in fact, such selling structure circumvented the selling restriction and should be deemed a violation of the offering circular.[48]

v General consumer protection regulations

Prior to the enactment of the FCP Act in 2011, many investors raised claims pursuant to general consumer protection regulations, for example, the Consumer Protection Act and the relevant Civil Code provisions.[49] The vast majority of the courts overruled the consumer protection claims, stating that the purchase of structured products is generally for investment purpose and should not be governed by the general consumer protection laws.[50] The competent authority for consumer protection in Taiwan is also generally of the view that investment activities are highly risky and are different in nature from consumption activities. The application of general consumer protection laws should exclude structured financial product transactions.[51] Since the promulgation of the FCP Act, it is expected that less investors will rely on general consumer protection regulations in financial and banking litigations when filing their claims.

IV LIABILITY

In the discussion of liability calculation, the court is generally of the view that in the event that a financial institution is held liable for failing to fulfil the obligation of disclosure, thereby leading to cancellation of the contract, or that the contract was not effectively formed, the financial institution should return the full principal amount of investment.

Some financial institutions have asserted the causation defence, stating that since the damage of the investor was in fact caused by a *force majeure* event, namely, the global financial crisis, there was no proximate causation between the action of the financial institution and the damage of the investor. These financial institutions have claimed that even if the financial

46 See Taipei District Court civil judgment 99-Su-Zi-438 (2010).

47 See Taiwan High Court civil judgment 99-Siao-Shan- Zi-5 (2010). See also Chen, Christopher Chao-hung, 'Structured notes fiasco in the courts: A study of relevant judgments between 2009 and 2010', *Academia Sinica Law Journal*, 2012.3, pp. 203–4.

48 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

49 *Supra* note 49, at 207–8.

50 See Taiwan High Court civil judgment 99-Siao-Shan- Zi-5 (2010). *Supra* note 49, at 208.

51 Consumer Protection Committee Letter Siao-Bao-Fa-Zi No.0980010052.

institutions fulfilled their obligation of disclosure, the investors would still make the same investment decisions and would still suffer from the global financial crisis. The courts remain split as to whether such defence of causation stands in such cases.[52]

V LOOKING AHEAD

Since the promulgation of the FCP Act, it can be expected that a majority of the disputes between financial institutions and investors and consumers will be resolved by the Financial Ombudsman Institution in future. Unlike the cases arising from structured product disputes, many of which are resolved through traditional litigation, since 2014 a certain proportion of the TRF investment disputes have been resolved through the mechanism of the Financial Ombudsman Institution. While the courts have provided abundant literature regarding structured product disputes, the TRF investment disputes that have been resolved through the Financial Ombudsman Institution have not been disclosed to the public, which means that, for the forseeable future, it will be difficult to take a closer look at TRF disputes.

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52 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010). Contra Taipei District Court civil judgment 98-Su-Zi-1684 (2010).

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