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### Judicial Inactivitism in Protecting Financial Consumer against Predatory Sale of Retail Structured Products: A Reflection from Retail Structured Notes Lawsuits in Taiwan

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# **Judicial Inactivitism in Protecting Financial Consumer against Predatory Sale of Retail Structured Products: A Reflection from Retail Structured Notes Lawsuits in Taiwan**

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## **Abstract**

This article analyzes 310 structured note lawsuits in Taiwan between 2000 and 2013 to examine courts' attitude in dealing with claims of misselling retail structured notes. We find that courts were generally not favorable to retail investors. This provides a contrast with the financial regulator's efforts to improve financial consumer protection since 2008. By examining plaintiffs' key arguments and courts' rulings, we find that it was difficult for investors to fulfill their burden of proof and courts were reluctant to award remedies when investors did sign on a contractual document confirming his knowledge on a few matters. While regulators are right to strengthen financial consumer protection, this article argues that Taiwan courts' inactivism to protect retail investors could be justified. However, regulators should pick up from what courts have left to ensure that customers fully comprehend the consequences when they sign on contractual documents, to avoid banks classifying customers as active investors too easily, and to clarify banks' duties toward a customer after a contract is signed. Regulators should also reconsider its regulatory structure to ensure foreign banks would not be able to issue securities to raise funds from local investors by way of a shadow banking system.

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# I. Introduction

In this article, we will illustrate that there is a gap between regulatory development for financial consumer protection and the relatively inactivity of courts in Taiwan with regard to misselling lawsuits for retail structured notes. While it is easy to criticize courts' inactivism in protection financial consumers, this article will justify courts' position. To create a complete legal framework, the financial regulator should take note from courts' rulings in order to strengthen regulatory rules aiming at financial consumer protection. The findings in this article may also offer valuable lessons for China, whose vast shadow banking system via so-called 'wealth management' products may be under stress,<sup>1</sup> to protect its retail customers.

Similar to Hong Kong and Singapore<sup>2</sup>, the collapse of Lehman Brothers (Lehman) in September 2008 led to heavy losses suffered by retail customers in Taiwan.<sup>3</sup> Since 2008, Taiwan's financial regulator vows to implement new rules to improve financial consumer protection. Unlike in Hong Kong and Singapore<sup>4</sup>, the structured notes saga in Taiwan resulted in many lawsuits brought by retail customers against counterparty banks for misselling.<sup>5</sup> Thus, it is interesting to examine the role of courts in protecting structured note investors.

The evidence comes from 310 lawsuits filed in Taiwanese courts since 2000 (mostly after 2008) with regard to retail structured notes (the terms used for these disputes being "structured note lawsuits" or "structured note disputes"). These lawsuits offer us an opportunity to examine various aspects of legal risk facing banks and their customers in misselling cases concerning

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<sup>1</sup> Josh Noble et al., *Chinese shadow banks face major test*, Financial Times, Jan. 16, 2014, <http://www.ft.com/cms/s/0/90fd764a-7e89-11e3-8642-00144feabdc0.html?siteedition=intl#axzz2qvBKFITL>.

<sup>2</sup> *Thanks, Hanks*, The Economist, Nov. 20, 2008, at [http://www.economist.com/finance/PrinterFriendly.cfm?story\\_id=12652247](http://www.economist.com/finance/PrinterFriendly.cfm?story_id=12652247).

<sup>3</sup> See Christopher Chen, *The Resolution of the Structured Notes Fiasco in Hong Kong, Singapore and Taiwan*, 34 COMP. LAW. 119, 119.

<sup>4</sup> In Singapore, there has been no reported judgment directly involving Lehman minibonds and only two other lawsuits were linked to DBS High Notes 5 issued by a local bank. See *Soon Kok Tiang v. DBS Bank Ltd* [2012] 1 SLR 397 (Court of Appeal, Singapore) and *Teo Wai Cheong v. Crédit Industriel et Commercial* [2013] 3 SLR 573 (Court of Appeal, Singapore). We find no civil lawsuit claiming remedies for misselling of structured notes in Hong Kong, but there were a few criminal cases dealing with retail structured notes. See *HKSAR v. Chu Lai Sze* [2010] HKEC 1820 (Court of First Instance, Hong Kong); *Cheung Kwai Kwai, Re* [2011] HKEC 1084 (District court, Hong Kong); *HKSAR v. Tai Ching* [2011] HKEC 1085 (District Court, Hong Kong).

<sup>5</sup> However, no investor in Taiwan has tried to bring a class action in the U.S., while some investors in Singapore did so. See *In re Lehman Brothers Holdings Inc.*, 2011 WL 5103346 (SDNY); *Ka Kin Wong v. HSBC USA, Inc.* 2010 WL 3154976 (S.D.N.Y.); *Dandong v Pinnacle Performance Ltd* 2011 WL 5170293 (S.D.N.Y.); *Dandong v Pinnacle Performance Ltd* 2011 WL 6156743 (S.D.N.Y.).

retail structured notes. Unfortunately, we find that courts in Taiwan were not quite generous to plaintiffs in offering remedies to retail customers. Therefore, there is an apparent gap between regulatory development and the attitude of courts. This leads us to wonder why Taiwan courts were reluctant to award remedies to retail investors and what should regulators do given courts' general inactivism.

In this article, we will analyze a number of structured note lawsuits in Taiwan to consider and explain the judicial inactivism. By analyzing the outcome of a lawsuit, specific arguments and their relationship with various factors, we may then consider the legal risk that a financial firm faces when their customers file legal actions for misselling. For simplicity and to avoid other implications, this article will only consider lawsuits concerning one single type of product – retail structured notes.

Some observers may see the structured notes saga as a part of history that is over and done with. After all, the chance of having another Lehman Brothers-type collapse seems to be small. However, this article suggests that the structured notes lawsuits could offer us some insights relevant for other investment products. Structured notes are supposed to be more complex than conventional products. Thus, if investors already find it difficult to claw back money for mis-sale of these exotic products, the prospect of recovering money for investment losses caused by more conventional products should not be any better.

In addition, issues surrounding structured notes are not unique to structured products. Since many products (e.g. mutual funds or investment-linked policies) are sold by the same group of wealth managers, it is not hard to imagine that the same staff might also fail to properly explain a fund or investment-linked insurance policy, or to correctly assess the suitability of a customer in relation to a risky investment vehicle. As local interest rates in Taiwan continue to be very low,<sup>6</sup> there is still appetite for unconventional structured products that offer a higher return from savings.<sup>7</sup> Our study would offer some food for thoughts for prospective investors, bankers, regulators and legal practitioners. This study can also provide a platform for further comparative research and empirical analysis. Although Taiwan is a civil law jurisdiction so that

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<sup>6</sup> According to the Central Bank, the average deposit interest rate for a one-month time deposit was barely 0.88% on Jan. 20, 2014. Even for a three-year time deposit, a customer would only receive 1.41% from his savings. See Central Bank of the Republic of China, [http://www.cbc.gov.tw/sp.asp?xdurl=banking/rates\\_04.asp&ctNode=371](http://www.cbc.gov.tw/sp.asp?xdurl=banking/rates_04.asp&ctNode=371).

<sup>7</sup> See *infra* Part II for the economic backdrop of the structured note market in Taiwan.

some legal arguments may not be directly applicable to other countries that may share similar problems, the discussion in this article may offer some general perception on misselling of financial products and may provide some guidance to China, where there have been a boom of so-called ‘wealth management’ products in the form of retail structured investment instruments since the global financial crisis.<sup>8</sup>

In the following parts, Part II will first describe the rise and fall of retail structured notes in Taiwan, including the market environment before 2008, a short description of retail structured notes in Taiwan and the structured note saga. In Part III we will paint a general picture of how Taiwan courts handle structured note lawsuits. We will analyze the general chance of winning if a customer files a lawsuit. This will help us to compare the results from lawsuits with the results from other alternative dispute resolution bodies. In Part IV, we will examine plaintiffs’ main arguments and courts’ attitude before we offer some thoughts on relevant regulatory reforms. Part V will conclude this article.

## **II. The Rise and Fall of Retail Structured Notes in Taiwan**

### **A. Market Backdrop**

The rise of retail structured notes in Taiwan has a social and economic backdrop. There was a combination of several characteristics in Taiwan’s market that fueled the boom of retail structured notes in the new millennium. First, the population was (and still is) dominated by ethnic Chinese, who commonly crave wealth-generating schemes. Second, fast economic growth since 1970s had led to accumulated wealth among members of a strong middle class. Third, the savings rate was high, but the market interest rate had been low for a decade. In terms of total amounts, it is estimated that the figure for gross national savings was about NTD \$2,880 billion

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<sup>8</sup> There are no official data about the size of China’s wealth management market. However, according to the Wall Street Journal, citing data offered by Fitch Ratings, about 10 trillion yuan (about US \$1.6 trillion) is invested in wealth management products. See Dinny McMahon, *Why You Should Worry About China’s Wealth Management Products*, Wall Street Journal, Oct. 15, 2012, <http://blogs.wsj.com/chinarealtime/2012/10/15/why-you-should-worry-about-chinas-wealth-management-products/>. The Financial Times also reported that “[t]he total outstanding issuance of these products reached RMB6.7tn at the end of the third quarter [of 2012], up 47% from the end of last year, according to the regulator.” See Simon Rabinovitch, *China Investment Products Draw Complaints*, Financial Times, Dec. 27, 2012, <http://www.ft.com/intl/cms/s/0/53c75f8e-5004-11e2-a231-00144feab49a.html#axzz2GKBMhEzX>.

(about USD \$96 billion) in 2002, about NTD \$3,668 billion (about USD \$122 billion) by 2008, and about NTD \$ 4,433 billion (about USD \$147 billion) by 2012.<sup>9</sup> According to the Directorate-General of Budget, Accounting and Statistics under the Executive Yuan, Taiwan’s gross national savings, in terms of percentage points of gross domestic product, was 27.03% in 2002, 28.36% in 2008 and 30.09% in 2012.<sup>10</sup> However, if we use the 12-month fixed deposit interest rate (for each January since 2001) at the Bank of Taiwan (the biggest state-owned bank in Taiwan) as a benchmark, the one-year time deposit rate was 1.875% per annum in Dec. 2002, 1.420% in Dec. 2008, and barely 1.355% in Dec. 2012.<sup>11</sup> Given the low interest rate, inflation would probably eat up most of the interest income from these cash savings.<sup>12</sup>

This meant that customers who had a decent amount of savings needed to find a way to generate income and preserve their savings to neutralize the effect of inflation. Apart from putting money into the equity market, mutual funds or real estate, retail structured notes offered a novel choice that could deliver higher returns by embedding financial derivatives into a retail investment vehicle.

## **B. Structured Notes in Taiwan**

In short, a structured financial product is a financial instrument that combines a conventional financial product (e.g., a deposit, life assurance policy, debenture, mutual fund, etc.) with features of financial derivatives. Through a structured product, an investor may enjoy the benefits of both a conventional financial product (e.g., the features of fixed income of bonds or deposits, or the protection of a life policy) and the advantages of financial derivatives (e.g., speculation in another asset).

By definition, a derivative is “a financial instrument whose value depends on (or derives from) the values of other, more basic underlying variables.”<sup>13</sup> The underlying variables of a derivative instrument can include a wide range of factors, from stocks and bonds to commodities or all sorts of market rates (e.g., interest rates or exchange rates). In a way, “applications of

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<sup>9</sup> Data is available in the website of the Directorate-General of Budget, Accounting and Statistics under the Executive Yuan (Table 5), <http://eng.dgbas.gov.tw/ct.asp?xItem=30672&ctNode=3339>.

<sup>10</sup> *Ibid.*

<sup>11</sup> See the Central Bank of the Republic of China website, <http://www.cbc.gov.tw/np.asp?ctNode=369&mp=1>.

<sup>12</sup> According to the Directorate-General of Budget, the Consumer Price Index stood at 3.53% in 2008 and 1.42% in 2012. See *supra* note 9 (Table 2).

<sup>13</sup> JOHN C. HULL, *OPTIONS, FUTURES, AND OTHER DERIVATIVES 1* (6th ed., 2006).

derivative instruments focus on using derivatives to transfer risk.”<sup>14</sup> Thus, derivatives provide a powerful tool for market participants to hedge financial or non-financial risks.<sup>15</sup> Derivatives also allow trading in the returns or price fluctuations of other assets without the necessity of trading in the assets themselves.<sup>16</sup>

By combining a conventional financial instrument with derivatives, a structured note may offer investors an opportunity to invest in unconventional assets or variables. It may also offer an alternative to conventional stock trading and investment in mutual funds.<sup>17</sup> It has been claimed that “[structured products] arguably generate investment opportunities that otherwise would not be available. In this sense, they ‘complete’ the markets for fixed income securities.”<sup>18</sup> For example, in one set of notes issued by UBS in 2007, the notes were linked to shares prices of Coach Inc., Apple Inc., Lehman Brothers and Arcelor Mittal, all of which were listed in the New York Stock Exchange.<sup>19</sup> This structured note allowed investors in Taiwan to gain or loss from the market movement of those 4 stocks without the need to open a stock account in the U.S. For a less globalized market like in Taiwan, this option may have looked even more attractive.

In a way, these structured notes provided a shadow banking system that channeled money from savings accounts to investments elsewhere in the world. Although structured notes are normally issued by a special purpose vehicle (SPV), a financial institution may still utilize the proceeds from issuance of notes through various smart arrangements. The trick is that proceeds from issuance of notes are often used to purchase collateral (normally another issue of debentures) as security. While there is no available information in Taiwan, we can take an example in Singapore. According to its documentation, each issue of the Pinnacle notes arranged

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<sup>14</sup> SATYAJIT DAS, STRUCTURED PRODUCTS VOLUME 1: EXOTIC OPTIONS; INTEREST RATES & CURRENCY 117 (3rd rev. ed., 2006).

<sup>15</sup> In general, financial risks include four main categories: market risk, credit risk, operational risk and liquidity risk. Other risks (e.g., accident risk) are generally non-financial in nature. See SATYAJIT DAS, RISK MANAGEMENT 5 (3rd ed., rev. ed., 2006).

<sup>16</sup> SATYAJIT DAS, DERIVATIVE PRODUCTS & PRICING 4 (3rd ed., 2006).

<sup>17</sup> For example, in Hong Kong, a study in 2005 suggested that 66 out of 72 equity-linked structured notes outstanding at the time referred only to Hong Kong stocks. See Joseph Lee and Veronica Chang, *A Survey on the Retail Structured Notes Market in Hong Kong* (Research Paper No. 24), <http://www.sfc.hk/sfc/doc/EN/research/research/rs%20paper%2024.pdf>.

<sup>18</sup> Frank Partnoy and David A. Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019, 1027-1028 (2007).

<sup>19</sup> See *Zhu Jiang Li v. Standard Chartered Bank*, <http://jirs.judicial.gov.tw> (Judicial Yuan of the Republic of China Laws and Regulations Retrieving System 司法院法學資料檢索系統, Chinese) (Sifayuan Faxue Ziliao)(Taiwan High Ct. Judgment 100 Gin-Shan No. 33, Dec. 17, 2013).

by Morgan Stanley was secured by interest-rate-linked notes issued by Morgan Stanley Capital Services Inc. or Morgan Stanley & Co. International. In other words, in the case of Pinnacle notes, Morgan Stanley effectively withdrew money from Singapore's retail investors through two issues of structured notes (i.e., one between the issuer/SPV and noteholders, and the other between the issuer/SPV and collateral issuers). How the money was transferred between the collateral issuer and other entities in the Morgan Stanley group was beyond the investors' reach.<sup>20</sup> However, we suspect the situation for notes issues in Taiwan was largely the same.

In Taiwan, many of the structured notes sold were linked to stock(s) or equity indices traded in other countries. For example, one issue of notes arranged by Lehman Brothers offered a coupon rate of 3.6% *per annum*, but the return of the principal was subject to movement of the Hong Kong Hang Seng Index and the Standard & Poor's 500 Index. If the levels of these two indices were higher than 100% of their original levels when the notes were issued, the investors could receive 100.1% of their investment upon maturity in addition to periodical interests. Otherwise, investors could still receive 100% of their investment, but without any capital gain.<sup>21</sup> In this case, investors could still earn three years' worth of interest. This was an example of a principal-protected equity-linked note because the return of 100% of the principal was protected. Unfortunately, the collapse of Lehman Brothers pretty much erased the whole capital protection arrangement.

Some equity-linked notes sold in Taiwan were designed with a default structure so that investors would lose all or part of their investment only when a certain event or threshold was triggered. For example, a popular type of structure in Taiwan was to connect payment of the notes to the relationship between the initial level of stock prices (or indexes) and a threshold level (e.g., 40% of the initial stock prices or index levels). If the stock price (or index) continued to be higher than the threshold level before the maturity of the notes, investors could recover 100% of the principal plus interest income. However, investors would lose all or a substantial part of their investment if the stock price (or index) dropped below the threshold level.<sup>22</sup> By this

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<sup>20</sup> Full documentation of Morgan Stanley Pinnacle Notes could be found on a dedicated website, <http://www.morganstanley.com/pinnaclenotes/notes.html>.

<sup>21</sup> See the explanation in *A v. Yuanta Bank, Sifayuan Faxue Ziliao* (Taipei Dist. Ct. Judgment 99 Gin No. 1, Nov. 2, 2010).

<sup>22</sup> See e.g. the notes in *B v. Huanan Bank, Sifayuan Faxue Ziliao* (Banciao Dist. Ct. Judgment 98 Su No. 355, Sep. 30, 2009). The notes under dispute in this case set the threshold to be 41%.

design, an investor's principal investment amount was protected as long as the stock price or index stayed above a certain floor. It seems to be reasonably safe to an investor if the threshold was set to be very low (e.g. 40% of the initial level).<sup>23</sup> However, when Lehman filed for bankruptcy protection, the market became so volatile that the threshold level was triggered for some notes in Taiwan, leading to heavy losses suffered by investors even if their notes were not arranged by Lehman.

Retail structured notes sold in Taiwan were mostly offshore in nature. Local investors usually invested in structured notes via a bank's trust department. This meant that they had to first open a trust account with a bank. Then they could instruct their bank (as a trustee) to invest in the structured notes that the bank promotes to them. This was also a common way for Taiwanese customers to invest in offshore mutual funds. However, each issue of structured notes was distributed exclusively by one bank. In contrast, the same mutual fund could be sold in several banks at the same time, allowing banks to compete over fees and services.

The main reason behind the trust arrangement is due to foreign exchange control. To open a channel for local investors to invest in foreign assets and to ease the pressure on the appreciation of New Taiwan dollars, the Central Bank allowed customers to invest in offshore investment vehicle via their trust account with a bank.<sup>24</sup> The Trust Association of the Republic of China (Trust Association) reported that outstanding investments in structured products via bank trust departments peaked in 2007 at amounts of over NTD \$909 billion (about USD \$30 billion).<sup>25</sup> Although this figure has continued to decline since 2007, the total amount invested in offshore structured notes still stood at about NTD \$345 billion (about USD \$11.5 billion) by the end of 2012.<sup>26</sup> The market size of structured notes actually rose in 2013 to about NTD \$380 billion (about USD \$12.68 billion) by the end of third quarter.<sup>27</sup> Though the market for

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<sup>23</sup> SATAJIT DAS, STRUCTURED PRODUCTS VOLUME 2: EQUITY; COMMODITY; CREDIT & NEW MARKETS 256 (3<sup>rd</sup> ed, rev edn, 2006).

<sup>24</sup> See the explanation by the Trust Association of the Republic of China (Trust Association), [http://210.68.77.78/8laws\\_83111.php](http://210.68.77.78/8laws_83111.php).

<sup>25</sup> See the statistics provided Trust Association in its website, <http://www.trust.org.tw/statistics/WebStatistics1.asp?Action=Search&pno=40>.

<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid.*

structured notes is dwarfed by that for mutual funds, which amounted to about NTD \$2,228 billion (about USD \$74 billion) by the end of 2012,<sup>28</sup> it is still quite substantial.

Despite an investment in offshore structured notes is often placed via a trust account, it is almost always non-discretionary in nature. The trustee bank acts like an agent of the customer. However, it is not uncommon that a bank's wealth management staff may provide some form of informal advice concerning which product may perform well, or whether it is a good time to buy. It is not a surprise that some plaintiffs argued that wealth managers have beautified structured notes without stressing the potential downside, given the pressure to have good sales record and to earn commission.<sup>29</sup> As a matter of law, a contentious legal issue is whether these kinds of communication may amount to a separate advisory contract, or if the banks have other legal duties to prevent misselling. This underlines many structured note lawsuits.

Because an investment is booked in a trust account, offshore structured notes are nominally held by the trustee bank. Thus, structured note investors in Taiwan are technically not legal note-holders. As Taiwan is a civil law jurisdiction, the country has no legal concept like that of equitable ownership as is known in a common law jurisdiction. Taiwanese investors have no proprietary interest in the notes they invest in (as trust assets) under Taiwan's trust law. At best a beneficiary or settlor can request the trustee to pay compensation or to restore the damaged trust asset to its original condition if the trustee disposes the trust asset in violation of the trust deed.<sup>30</sup> This posed a problem after the collapse of Lehman Brothers (Lehman) because local investors had no standing to participate in the bankruptcy proceedings in New York or in Europe, which left their fate in the hands of their counterparty banks.

The relationship between a domestic bank in Taiwan and a foreign issuer (and/or an arranging bank) is also unclear. Banks in Taiwan almost always argue that they have no control over how the notes are issued in the first place.<sup>31</sup> However, it is arguable that domestic banks in

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<sup>28</sup> *Ibid.*

<sup>29</sup> See e.g. Taishin Bank v. Sun Chun E, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 101 Shan No. 35, Mar. 12, 2013), Ba Ming Investment Ltd v. Taishin Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 99 Shan No. 564, Oct. 2, 2012).

<sup>30</sup> Trust Law art. 23, <http://law.moj.gov.tw/eng> (Laws and Regulations Database of the Republic of China 全國法規資料庫規查詢系統, English)(L. & Reg. DB)(Taiwan)

<sup>31</sup> For example, A v. DBS Bank (Singapore), Sifayuan Faxue Ziliao (Taipei Dist. Ct. Judgment 99 Chong-Su No. 168, Jul. 26, 2010); Deng Ming Shen v. Yushan Bank, Sifayuan Faxue Ziliao (Taipei Dist. Ct. Judgment 99 Gin-Jian-Shan No. 3, Dec. 17, 2010).

Taiwan have some kind of cooperation with foreign banks regarding the overall amounts of issuance and the selection of reference entities. On the one hand, this may help local banks to promote a product in advance. On the other, this also suits the nature of debenture. Structured notes are significantly different from open-end mutual funds, in which units may be increased at any time. Thus, it is reasonable that a foreign issuer and a local bank would sit down to talk about a potential product before the real issue in order to allow foreign issuers to collect all of the proceeds of issue once the notes were issued to Taiwanese banks (and then to local investors via their trust accounts). If this is the case, a local bank is not as innocent as it claims, though we have no documentary proof in the public domain.

This kind of cooperation would make the arrangement similar to the “originate-to-distribute” model for mortgage-backed securities in the US.<sup>32</sup> A foreign issuer comes out with the idea of issuing structured notes. Local banks agree with underlying terms, including reference assets and payment structure. Then local investors in Taiwan paid a lump sum to invest in the notes that helped foreign banks to tap in a large sum of cash savings in Taiwan via shrewd arrangements. The issue is similar to the predatory lending problem seen in the U.S.<sup>33</sup> In a way, structured note investors were the prey of local and foreign bankers. This contributed to the public perception that there was widespread problem of misselling. Then, the question is how the law should respond to the problem. This is the main theme of this article.

## C. Structured Notes Saga

The collapse of Lehman in September 2008 triggered a large number of consumer complaints about offshore structured notes in Taiwan. While Taiwan’s financial regulator provides no official investigation report,<sup>34</sup> it did find that local bank had some faults with regard to consumer protection after an inspection of local banks in 2008, including not setting up a proper regime to review the risk level of a structured product, inconsistency between a

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<sup>32</sup> See Cristie Ford and Carol Liao, *Power without Property, Still: Unger, Berle, and the Derivatives Revolution*, 33 SEATTLE U. L. REV. 889, 903-906 (2010).

<sup>33</sup> For a discussion of the predatory lending problem in the US, see Kathleen C, Engel and Patricia A McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039 (2007).

<sup>34</sup> See Monetary Authority of Singapore, *Investigation Report on the Sale and Marketing of Structured Notes linked to Lehman Brothers* (2009), <http://www.mas.gov.sg/en/News-and-Publications/Enforcement-Actions/2009/7-July-2009.aspx>; Hong Kong Securities and Futures Commission, *Issues Raised by the Lehman Minibonds Crisis: Report to the Financial Secretary* (2008), <http://www.sfc.hk/web/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf>.

promotion material and product documentation, non-disclosure of information required to be disclosed, non-disclosure of net value of a product in a bank statement, and selling a product that is too risky to a customer's risk profile.<sup>35</sup> As we will see below, those were also popular arguments raised by plaintiffs in structured note lawsuits.<sup>36</sup>

After the structured notes saga, banks in Taiwan were encouraged to settle with customers amicably.<sup>37</sup> Other than writing off their losses, customers may consider accepting a settlement offer from the counterparty financial institution, complaining via informal channels,<sup>38</sup> filing a complaint to an alternative dispute resolution body, or ultimately bringing a lawsuit.

There are no data indicating how many investors complained directly to the financial regulator. After the crisis, the Bankers Association of the Republic of China (the "Bankers Association") set up a dispute resolution panel consisting of nine members to handle the structured note complaints. According to the Bankers Association, this panel had received a total of 68,367 complaints regarding structured notes by the end of 2013.<sup>39</sup> About 63% of these complaints were settled before the dispute resolution panel adjudicated them. Also, as the dispute resolution panel was not created by law, any adjudication it has made has no compulsory or binding effect on either party. Banks were simply expected to accept the adjudication, though we found no judgment brought by a bank to challenge the adjudication or settlement by the Bankers Association. This non-binding nature of the settlements means that customers can still file lawsuits if they are not happy with the dispute resolution panel's rulings. However, if an investor accepts the ruling, the adjudication amounts to a contract of compromise, and there is very little chance that the investor can overturn the settlement afterwards.<sup>40</sup>

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<sup>35</sup> See website of the Financial Examination Bureau:

[http://www.feb.gov.tw/ch/home.jsp?id=305&parentpath=0,5,297,301&mcustomize=onemessages\\_view.jsp&dataserno=38290&aplistdn=ou=data,ou=disclosures,ou=one,ou=chinese,ou=ap\\_root,o=fsc,c=tw&toolsflag=Y](http://www.feb.gov.tw/ch/home.jsp?id=305&parentpath=0,5,297,301&mcustomize=onemessages_view.jsp&dataserno=38290&aplistdn=ou=data,ou=disclosures,ou=one,ou=chinese,ou=ap_root,o=fsc,c=tw&toolsflag=Y).

<sup>36</sup> See *infra* Part IV.

<sup>37</sup> See the description by the financial regulator in its website:

<http://www.banking.gov.tw/ch/home.jsp?id=19&parentpath=0,5>.

<sup>38</sup> For example, in Taiwan, some victims of the Lehman-related structured notes protested against a bank by carrying a coffin to the door of the bank. See *Bu Kan Suen Shi*, in *Lian Ji Jiou Huei Jiang Tai Guan Kang Yi*, Liberty Times (Chinese), Dec. 4, 2008, at

<http://iservice.libertytimes.com.tw/liveNews/news.php?no=156334&type=%E8%B2%A1%E7%B6%93>.

<sup>39</sup> The website of Bankers Association: <http://www.ba.org.tw/all.aspx?sn=734>.

<sup>40</sup> In 12 of the 310 lawsuits (3.87%), investors tried to overturn a prior settlement agreement with a bank or their decision to accept an adjudication ruling issued by the Bankers Association. However, none of these cases were in the end held in favor of the plaintiffs. The Civil Code provides that "[t]he effect of a compromise and settlement is to extinguish the rights abandoned by each party and to secure to each party those rights which are specified in the

In addition, we found a total of 310 lawsuits regarding offshore structured notes since 2000, the year when most (if not all) of Taiwan's court judgments at all levels started to be available online for free.<sup>41</sup> However, only 1 structured note case occurred before 2008 and another 2 in 2008. The other 307 cases were all filed after 2008. In over 67% of cases, the judgment in the first instance was issued in 2010 and 2011 (a total of 209 cases). This means that the rise in cases indicates that these lawsuits were filed around 2009 and 2010 and thus very likely a result of the collapse of Lehman. In fact, in at least 167 of these 310 lawsuits, the notes under dispute were known to be issued or arranged by Lehman entities.

As expected, most lawsuits took place in the jurisdiction of the Taipei District Court, which covers the principal office of most of Taiwan's financial institutions.<sup>42</sup> Among the 310 lawsuits, the lowest investment amount found was only NTD \$22,000 (about USD \$730) and the highest amounted to about NTD \$156 million (about USD \$5 million).<sup>43</sup> The mean was about NTD \$5.15 million (about USD \$170,000). However, the median was only about NTD \$1.89 million (about USD \$63,000). It is obvious that the mean was drawn higher due to some cases having a large sum of investment.

These lawsuits provide us with valuable information that we may further examine. In the next part, we will further analyze these structured note lawsuits to answer an essential question: how likely is it that disgruntled investors can succeed in suing a counterparty bank for their investment losses? Then we will analyze plaintiffs' arguments in Part IV.

### **III. The Judicial Inactivism**

In this part, we will illustrate that Taiwan courts in general were not in favor of structured note investors. Combined with sample results from other dispute resolution body, we find that

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compromise and settlement." See Civil Code art. 737, L. & Reg. DB (Taiwan). Thus, once a party has entered into a compromise and settlement contract with the other party, all prior rights and obligations are replaced by whatever is specified in the settlement agreement. This means that once an investor accepts a bank's settlement offer, he has little chance to revise his decision.

<sup>41</sup> Judicial Yuan of the Republic of China Laws and Regulations Retrieving System 司法院法學資料檢索系統, Chinese (Sifayuan Faxue Ziliao), <http://jirs.judicial.gov.tw/Index.htm>.

<sup>42</sup> Some 181 of the 310 lawsuits (58.39%) were handled by the Taipei District Court. The runner-up is Kaohsiung District Court in the second biggest city in Taiwan, which received 32 lawsuits.

<sup>43</sup> In some cases, the original investment amount or the claim amount was denominated in a foreign currency. For simplicity, this article uses the following currency rates: 1 US dollar = 30 New Taiwan dollars (NTD); 1 Australian dollar = 28 NTD; 1 New Zealand dollar = 22 NTD; 1 Hong Kong dollar = 4 NTD; 1 NTD = 3 Japanese yen.

banks face very little pressure from courts to settle with customers. This would have some policy implications.

## A. Plaintiff's Chance of Winning in General

To sue or not to sue, it is always a question facing a potential plaintiff. In general, it is reasonable for a plaintiff to file a lawsuit if the expected recovery value by bringing a lawsuit, minus litigation cost, is larger than the settlement amount offered by the defendant.<sup>44</sup> Apart from expenses<sup>45</sup>, the most crucial piece of information in the decision-making process is the chance of winning.

If we examine the final results of the 310 structured note lawsuits brought by investors between 2000 and 2013, plaintiffs only won (including a partial win) in 52 cases if we use the result of the final judgment of a lawsuit by the end of 2013. This suggests that the general odds of winning are 16.77% for plaintiffs (and 83.23% for defending banks).

Plaintiffs enjoyed a slightly higher chance of winning at the District Court level at 19.35% (60 cases out of 310). 98 of the 310 District Court judgments were appealed to the Taiwan High Court. Of these, the original plaintiffs won 22 cases (regardless whether they were the appellants or respondents), suggesting a 22.45% chance of winning in the second instance. Among the 98 appeals, the Taiwan High Court agreed with District Court judges in 71 lawsuits. In 16 cases, the appellate court overturned a District Court judgment that had favored a plaintiff. In contrast, on 11 occasions the Taiwan High Court reversed a District Court decision that was against a plaintiff. Overall there was a positive correlation and a statistically significant relationship between the results in the District Courts and in the Taiwan High Court ( $\chi^2 = 7.16$ ,  $p = 0.007$ , correlation = 0.27). This means that we can generally expect the appellant court to be in line with District Courts. The practical implication may be that it might not be worth the money to appeal to the THC.

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<sup>44</sup> See RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 568-569 (6th ed. 2003).

<sup>45</sup> Apart from fees paid to lawyers to conduct a lawsuit (if a plaintiff hires one) and the opportunity cost of spending time to attend hearings, the most prominent litigation cost facing a plaintiff is to advance litigation expenses to the court. The amount that should be advanced would depend on the amount a plaintiff claims, but roughly it is about 1% of the claim amount. See Taiwan Civil Code of Civil Procedure art. 466-1, L. & Reg. DB (Taiwan). See also the table provided by the Judicial Yuan in <http://www.judicial.gov.tw/assist/assist04.asp>.

By the end of 2013, we also found 21 appeals to the Supreme Court (from the 98 decisions by the Taiwan High Court).<sup>46</sup> However, the general chance of winning in the Supreme Court was merely 4.76%. Only in one of these appeals has the Supreme Court held in favor of the original plaintiff in the end. Among the 6 appeals from Taiwan High Court judgments holding for original plaintiffs, 5 judgments were vacated by the Supreme Court. In the sole case where the Supreme Court upheld an appellate decision in favor of a plaintiff, the plaintiff successfully proved that the investment was placed by his wife without his authority.<sup>47</sup> Judges in all levels had no problem with allowing this plaintiff's action. However, the situation in this case was rather special, and banks can easily avert this problem by double-checking the identity and authority of the person who places an investment in another person's account. Therefore, we may conclude that the Supreme Court has taken a position that is overwhelmingly favorable to banks.

We should note that even after several Supreme Court decisions in favor of banks, there continued to be District Court judgments holding for plaintiffs, based on similar arguments.<sup>48</sup> We should also note that the Supreme Court is only responsible for an appeal on legal points. Thus, lower courts still have some liberty to make factual findings.

If we view from the bank's side, the expected recovery value (ERV) for an investor/plaintiff also means the expected loss for a defending bank. This expense represents the legal risk that a bank underwrites when an investor files a lawsuit to claim losses regarding structured notes. If the ERV plus litigation cost is higher than a settlement offer, it means that the bank is settling the claim with a better deal. In this case, a reasonable bank should offer to settle the dispute with a customer, or accept a settlement offer provided by the customer. The bank

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<sup>46</sup> In Taiwan, an appellate judgment would be allowed appeal to the Supreme Court if the amount of the claim is higher than NTD \$1.5 million (about USD \$50,000). See Taiwan Code of Civil Procedure art. 466, L. & Reg. DB (Taiwan).

<sup>47</sup> Zhang Mao Xiong v. China Trust Bank, Sifayuan Faxue Ziliao (Keelung Dist. Ct. Judgment 98 Su No. 463, Jan. 13, 2011), affirmed by China Trust Bank v. Zhang Mao Xiong, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 100 Shan No. 202, Jul. 12, 2011), affirmed by China Trust Bank v. Zhang Mao Xiong, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 101 Tai-Shan 1777, Oct. 31, 2012).

<sup>48</sup> For example, Judge Zhao Zi Rong continued to hold in favor of the plaintiff (all of his three judgments were against banks but all vacated by the higher court) even after his earlier judgment was overturned by the Taiwan High Court. See Yang Li Feng v. First Commercial Bank, Sifayuan Faxue Ziliao (Taipei Dist. Ct. Judgment 99 Chong-Su No. 133, Nov. 10, 2010), vacated by First Commercial Bank v. Yang Li Feng (Taiwan High Ct. Judgment 100 Shan No. 47, Aug. 30, 2011); Zheng Bin v. China Trust Bank (Taipei Dist. Ct. Judgment 99 Gin No. 25, Oct. 26, 2011), vacated by China Trust Bank v. Zheng Bin (Taiwan High Ct. Judgment 100 Gin-Shan-Yi No. 10, May 29, 2012).

then might save litigation costs.<sup>49</sup> Given that a plaintiff's general chance of winning a misselling lawsuit is barely 16.77%, the net result is that banks do not have to offer much to settle with disgruntling customers. This may further influence a bank's behavior when dealing with a foreign issuer to cover money. We will consider this issue in more details later.<sup>50</sup>

Another interesting question is whether there is an association between hiring an attorney<sup>51</sup> and the result of a judgment. For the sake of simplicity, this article will not present all of the data on this point. In the District Courts, about 61.17% of plaintiffs did hire an attorney to represent them in court, while about 75.51% of defendants hired attorneys.<sup>52</sup> A simple analysis shows that there is no statistically significant relationship<sup>53</sup> between a plaintiff's hiring a lawyer and a winning judgment at the District Court level ( $\chi^2 = 0.46, p = 0.497$ ). However, there does seem to be a statistically significant relationship between a plaintiff winning a judgment and the defendant hiring an attorney ( $\chi^2 = 4.05, p = 0.044, \text{correlation} = 0.11$ ).<sup>54</sup>

It may be too much to suggest that a bank hiring an attorney will have a negative effect on the result of litigation at the District Court level. However, among the structured notes lawsuits, the odds ratio that a plaintiff would win a case when a bank hired an attorney was about 2.03 times higher than when the bank did not. This analysis may prove that there is no particular evidence showing that banks having better weapons in terms legal representation. Our finding may provide an interesting point for future study if we can compare with judgments for other disputes, though we should not exaggerate the result.

In sum, in general Taiwan courts were unfavorable to plaintiffs claiming misselling of retail structured notes. The Supreme Court so far only awarded remedies in 1 of the 21 cases the court has handled. The data also begs us a question: why has the court so unfavorable to retail

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<sup>49</sup> As a defendant, a bank does not have to advance litigation expenses to the court. Thus, a bank's legal cost is more or less reduced to fees payable to attorneys if a bank hires an external counsel.

<sup>50</sup> See *infra* III.D.

<sup>51</sup> In this article, a party is deemed to have hired an attorney if it appears in a judgment that the plaintiff or defendant is represented by a person with the designation of *lu shi* (i.e., attorney-at-law) after his name. We should be aware that a bank might assign in-house legal staff, who might or might not be qualified as licensed lawyers to conduct litigation. Since we can find no further information from relevant judgments, we would deem those staff without formal qualifications as being attorneys-at-law.

<sup>52</sup> For an appeal to the Supreme Court, both parties are required by law to be represented by a qualified attorney. See Taiwan Civil Code of Civil Procedure art. 466-1, L. & Reg. DB (Taiwan).

<sup>53</sup> This research sets the *alpha* at 5%.

<sup>54</sup> However, we find no statistically significant relationship between an original plaintiff or a defendant hiring an attorney and the plaintiff winning the judgment after analyzing the 98 judgments issued by the Taiwan High Court.

investors? Before we further examine details of plaintiffs' arguments, we can compare our litigation data with results published by other dispute resolution channels. This would help us to get a better picture of the resolution of the structured note saga in Taiwan.

## **B. Can a Customer Recover More by Filing a Complaint to an Alternative Dispute Resolution Body?**

For a consumer, one question is whether it is more beneficial to bring a case to an alternative dispute resolution (ADR) body rather than filing a lawsuit. After the collapse of Lehman Brothers and the ensuing structured notes saga, one major regulatory effort in Taiwan was to set up the Financial Ombudsman Institution (FOI) in January 2013. This organization is a new ADR body specializing in consumer financial complaints based on the Financial Consumer Protection Act (FCPA) passed in June 2011. Although the FOI has not published data on how it handled structured note disputes, we may compare data from the Bankers Association with the results of structured notes lawsuits.

As required by the Financial Supervisory Commission (FSC), the sole financial regulator in Taiwan, the Bankers Association of the Republic of China (Bankers Association) was tasked to form a dispute resolution panel to handle structured note disputes.<sup>55</sup> According to the Bankers Association, by the end of 2013, it had handled a total of 68,367 complaints regarding structured notes, 43,513 of which had been settled without applying adjudication.<sup>56</sup> Among the remaining 25,214 cases that applied for adjudication,<sup>57</sup> 14,365 cases have settled before adjudication. Other than cases withdrawn or dismissed without adjudication (2,327 cases), the Bankers Association awarded compensation in 8,285 cases and offered no remedy in 237 cases.<sup>58</sup> This means that an investor would have about a 97.22% chance of receiving some compensation by applying for adjudication to the Bankers Association, if the case is not otherwise settled or dismissed.

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<sup>55</sup> See *supra* note 37.

<sup>56</sup> *Supra* note 39.

<sup>57</sup> Any decision after adjudication still does not have any legal consequence. If both parties accept with the ruling, it would be considered a settlement contract. See *H v. Tachung Bank, Sifayuan Faxue Ziliao* (Chunghua Dist. Ct. Judgment 99 Su No. 415, Jun. 30, 2010). However, the adjudicated decision cannot be used as a cause of action. See *Lin Ya Rou v. Standard Chartered Bank, Sifayuan Faxue Ziliao* (Taipei Dist. Ct. Judgment 99 Su No. 2352, Dec. 17, 2010).

<sup>58</sup> *Supra* note 39.

The next question is how much compensation the complainants received. However, the Bankers Association only published statistics on a sample of 100 cases for reference purposes.<sup>59</sup> We do not know how these 100 cases were sampled. Thus, we assume that these 100 cases were randomly selected, and the result is close to representing the whole population. According to the Bankers Association, in 77% of these 100 cases the complainant received all or partial compensation (i.e., 23% of the complainants recovered nothing).<sup>60</sup> Among the 77 cases in which a complainant received some form of compensation, the average recovery rate was 20.31%.<sup>61</sup> However, if we consider the 100 cases as a whole, the average recovery rate drops to 15.64%.<sup>62</sup> These data shows that complainants are quite likely to receive some compensation, but they should not expect to recover much.

Would an investor do better if he decides to file a lawsuit? As discussed in the previous section, a plaintiff would have 16.77% chance of winning some form of compensation based on the final result of the 310 lawsuits by the end of 2013. If we analyze the 310 lawsuits as a whole, the mean recovery rate (i.e. the quantum of damages awarded by courts divided by the amount that a plaintiff claimed) was 13.96% (as most plaintiffs recovered nothing). However, among the 52 lawsuits that a plaintiff won, the average recovery rate was 76.74%.<sup>63</sup> Thus, if an investor chooses to file a lawsuit, statistics tells us that his chance of winning some compensation is lower than when he files a complaint to the Bankers Association. However, if he does manage to win the lawsuit, he can expect to recover about over three quarters of his investment. He may then make an adjustment by evaluating litigation expenses and other costs.

Overall, an investor's expected recovery rate does not vary much no matter he brings a lawsuit or files a complaint to the Bankers Association. However, unlike litigation, there is no need to advance any litigation expense or to hire an attorney if one complains to the Bankers Association. Thus, it seems to be more economical for investors to file a complaint to the Bankers Association than bringing a lawsuit, even though the reward could be higher if they somehow win a lawsuit.

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<sup>59</sup> See Bankers Association website: [http://www.ba.org.tw/News\\_File/連動債案件第一批評議結果.doc](http://www.ba.org.tw/News_File/連動債案件第一批評議結果.doc). See also the website of Taiwan Chamber of Commerce: <http://www.tcoc.org.tw/IS/Dotnet/ShowArticle.aspx?ID=50396&AspxAutoDetectCookieSupport=1>.

<sup>60</sup> *Ibid.*

<sup>61</sup> *Ibid.*

<sup>62</sup> *Ibid.*

<sup>63</sup> The median is 88.01%

Why was the average amount of compensation offered by the Bankers Association so low? There could be several explanations. First, the Bankers Association was simply overwhelmed by the number of complaints. In fact, the Bankers Association formed a 9-member dispute resolution committee to handle these disputes.<sup>64</sup> In contrast, Singapore's Financial Industry Disputes Resolution Centre (FIDReC) assigned 15 adjudicators<sup>65</sup> to handle about only 2,364 consumer complaints about structured notes<sup>66</sup>. The strain on manpower for Taiwan's Bankers Association was obvious.

Thus, we may argue that it was beyond the capacity of the Bankers Association to handle so many complaints with sufficient attention to details within a short period of time. This may explain the approach taken by the Bankers Association to deal with those complaints. According to the Bankers Association, it handled the complaints by first classifying key issues in each case into eight main categories.<sup>67</sup> Relying on the complainants' statements of facts and how serious a bank's fault was (e.g., no fault or grossly negligent) on paper, the committee created a score sheet for each case that helped the committee to review each case quickly in a more standardized manner.<sup>68</sup> There is no doubt that this technique helped the Bankers Association to handle a large number of complaints within three years. However, this approach might have also contributed to the result that most complainants received some compensation, but few recovered very much. This is also a sign that banks might have committed some forms of misselling during the sales process, but there were few serious misselling found by the Bankers Association.

A second possible explanation is that the Bankers Association is a trade association of banks. It is natural that the Bankers Association would handle complaints more for the benefit of banks than of customers. However, we have no meaningful way to examine whether this perception is true or false, as there are no available data or evidence on which to make further inquiries.

A third possible reason for the low compensation is to protect the banking system. In fact, exposure to structured notes heavily concentrated on certain banks. Therefore, had the Bankers

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<sup>64</sup> The website of Bankers Association: <http://www.ba.org.tw/normal.aspx?sn=16&AA=9>.

<sup>65</sup> The website of FIDReC: [http://www.fidrec.com.sg/website/adjust\\_structured.html](http://www.fidrec.com.sg/website/adjust_structured.html).

<sup>66</sup> FIDReC, *Annual Report of 2010-2011*, at 16, <http://www.fidrec.com.sg/website/annualreports.html>.

<sup>67</sup> *Supra* note 59.

<sup>68</sup> *Supra* note 59.

Association applied a heavier hand to its member banks, some banks might have faced serious solvency problems, which would have raised an even bigger scandal.

From the statistics offered by the Bankers Association, the China Trust received a total of 26,447 complaints (with or without adjudication), nearly 39% of the total complaints received by the Bankers Association.<sup>69</sup> The runner-up was the Taishin Bank, another successful private commercial bank (about 15% of the complaints).<sup>70</sup> The third was the First Bank (nearly 10%), a government-controlled bank. Altogether, over 60% of the complaints that were filed to the Bankers Association were concentrated on these three banks. This coincides with the litigation data we collected.<sup>71</sup>

Unfortunately, the China Trust happens to be the most successful private commercial bank on the island. It would be unthinkable if these three banks ran into trouble merely because of the need to return a large amount of cash to structured note investors. Given that the Taiwan government is quite wary of bank failures amid global financial crises<sup>72</sup>, it is understandable that the Bankers Association did not force the banks to pay massive compensations to consumers. However, to make more consumers happy, most of them received something in compensation for their losses.

In sum, by comparing with data released by the Bankers Association, we find that the expected recovery rate was similar no matter an investor files for a lawsuit or complains to the Bankers Association. By litigation, an investor's chance of winning is low, but the potential reward is higher. In contrast, an investor was more likely to win some compensation from the Bankers Association, but he would not receive much in the end. This may have further implications on banks' behavior and regulatory policy that we will discuss in Section D below.

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<sup>69</sup> See *supra* note 39.

<sup>70</sup> *Ibid.*

<sup>71</sup> Among the 310 lawsuits, 63 cases (20.32%) were brought against the China Trust, 48 (15.48%) against Taishin Bank, and 26 (8.39%) against the First Bank.

<sup>72</sup> While Taiwan government did not really bail out local banks during the financial crisis, the Executive Yuan announced that the government would guarantee the full amount of a person's deposit in a bank account in order to stabilize the banking system. See website of the Executive Yuan: [http://www.ey.gov.tw/News\\_Content.aspx?n=3D06E532B0D8316C&sms=4ACFA38B877F185F&s=756191AC4DF53C95](http://www.ey.gov.tw/News_Content.aspx?n=3D06E532B0D8316C&sms=4ACFA38B877F185F&s=756191AC4DF53C95).

## C. Is a Plaintiff More Likely to Win Concerning a More Exotic Product?

If we look beyond structured notes, a broader inquiry concerns whether an investor is more likely to succeed if the investment product is less conventional and more exotic. The hypothesis is that exotic investment products (e.g., structured products) are usually more complex and riskier than conventional ones (e.g., mutual funds) so that it may be easier to find a fault in the sales process, and therefore a plaintiff is more likely to win. Aside from direct trading in the stock market and investment in real estate, mutual funds are probably the most popular retail investment products. Like structured notes, these products are also commonly sold via a bank's trust department. Therefore we can compare the results of structured note lawsuits with those regarding mutual funds to prove whether the above hypothesis is true or false.

The market for mutual funds is certainly huge in Taiwan. According to the Trust Association, by the end of 2012, money invested in offshore mutual funds via banks' trust departments amounted to over NTD \$2,228 billion (about USD \$70.2 billion), which was six times the total amount invested in offshore structured notes at that time.<sup>73</sup> However, despite the vast total amount of investment in mutual funds, there have been remarkably few lawsuits alleging misselling of mutual funds. Between 2000 and 2013, we find only 27 lawsuits regarding mutual funds, a sharp contrast with the 310 structured note lawsuits during the same span.

One practical explanation for the difference in the number of lawsuits may be that the problems with structured notes were triggered by one single event and were well publicized. Thus, many people were more aware of the issues. Some people might have even filed a lawsuit just to try their luck. In contrast, mutual funds are generally simpler and better understood by local investors so that the customers might feel less resentment upon suffering losses.

Another reason might be due to the nature of mutual funds and structured notes. Structured notes are debt instruments. Thus, when Lehman collapsed, all notes issued or guaranteed by Lehman were under default. Investors had no choice but to either seek legal remedies or wait for the end of the bankruptcy proceedings. In contrast, there has been no reported collapse of major onshore or offshore fund management companies in Taiwan.

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<sup>73</sup> See *supra* note 25.

Therefore, mutual fund investors who suffer losses might still have a chance of recovering their investments by holding their funds for a longer term.

Is a plaintiff is more likely to win if the product he invests in is a more exotic financial product? The table below shows the relationship between the investment and the final result of relevant lawsuits by the end of 2013:

**Table 1 Products and chance of winning**

<b>Product</b>	<b>Total</b>	<b>The number of cases in which investors won</b>	<b>Plaintiff's Chance of winning</b>
Mutual funds	27	4	14.81%
Structured notes	310	52	16.77%
Total	337	56	16.62%

We can see that a plaintiff's chance of winning was slightly higher for structured notes than for mutual funds. This finding seems to prove our assertion that courts are more sympathetic to investors of more exotic products. However, statistically, there is no significant relationship between the type of product and the final result of a lawsuit (Fisher's exact = 1.00). Thus, the type of product is not a valid predictor for the final result of a lawsuit so far.

However, the number of structured note lawsuits greatly outnumbers those of mutual funds. Thus, we should not exaggerate the small differences. As neither the Bankers Association nor the FOI has published any data on any complaint regarding misselling of mutual funds, we have no way to examine whether alternative dispute resolution bodies would be more benevolent to structured note investors than to mutual fund investors.

## **D. Policy Implications from Low Expected Recover Value**

In the above three sections, we first find that structured note investors had a very low chance of winning a lawsuit to recover some compensation. Second, by comparing litigation data and statistics released by the Bankers Association, we find that a plaintiff's expected recovery rate by litigation is comparable to that by complaining to the Bankers Association. Third, there is no significant difference between the chance of winning of a structured note investor and that of a mutual fund investor, though there were far fewer lawsuits brought by the latter than the former.

What may the above findings connote for regulatory policy and financial consumer protection? The results of structured note lawsuits tell us that there is very little pressure on Taiwanese banks to pursue the best interest of local investors to recover as much value as possible from Lehman entities or other foreign issuers. Overall, the structured notes lawsuits produced a poor result for investors in Taiwan. For investors of notes issued or arranged by Lehman, most customers ended up with recovering no more than 20% of their original investments.<sup>74</sup> In contrast, holders of Lehman minibonds<sup>75</sup> in Hong Kong or Singapore recovered more than half (even up to over 90%) of their investments after the receivers settled with Lehman's liquidator.<sup>76</sup>

There is no reason to suggest that Taiwanese investors deserve poorer treatment than those in Hong Kong or Singapore. However, this result may be explained by our data shown the previous three sections. From banks' angle, whatever way an investor seeks remedies, the common result is that banks' expected liability to a complainant is low.<sup>77</sup> As the nominal holders of offshore structured notes that are held on trust for domestic investors,<sup>78</sup> Taiwanese banks should in theory be able to make a claim from the liquidator of Lehman Brothers (if the notes were issued by Lehman entities), or to seek any remedy pursuant to the documentation of the respective notes. However, the low recovery rate offered by courts or the Bankers Association means that banks in Taiwan have few incentives to actively negotiate with Lehman's liquidators or a foreign issuer to recover any remaining value, unless regulators are willing to exert more pressure on them<sup>79</sup>. There is also no incentive for banks in Taiwan to offer much in settling

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<sup>74</sup> See Taishin Bank website: <https://www.taishinbank.com.tw/TS/TS02/TS0204/TS020404/TS02040406/index.htm>; and China Trust Bank website: [https://www.chinatrust.com.tw/CTCBPortalWeb/appmanager/ebank/rb?\\_nfpb=true&\\_pageLabel=TW\\_RB\\_CM\\_structured\\_000009#](https://www.chinatrust.com.tw/CTCBPortalWeb/appmanager/ebank/rb?_nfpb=true&_pageLabel=TW_RB_CM_structured_000009#).

<sup>75</sup> The term "minibonds" was used by Lehman Brothers for some credit-linked notes issued by local special purpose vehicles in Hong Kong and Singapore. For further explanation on minibonds, see Christopher Chen, *Product Due Diligence and the Suitability of Minibonds: Taking the Benefit of Hindsight*, 2011 SING. J. LEGAL STUD. 309, 311-314 (2011).

<sup>76</sup> For Hong Kong, see <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR100>; for Singapore, see [http://www.mas.gov.sg/news\\_room/press\\_releases/2010/MAS\\_Welcomes\\_Announcement\\_of\\_The\\_Distribution\\_of\\_The\\_Recovery\\_Values\\_of\\_The\\_Minibond\\_Notes.html](http://www.mas.gov.sg/news_room/press_releases/2010/MAS_Welcomes_Announcement_of_The_Distribution_of_The_Recovery_Values_of_The_Minibond_Notes.html).

<sup>77</sup> See *supra* Part III.A.

<sup>78</sup> See *supra* Part II.B.

<sup>79</sup> The Financial Supervisory Commission did press local banks to sue Lehman's subsidiary in Taiwan for structured note losses on the ground of lifting corporate veil. However, those lawsuits were all dismissed by Taiwan courts. See *First Commercial Bank v. Lehman Brothers International (Europe)*, Sifayuan Faxue Ziliao (Supreme Ct. Judgment

complaints voluntarily. After all, banks in Taiwan literally could pass on book losses to domestic customers, while retaining the fees they received. This may be good news to bankers, but it is a bad one to investors.

A bigger question is whether it is necessary to create the Financial Ombudsman Institution (FOI) to deal with financial consumer complaints. There is no doubt that the FOI deals with a wide variety of financial instruments from bank products to securities and insurance.<sup>80</sup> However, this article argues that it would be naïve to believe that the FOI would have been able to deal with a large number of complaints at one single time if the structured note saga were to occur again.

If the results from the Bankers Association are a guide, an alternative dispute resolution body may be flooded with complaints that it could not afford to handle each case with sufficient attention. As discussed earlier, this may be one of the factors that contribute to low recovery rate from the Bankers Association. If an alternative dispute resolution body only offers minimal compensation to customers, it is arguable whether it is indeed beneficial to financial consumers.

Assuming that we cannot suddenly change courts' position, regulators should take note that Taiwanese banks faced very little pressure from litigation or the Bankers Association. However, litigation or dispute resolution should not be the end of structured note disputes. As the nominal holder of notes, banks can still seek compensation or recover as much value as possible from Lehman or other foreign issuer. This should also be seen as part of the bank's duty as the trustee.<sup>81</sup>

From this light, regulators should also ensure that banks would have sufficient incentives to recover more money from a foreign issuer in addition to creating a suitable outlet to handle consumer complaints. For example, in Hong Kong, the securities regulator entered into a collective settlement agreement with 16 banks. Under the agreement, those banks agreed to buy

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102 Tai-Shan No. 1528, Aug. 15, 2013); *Mega International Commercial Bank v. Lehman Brothers Securities*, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 101 Tai-Shan 1888, Nov. 21, 2012).

<sup>80</sup> In fact, during the first year of its operation over 80% of complaints were about insurance companies and only about 10% were about banks. See statistics for 2012 in FOI website:

[http://www.foi.org.tw/Area/Statistics/StatisticsArea101\\_4a5.aspx](http://www.foi.org.tw/Area/Statistics/StatisticsArea101_4a5.aspx).

<sup>81</sup> See Trust Enterprise Act art. 22 and Trust Law art. 22, L. & Reg. DB (Taiwan).

back notes from customers at 60% of its nominal value.<sup>82</sup> If banks could recover over 60% from Lehman's liquidator, any excess would be returned to customers.<sup>83</sup> This was in return for a regulator's promise to suspend any further investigation or disciplinary action.<sup>84</sup> Banks also did not admit any legal liability by entering into this settlement.<sup>85</sup> While there could be other legal issues flowing from this kind of settlement,<sup>86</sup> it did seem to lead to a result that holders of Lehman minibonds in Hong Kong recovered better than their counterpart in Singapore and much more than those investors in Taiwan.<sup>87</sup> This offers a lesson for Taiwan's regulators to think about in the future.

## IV. Rethinking Financial Consumer Protection from Structured Notes Lawsuits

In this part, we will continue to analyze structured note lawsuits by further examining plaintiff's key arguments and regulatory responses. As discussed in the previous part, Taiwan courts had not shown much sympathy for structured note investors. While this is a bad news for customers, must it be a bad position that should be corrected? In this part, we will examine court's rulings with regard to various issues raised by plaintiffs in order to understand underlying reasons and policy implications. As Taiwan courts rarely consider one cause of action after another, examining the arguments may help us get a better picture of what these lawsuits were about. Analyzing the arguments used can also offer us a platform for re-examining regulatory reforms aimed at improving financial consumer protection following the global financial crisis of 2008. In the following sections, we will first introduce key arguments we find from the 310 structured note lawsuits. Then we will examine each argument one by one from formation, product disclosure, suitability, post-sale dealings and sales restriction.

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<sup>82</sup> See the announcement by the Hong Kong Securities and Futures Commission on Jul. 22, 2009, <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=09PR100>.

<sup>83</sup> *Ibid.*

<sup>84</sup> *Ibid.*

<sup>85</sup> *Ibid.*

<sup>86</sup> For example, one investor tried to challenge the validity of the collective settlement agreement by applying for judicial review, which was rejected by Hong Kong court. See *Shek Lai San v Securities and Futures Commission* [2010] H.K.E.C. 640 (C.F.I.).

<sup>87</sup> See Christopher Chen, *The Resolution of the Structured Note Fiasco in Hong Kong, Singapore and Taiwan*, 34(4) COMP. LAW. 119, 120-121 (2013).

## A. Plaintiff's Main Arguments and Regulatory Responses

There is no doubt that many of the structured note lawsuits share some common issues. However, how to classify disputes properly is a more challenging task. To facilitate dispute resolution, the Bankers Association largely categorized structured note complaints into the following nine categories:

- (1) the complainant did not sign the relevant trust contract;
- (2) no exercise of know-your-customer procedure;
- (3) no double-check of the risk rating of the products that the complainants purchased or of the complainants' risk profiles;
- (4) lack of explanation of terms and conditions of a product (e.g., reference asset);
- (5) lack of disclosure of the risk rating of a product;
- (6) no regular notice of bank statements or provision of any list of investment assets;
- (7) sale processes that breached regulatory rules, or breached self-regulatory rules issued by the Bankers' Association;
- (8) other issues, or factors prescribed by the financial regulator (e.g., sale to elder people, those with low education, handicapped persons, etc.); and
- (9) notes issued by Lehman Brothers.<sup>88</sup>

We do not have further details on the criteria for each category. Based on the textual reading of the relevant judgments and the author's own understanding of the disputes, this article classifies structured note disputes into the following 5 main categories:

- a. Issues concerning the formation of a contract (hereinafter referred to as "formation issues" or "formation argument") including disputes about the genuineness of a customer's signature, capacity, or simply no meeting of minds.
- b. Lack of explanation or warning concerning the risk of a product (hereinafter referred as "product disclosure issues" or "product disclosure argument"). Unlike the Bankers Association categories, this article combines the lack of disclosure on product terms and lack of risk warnings into one category, because the two are well connected, and risk warnings can be seen as part of the information that should be disclosed to a customer.
- c. Issues concerning know-your-customer and suitability assessment (hereinafter referred as "suitability issues" or "suitability argument"). Although the know-your-customer process (i.e., acquiring relevant information about a customer and understanding what a customer wants) and suitability assessment could in theory be separated, this article determines that the two factors can be combined into one variable. After all, the know-your-customer process is a predecessor to examining a customer's suitability in relation to an investment product, and the failure of suitability assessment can often be

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<sup>88</sup> *Supra* note 59.

traced back to the know-your-customer stage. Combining these two factors can also increase the number of observations to improve analytical power.

- d. Issues occurring after the sale of a product (hereinafter referred as “post-sale issues” or “post-sale argument”), including a bank’s failure to dispatch bank statements regularly or to send timely notice after an important market event.
- e. Issues about a breach of sales restriction provision in the prospectus of a note (hereinafter “sales restriction issues” or “sales restriction argument”).

This does not mean that there is no other legal issue. For example, in some rare cases there have been claims of a bank embezzling customer money.<sup>89</sup> However, the above 5 categories were the most popular arguments raised by plaintiffs, and they also raised important legal issues for us to consider. On this basis, the table below shows the distribution of each type of complaint among the 310 structured note lawsuits, and their chances of winning. We should note that it is not uncommon that a plaintiff raised more than one argument in one action. The table below shows that number of lawsuits with the types of disputes and the chances of winning a lawsuit.

**Table 2 Main arguments and outcome of litigation**

Main issues	Total number (% out of 310 cases)	The number of winning cases containing this argument	Chance of winning when there was this argument	Association between raising a particular argument and winning a case in the end	The number of courts accepting this argument (% of all 310 cases)	Percentage (% of cases having this argument)
(a) Formation issues	79 (25.48%)	20	25.32%	$chi2 = 5.54, p = 0.02$	14 (4.52%)	17.72%
(b) Product disclosure issues	281 (90.65%)	45	16.01%	$chi2 = 1.24, p = 0.27$	33 (10.65%)	11.74%
(c) Suitability issues (including know-your-customer)	122 (39.35%)	20	16.39%	$chi2 = 0.02, p = 0.89$	5 (1.61%)	4.10%
(d) Post-sale issues	160 (51.61%)	22	13.75%	$chi2 = 2.17, p = 0.14$	15 (4.84%)	9.38%
(e) Sales restriction issues	63 (20.32%)	7	11.11%	$chi2 = 1.82, p = 0.18$	0 (0%)	0%
Overall	310	52	16.77%	N/A	N/A	N/A

From the table above, we can see that product disclosure issue has been the most popular argument raised by plaintiffs. Suitability and post-sale arguments were also popular. In addition,

<sup>89</sup> E.g. Lin Mei Lian v. Xie Hui Yu, Sifayuan Faxue Ziliao (Tainan Dist. Ct. Judgment 100 Jian-Shan No. 156, Mar. 26, 2013); Zhang Yong Hua v. First Commercial Bank (Yunlin Dist. Ct. Judgment 100 Su No. 425, Apr. 17, 2012).

we should note that sometimes courts grant remedies on more than one ground. In particular, in 9 cases the final judgments allowed both product disclosure and post-sale arguments, and in another 3 cases the final judgments allowed both product disclosure and suitability arguments. However, courts did not seem to receive these arguments very well, reflecting the low chance of winning. The argument that has enjoyed a higher chance of success was the formation argument. This is also the only issue that seems to have a statistically significant relationship with the final result of the lawsuit with a weak correlation (correlation = 0.13). On this basis, we may further examine details of each issue, key points, court’s reasoning, and regulatory responses.

## B. Formation Issue

From the previous section, we find that courts seem to be more acceptable to formation issues. By raising formation issues, the odds of winning were 2.11 times higher than by not raising these issues. Why did that happen? We may examine the exact arguments that raise formation issues. This is shown in the table below:

**Table 3 Types of formation argument**

Dispute	Total number	Number of cases where plaintiff won in the end	Number of cases where formation issue was accepted by courts
Authenticity of signature/stamp	33	8	4
No meeting of minds <sup>90</sup>	32	9	8
Unauthorized transaction	5	2	1
Lack of capacity	0	0	0
Contract void due to lack of contract review period <sup>91</sup>	1	0	0
Lack of formality	5	1	1
Sham transaction	1	0	0
Common mistake	1	0	0
No meeting of minds & formality	1	0	0
Total	79	20	14

From Table 3, we may find that the formation issue concentrates on two main disputes: authenticity of investors’ signature and no meeting of minds. However, among the 14 cases in which judgments in favor of the plaintiffs were based on formation issues, a majority (57.14%)

<sup>90</sup> Civil Code art 153, L. & Reg. DB (Taiwan).

<sup>91</sup> Taiwan’s Consumer Protection Law requires that “a reasonable period of no less than thirty (30) days must be given to consumers for them to review the contents of all terms and conditions [in a standardized contract]”. See Consumer Protection Law art. 11-1, L. & Reg. DB (Taiwan).

concerned with no meeting of minds. This seems to suggest that arguing for no meeting of minds (and no proper contract) seemed to be the best shot for plaintiffs.

We may try to explain the reasons behind those disputes. First, it is a common practice in Taiwan to rely on a personal stamp (rather than a person's own signature) on an application form or document. Under Taiwan law, the application of the stamp has the same effect with his personal signature.<sup>92</sup> Thus, if the application of a stamp is not authorized, a contract might become an unauthorized transaction.<sup>93</sup> In the worse scenario, some staff did steal the stamp or apply the stamp when a customer is not witnessing.<sup>94</sup> However, this does not seem to be an apparent problem for structured notes.

Nonetheless, the authenticity of signature/stamp is a factual question. It may not be uncommon for bank staff to apply the stamp on behalf a customer often in front of him for the sake of convenience so that a customer does not have to get his hands dirty. Sometimes a banker might ask a customer to sign first before the banker filling out other details (e.g. the name of a product) later.<sup>95</sup> This may save a customer's time on those details. Even a customer's stamp is applied by a banker or parts of a form or contract is blank when a customer signs, it does not necessarily imply that the stamp or signature must be unauthorized. Therefore, a plaintiff still has to prove that the signature or stamp was unauthorized. Unfortunately, the fact that a genuine stamp or signature appeared in a contractual document has put a plaintiff in a disadvantageous position. This might explain why courts rarely accept this argument.

Second, it is also interesting to see the number of cases arguing for no meeting of minds when a contract was entered into, especially when no case in our dataset involved oral contract. In particular, among the 32 cases arguing for no meeting of minds, 18 of these cases were specifically concerned with certain issue of notes dubbed as "K1 notes"<sup>96</sup>. Of the 18 case, plaintiffs successfully convinced the court in 7 cases if we use the final result as a benchmark.

The problem with K1 notes was that the notes were linked to the price movement of a series of funds under the same umbrella fund. There have been 3 appeals to the Supreme Court

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<sup>92</sup> Civil Code art. 2, L. & Reg. DB (Taiwan).

<sup>93</sup> Civil Code art. 103, L. & Reg. DB (Taiwan).

<sup>94</sup> See e.g. *Jian You Zhe v. Taishin Bank, Sifayuan Faxue Ziliao* (Banciao Dist. Ct. Judgment 99 Su No. 912, Dec. 15, 2010).

<sup>95</sup> See e.g. *C v. Bank of Panhsin, Sifayuan Faxue Ziliao* (Banciao Dist. Ct. Judgment 98 Su No. 989, Nov. 17, 2009).

<sup>96</sup> These notes were issued by Barclays Bank plc, but were distributed by Citibank in Taiwan.

concerning K1 notes so far, in none of which the Supreme Court held in favor of original plaintiffs.<sup>97</sup> This should set the tone of ongoing or prospective cases relating to K1 notes.

It seems that the issues about K1 notes were rather special, as there was some confusion over the subject matter investment in the documentation of these notes, which led some investors to believe that they were investing in funds rather than structured notes.<sup>98</sup> Had they read the contract carefully when placing the investment, investors should have known that they were purchasing structured notes rather than mutual funds. Therefore, it is important that we should not over-generalize or exaggerate our data.

In the end, can regulators do anything to address potential problems? Among the regulatory reform in Taiwan after 2008, there is no particular rule designed to ensure the authenticity of a customer's signature. It was (and still is) already a crime if a person stole another person's stamp or forged another person's signature before the financial crisis.<sup>99</sup> In fact, issues about customers' signature or stamp have already been addressed in some regulations. For example, an insurance company should ensure that an insured to personally sign on a document evaluating his suitability and risk profile.<sup>100</sup> Thus, formation issues are more likely to be compliance problems, since there is no apparent issue on banks illegally using customers' signature. Nonetheless, this is still a point that regulators could monitor in the future that can complement with the necessity to warn a customer's awareness of the consequences of his signature.<sup>101</sup>

## C. Product Disclosure Issue

A bank failing to disclose proper information of a structured note or to warn the risks thereof has been the most popular argument brought forward by a plaintiff. There is no doubt that many structured note investors had no clear idea about the product they purchased. The novelty and complexity of a structured product already make it more likely that a customer does

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<sup>97</sup> Lin Huang Shu Mei v. Citibank, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 102 Tai-Shan No. 1263, Jul. 4, 2013); Lin An Bi E v. Citibank, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 100 Tai-Shan No. 1589, Sep. 22, 2011); Citibank v. Lai Zong Xi, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 102 Tai-Shan No. 1845, Oct. 2 2013).

<sup>98</sup> See e.g. the description in Que Ya Zhen v. Citibank, Sifayuan Faxue Ziliao (Taipei Dist. Ct. Judgment 101 Su No. 1947, Feb. 7, 2013).

<sup>99</sup> E.g. Criminal Code of the Republic of China art. 210 and 217, L. & Reg. DB (Taiwan).

<sup>100</sup> Directions for Sale of Investment-linked Insurance Products art. 13(4), <http://law.fsc.gov.tw/law/EngLawContent.aspx?id=FL046517> (Laws and Regulations Retrieving System, English).

<sup>101</sup> See *infra* Part III.C.3.

not quite understand the instrument. It does not help that underlying assets of structured notes sold in Taiwan could not refer to stocks traded in Taiwan.<sup>102</sup> This makes it even less likely that a domestic investor would understand the risk of a product, even if he knows well the product structure.

In addition, full documentation of a structured product tends to be very long. To quote an English judge, it has been observed that “[t]he contractual documentation in this matter consists of more than 500 pages and its size and complexity, which ... make it easier to understand, if not to excuse, why senior banking figures ... had little understanding of this market and of the risks their institutions were undertaking.”<sup>103</sup> There is no reason to suggest that an ordinary retail investor could have done a better job.

On this basis, it seems reasonable that regulators put in much effort to strengthen product disclosure. Nonetheless, what is striking is that courts do not seem to be enthusiastic about plaintiffs’ product disclosure arguments. As mentioned earlier, Taiwan courts rarely accepted product disclosure argument.<sup>104</sup> This provides a sharp contrast with the perception by regulators. Courts’ attitude in certain issues would also offer something for regulators to ponder in the future.

## **1. Litigation Strategy and Causes of Action**

First, we can analyze the legal underpinnings to support the product disclosure argument. In general, a plaintiff may adopt two strategies. On the one hand, an investor could sue the counterparty bank (and/or its salesperson) for damages (referred as the “damages strategy.”). If he succeeds, he may offset his losses with court-ordered compensation from the bank. On the other hand, an investor can argue that his contract with the selling bank should be void *ab initio*, or voidable, so that he might recover his whole principal investment amount by claiming unjust enrichment after a contract is vitiated (referred as “unjust enrichment strategy”). If we focus only on cases that raise product disclosure issues, we find that in 149 of the 281 cases plaintiff adopted both strategies. In 111 cases plaintiffs chose only the damages strategy but in only 21 cases plaintiffs only used the unjust enrichment strategy.

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<sup>102</sup> Regulations Governing Offshore Structured Products art. 17, L. & Reg. DB (Taiwan).

<sup>103</sup> *UBS v. HSH Nordbank A.G.* [2008] EWHC 1529 (Comm), at [2] (*per* Lord Collins).

<sup>104</sup> See *supra* Table 2.

There are a variety of causes of action in the Civil Code or in other special laws that may help an investor to sue for damages. Table 4 below shows some main causes of action that were raised by plaintiffs in structured note lawsuits:

**Table 4 Causes of action to sue for damages**

Cause of action	Total number (% out of 310 cases)	Total number among cases with product disclosure argument
(1) Tort <sup>105</sup>	202 (65.16%)	186 (66.19%)
(2) Breach of contract <sup>106</sup>	123 (39.68%)	113 (40.21)
(3) Breach of duty of care under the Trust Act <sup>107</sup>	207 (66.67%)	194 (69.04%)
(4) Breach of duty of care under a contract of mandate <sup>108</sup>	182 (58.71%)	167 (59.43%)
(5) Breach of duty of care under the Trust Business Act <sup>109</sup>	65 (20.97%)	63 (22.42%)
Sum: breach of duty of case by an agent of trustee (3) to (5))	240 (77.42%)	222 (79.00%)
(6) Pre-contractual duty of care <sup>110</sup>	17 (5.48%)	16 (5.69%)

The most popular cause of action was tort, which was also commonly used in association with all types of arguments. It is also popular to sue for damages for a violation of the banks' duty of care under their contracts or trust relationship. Such a duty may come from the so-called contract of mandate under the Civil Code, or from the Trust Act or the Trust Business Act. Under Taiwan's Civil Code, a contract of mandate provides some general provisions governing contracts in which one party authorizes or gives some power to another person to conduct certain actions for the first party.<sup>111</sup> Provisions in the Trust Act or the Trust Business Act are applicable as retail investors in Taiwan invested in offshore structured notes mostly via their banks' trust departments.<sup>112</sup> In a way, the duty of care under a contract of mandate in the Civil Code and the duty of care under the Trust Act or Trust Business Act are of the same genre, as they all specify a bank's duty to care to "administer the trust affairs with the care of a prudent administrator."<sup>113</sup> Therefore, we may regroup them into one broad category of "contractual duty of care".

<sup>105</sup> Civil Code art. 184, L. & Reg. DB (Taiwan).

<sup>106</sup> Civil Code art. 225, 226 and 227, L. & Reg. DB (Taiwan).

<sup>107</sup> Trust law art. 22 and 23, L. & Reg. DB (Taiwan).

<sup>108</sup> Civil Code art. 535 and 544, L. & Reg. DB (Taiwan).

<sup>109</sup> Trust Business Act art. 22, L. & Reg. DB (Taiwan).

<sup>110</sup> Civil Code art. 245-1, L. & Reg. DB (Taiwan).

<sup>111</sup> Civil Code art. 528, L. & Reg. DB (Taiwan).

<sup>112</sup> See *supra* Part II.B.

<sup>113</sup> Trust Law art. 22, L. & Reg. DB (Taiwan).

Moreover, some plaintiffs also tried to argue for a breach of contract in general. It is sensible that a dispute over a breach of post-sale obligations would involve a breach of contractual duty, as the dispute arises after a contract is made. However, it is less clear how product disclosure or suitability issues are relevant to a breach of contract. One possible explanation is that a customer must first open a trust account before he makes any investment instruction. Therefore, a customer may argue that the bank breaches the contract regarding the trust account. However, none of the structured note judgment tries to clarify this matter. Another explanation is that arguing for a breach of contract may complement an argument for a breach of a bank's contractual duty of care if a bank fails to explain a product properly or to assess a customer's suitability. In fact, only in 9 cases a plaintiff raises a breach of contract without raising a breach of the contractual duty of care. The two variables have a statistically significant relationship ( $chi2 = 27.17, p < 0.001, correlation = 29.61$ )

To vitiate a contract, the most popular provisions that can help a plaintiff to vitiate a contract are shown in the table below:

**Table 5 Basis for unjust enrichment strategy**

	<b>Total number (% out of 310 cases)</b>	<b>Total number among cases with product disclosure argument</b>
(a) Fraudulent misrepresentation (rescission) <sup>114</sup>	118 (41.29%)	124 (44.13%)
(b) Mistake (rescission) <sup>115</sup>	30 (9.68%)	29 (10.32%)
(c) Illegality and public policy (void)	39 (12.58%)	38 (13.52%)
(d) Rescission of contract due to a defaulting party's impossibility to perform <sup>116</sup>	51 (16.45%)	48 (17.08%)
(e) Unjust enrichment <sup>117</sup>	86 (27.74%)	80 (28.47%)

It is not a surprise that the most popular argument for setting aside a contract was arguing for a bank's fraudulent misrepresentation.<sup>118</sup> It is clear that disclosure (or non-disclosure) is linked with misstatement or omission of material information. The strongest argument is that a

<sup>114</sup> Civil Code art. 92, L. & Reg. DB (Taiwan).

<sup>115</sup> Civil Code art. 88, L. & Reg. DB (Taiwan).

<sup>116</sup> Civil Code art. 226, 256 and 259, L. & Reg. DB (Taiwan).

<sup>117</sup> Civil Code art. 179, L. & Reg. DB (Taiwan). The general provision of unjust enrichment, which is considered as one of the main sources to create an obligation under Taiwan's Civil Code, has been raised in many cases with or without referring to other provisions. To avoid confusion, this article only codes this cause when a plaintiff clearly mentions article 179 as a cause of action.

<sup>118</sup> There is no right to rescind a contract due to negligent or innocent misrepresentation under Taiwan's Civil Code. The misrepresentation must be fraudulent to give rise to a right to rescind a contract. See Civil Code art. 92, L. & Reg. DB (Taiwan).

contract should be void *ab initio* for violation of mandatory laws or public policy. Some argued that their contracts with banks had been rescinded after a breach of contract due to the counterparty bank's impossibility to perform, so that the counterparty bank should refund their principal investment amount.<sup>119</sup> Given that plaintiffs' chance of winning is so low, we did not find any particular litigation strategy or cause of action (or legal ground) to have any statistically significant relationship with the final result of a lawsuit.<sup>120</sup>

Whether there is indeed misrepresentation, omission of material information or a breach of regulatory rules is a matter of fact that we cannot speculate. However, one explanation for the observation above is that plaintiffs used the same facts or allegations whatever litigation strategy or cause of action they relied upon (e.g. non-disclosure of material information of a product to support a commitment of tort and fraudulent misrepresentation). Thus, if courts decided that there was no improper behavior, a plaintiff's action would fail completely.

On this basis, we find that there could be two main reasons behind the court's inactivism regarding product disclosure: (1) lack of special cause of action and onus of proof, and (2) the difficulty to overcome an investor's own signature in a contractual document. These issues will be explored in turn in the next two sections.

## **2. Lack of Special Cause of Action and Onus of Proof**

The lack of a special cause of action and the onus of proof would affect a plaintiff's chance of winning. First, investors had to rely on private law cause of actions to seek compensation or to vitiate a contract. However, the lack of product disclosure is usually a problem that arises before a contractual is made. Taiwan's Civil Code does not prescribe a pre-contractual duty of disclosure by a seller.<sup>121</sup> Taiwan law also has not taken the German approach to create an implied advisory contract between a bank and a customer when sales process starts.

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<sup>119</sup> Civil Code art. 226, 256 and 259, L. & Reg. DB (Taiwan).

<sup>120</sup> By applying logistic regression to analyze the composite effect of both litigation strategies and the final result of a structured note lawsuit, we find that there is no statistically significant relationship between the final result and either strategy ( $p = 0.42$  for damages strategy and  $p = 0.51$  for unjust enrichment strategy). We also find no compound effect when a plaintiff adopts both strategies ( $p = 0.66$ ).

<sup>121</sup> Under article 245-1 of the Civil Code, a person could sue the counterparty for damages if the counterparty was in bad faith and failed to represent relevant information. However the condition to trigger this cause of action is that the contract has not been entered into. This makes this provision difficult to be applied to structured note lawsuits. See Civil Code art. 245-1, L. & Reg. DB (Taiwan).

<sup>122</sup> Thus, it is understandable that most judges were not very active in offering remedies in private law. Whether the new statutory cause of action created in the Financial Consumer Protection Act is sufficient to overcome the problem will be further analyzed later.

In addition, because there is no specific cause of action dedicated to a failure of product disclosure, plaintiffs have to first prove that a bank owes a duty to disclose certain information or that a bank has to disclose more information (than those already disclosed or offered in contractual documents) in order to justify a tort, a breach of contractual duty of care or a breach of contract. This might prove to be a difficult task, given the difficulty to overcome the burden of proof that we will discuss in the next paragraph.

Second, the general principle is that a plaintiff bears the onus of proof. Therefore, whatever cause of action (e.g. tort or contractual duty of care) or legal ground (e.g. fraudulent misrepresentation) employed by a plaintiff, he has to prove that the bank and/or its staff has breached the law or its duties. However, there are considerable difficulties in the case of misselling of structured notes. First, it is difficult to prove the intention of the bank. For example, to justify fraudulent misrepresentation, the onus is on a plaintiff to prove the counterparty's intention to defraud.<sup>123</sup> To establish a tort, a plaintiff must prove that the counterparty either knowing or negligently failed to disclose certain information.<sup>124</sup> As an investment could be made several years before the litigation started, it is always a taunting task.

To help investors, some judgments tried to reverse the onus of proof in order to render a judgment more favorable to plaintiff investors.<sup>125</sup> However, such an approach has no clear

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<sup>122</sup> See Jacob Bonavita, *The Regulation of "Speculative Interest-rate Bets" by the German Federal Court of Justice – New Dimensions of Market Intervention Hidden Behind the Old Information Model*, 13 EUROPEAN BUSINESS ORGANIZATION REVIEW 271 (2012) ◦

<sup>123</sup> Jiang Kun Yong v. Li Tui, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 44 Tai-Shan No. 75, Jan. 29, 1955).

<sup>124</sup> Civil Code art. 184, L. & Reg. DB (Taiwan).

<sup>125</sup> See e.g. Lin Shi v. Yuanta Commercial Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Tainan Branch Judgment 99 Shan-Yi No. 157, Mar. 22, 2011); King's Town Bank v. Zheng Ming Fen, Sifayuan Faxue Ziliao (Taiwan High Ct. Tainan Branch Judgment 99 Shan-Yi No. 167, Jan. 28, 2011); A. v. China Trust Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 98 Shan-Yi 299, Jan. 5, 2010); D. v. ABN Amro, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 98 Su No. 1052, Dec. 31, 2009); Chen Mei Fang v. China Trust Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 99 Chong-Shan No. 45, Nov. 23, 2010); D. v. ABN Amro, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 99 Shan-Yi No. 181, Nov. 16, 2010).

jurisprudential basis under Taiwan law. It was also clear that the Supreme Court did not seem endorse this theory.<sup>126</sup> Thus, the door to shift the onus of proof to banks may have been closed.

Moreover, even if there is a record of the sales process, a plaintiff often has to overcome his own signature in a document in which the plaintiff warrants that all documents have been disclosed and understood. Thus, investors were already in a poor position before filing a lawsuit. This point will be examined in the next section.

### 3. Overcoming Contractual Term

An even bigger obstacle for an investor is to overcome his own signature in a contractual document that contains a variety of disclaimers, warranties or non-reliance clauses. Documents provided by banks often contained a long list of risk warnings. Regardless of whether a bank has failed in product disclosure, the question then becomes whether a customer's own signature on a contractual document would be sufficient to show that the customer has either confirmed his understanding of the information or constituted a waiver.

From the structured note lawsuits, we found two views. The majority of Taiwan court took the position that an investor has confirmed his knowledge of the content of the structured note and the terms of contract when he signs on the contract.<sup>127</sup> If this is the case, an investor would be more likely to lose a case if the signature on the contract is authentic. Whether the bank has disclosed sufficient information would become a secondary question. In contrast, the minority view provides that the court should review the substance of a bank's sales process to see if the bank has fulfilled its duty to explain a product to a financial consumer.<sup>128</sup>

Which view is better? The majority view has some advantage over the minority view. On the one hand, the majority position may provide more stability in law. Until legislators revise the law,<sup>129</sup> arguably it is imprudent to change the traditional position in law just because the courts are suddenly flooded with cases of the same kind. On the other hand, such stability may help to

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<sup>126</sup> China Trust Bank v. Chen Mei Fang, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 101 Tai-Shan No. 26, Jan. 5, 2012), vacating Chen Mei Fang v. China Trust Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 99 Chong-Shan No. 45, Nov. 23, 2010)

<sup>127</sup> Chao-hung Chen, *Structured Notes Fiasco in the Courts: A Study of Relevant Judgments between 2009 and 2010* (2012) 10 ACADEMIA SINICA LAW JOURNAL 161, 181-186.

<sup>128</sup> See *supra* note 125.

<sup>129</sup> The statutory action provided by the Financial Consumer Protection Act in 2011 seems to shift at least part of the burden of proof to financial institutions. See Financial Consumer Protection Act art. 11, L. & Reg. DB (Taiwan).

increase legal certainty. One inherent problem with the minority view in Taiwan is the uncertainty over how far a court should review the substance of the sales process. By focusing on the signature of a customer, it is easier for a bank to comply, and this standard also sends a signal to customers that they should be cautious before signing a contractual document. The majority view may also force investors to be more cautious when signing a contract. This may avoid moral hazard. After all, such contracts involve a serious investment decision, not just a trip to the supermarket.

Some courts adopting the minority view even went as far as requiring banks to explain each contractual term in details.<sup>130</sup> As mentioned earlier, documentation for structured notes tend to be very long and complicated. Thus, it is impractical for banks to read each term one by one. To avoid misselling, it should be more economically efficient to require a customer to read a contract than requiring a bank to read and explain every term and condition.<sup>131</sup> It is also doubtful how many investors would have the patience to listen to every detail. As courts can only review the sales process from hindsight, the minority view might raise banks' legal risk and increase the chance that a customer opportunistically challenging a bank's disclosure and sales process when his investment is losing money.

In sum, this article argues that the majority view taken by Taiwan court can be justified. Then, regulators should recognize courts' position and the limit of relying on private law to protect retail investors. As will be discussed below, Taiwan's regulator has not done enough in this regard

#### **4. Reflection on Disclosure and Consumer Protection**

From the discussion above, we find that the product disclosure issue has been the most popular argument raised by plaintiffs' in structured note lawsuits. In general, this argument was not received well by Taiwan courts. Lack of special cause of action forced retail customers to rely on private law causes of action, but it is quite difficult for customers to prove that the bank

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<sup>130</sup> E.g. *D. v. ABN Amro, Sifayuan Faxue Ziliao* (Taiwan High Ct. Judgment 99 Shan-Yi No. 181, Nov. 16, 2010); *King's Town Bank v. Zheng Ming Fen, Sifayuan Faxue Ziliao* (Taiwan High Ct. Tainan Branch Judgment 99 Shan-Yi No. 167, Jan. 28, 2011).

<sup>131</sup> However, this article agrees that banks should disclose and explain important terms of a product to a customer.

has failed to disclose or has misrepresented material information about a product. It is also difficult for them to overcome their signature on contractual documents.

On this basis, we may come back to review new regulatory rules aiming at providing customers with more information. New rules require that a bank should not provide false or misleading information.<sup>132</sup> In addition, the Financial Consumer Protection Act (FCPA) provides that '[a financial services enterprise] shall fully explain the important aspects of the financial products or services, and of the contract, to the financial consumer, and shall also fully disclose the associated risks' before it enters into a contract with a financial consumer for the provision of financial products or services.<sup>133</sup> The Regulations Governing Offshore Structured Products, published in 2010 before the FCPA, also contains a similar duty.<sup>134</sup> The FCPA also created a statutory cause of action for a breach of the duty.<sup>135</sup>

However, is the new law sufficient to protect retail investors? There are several reflections from our analysis of structured note lawsuits. First, the purpose of product disclosure is to help customers to understand a product before he makes an investment decision. Therefore, disclosure could help to address the shortcomings of the principle of *caveat emptor*.<sup>136</sup>

Nonetheless, product disclosure will not be effective unless customers pay attention to them. From 310 structured note lawsuits, a common problem is that a customer signs a contract without realizing its content. If we accept that the court would not change its majority view, regulators should further focus on warning customers on the consequences of failing to comprehend a contract before signing it. This is a step further than requiring a bank to explain a product or to provide a list of warnings to a customer. This may strengthen the court's majority view to give effect of a customer's signature without courts radically changing the position.

Second, the new requirement that banks must record all conversions during the sales process<sup>137</sup> may help prospective plaintiffs to overcome evidential disadvantage. However, there

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<sup>132</sup> Financial Consumer Protection Act art. 8, L. & Reg. DB (Taiwan).

<sup>133</sup> Financial Consumer Protection Act art. 10, L. & Reg. DB (Taiwan).

<sup>134</sup> Regulations Governing Offshore Structured Products art. 22, L. & Reg. DB (Taiwan).

<sup>135</sup> Financial Consumer Protection Act art. 11, L. & Reg. DB (Taiwan).

<sup>136</sup> For a discussion of the doctrine of *caveat emptor* in the context of financial investment, see generally Catarina Sandeberg, *From Caveat Emptor to Caveat Venditor – The Winding Road to Prospective Liability in Scandinavian Countries*, 2003 JOURNAL OF BUSINESS LAW 91 (2003); Peter Muchlinski, "Caveat Investor?" *The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard*, 55(3) INT. COMP. LAW Q. 527 (2006).

<sup>137</sup> Regulations Governing Offshore Structured Products art. 22, L. & Reg. DB (Taiwan).

are other potential issues regarding recording. It is one thing to force banks to disclose certain information; it is another how a bank would comply with the requirement. For example, bank staff could read the warnings as quickly as possible as experienced in many long-distance telephone sales. This practice might not help customers to understand a product, but it could help a bank to comply with a rule to warn customers of risk. In contrast, if a bank has to show that it could explain every item in details until the point of where a customer understands, this falls into the trap of the minority view that we discuss earlier. Where to draw a fine line between proper compliance with inappropriate conduct should be elaborated by regulators in the future.

Third, should we regulate the use of disclaimer or waivers? So far Taiwan law has not directly regulated the terms of a financial instrument. Some investors attempted to rely on the Consumer Protection Act to avoid unfair terms.<sup>138</sup> However, the argument has been dismissed by courts as the court held that the Consumer Protection Act did not intend to cover financial transactions when it is made in 1994.<sup>139</sup>

The FCPA addresses the issue by providing that “[c]ontractual provisions entered into by a financial services enterprise and a financial consumer that are clearly unfair shall be invalid.”<sup>140</sup> However, it remains unclear when a term would be defined as unfair. It worth noting that in none of the 310 structured note lawsuits we have surveyed investors challenged the fairness of an exclusion clause or non-reliance clause. Thus, structured note lawsuits have not provided us with more guidance. This is an area that worth monitoring in the future when there are more cases challenging the fairness of a term of a financial instrument.

Last, will the new statutory cause of action in the FCPA make it easier for investors to sue for damages? The FCPA provides that “[a] financial services enterprise which, by violating any provision in either of the two preceding articles, causes harm to a financial consumer shall bear liability for damages”.<sup>141</sup> However, a firm is not liable “if the financial services enterprise can prove that occurrence of the harm was not due to: its failure to fully understand the

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<sup>138</sup> Consumer Protection Law art. 12, L. & Reg. DB (Taiwan).

<sup>139</sup> According to the interpretation of the Consumer Protection Committee, the Consumer Protection Law does not intend to regulate financial investment. This opinion has been relied upon by Taiwan courts. See e.g. Cui Xu Wei v. Taishin Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 100 Shan No. 335, Aug. 10, 2011); Chen Shun Qing v. Bank SinoPac, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 100 Gin-Shan No. 13, Apr. 3, 2012).

<sup>140</sup> Financial Consumer Protection Act art. 7, L. & Reg. DB (Taiwan).

<sup>141</sup> Financial Consumer Protection Act art. 11, L. & Reg. DB (Taiwan).

suitability of a product or service to the financial consumer; its failure to provide an explanation, or provision of an explanation that was untrue or incorrect; or its failure to fully disclose risks.”<sup>142</sup>

On the fact of it, the new cause of action seems to have shifted the burden of proof from the plaintiff investor to a bank by providing that a bank is exonerated from liability only when it can prove that a customer’s losses are not caused by the bank’s breach of the FCPA. However, it is unclear whether a customer still has to show that the bank breaches the provisions in the FCPA (at least on the fact of it) in order to trigger the statutory cause of action.

In addition, causation is still a contentious issue. As shown in many structured note lawsuits, many Taiwan courts held that losses caused by the collapse of Lehman was not a bank’s fault and therefore there was no causation between investment losses subsequent to such a significant market event and a bank’s breach of duties (if any).<sup>143</sup> However, the FCPA has not clearly addressed this problem. In fact, were the FCPA to be applicable to structured note lawsuits, banks might have successfully argued that investors’ losses would have not been caused by the bank’s failure to disclose product information (if proved). In this situation, the collapse of Lehman was more like a *force majeure* event. It remains to be seen how Taiwan court will interpret the statute in the future.

In sum, this article argues that Taiwan’s regulator rightfully tries to strengthen product disclosure to retail investors. This corresponds to the large number of lawsuits raising product disclosure arguments. However, apart from general disclosure of product information and risk warnings, regulators should further strengthen the need to warn a customer of the consequence of his signature on a contractual document in order to respond to courts’ position. Moreover, it remains unclear how the FCPA would apply to exclusion clauses, warranties or non-reliance clauses in a contract. The new requirement to record sales process and the creation of a new cause of action may help investors to sue for damages and to overcome evidential disadvantage. However, regulators should continue to define the best practice that a bank should follow when conversing with a customer. In general, this article agrees that a special cause of action should

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<sup>142</sup> *Ibid.*

<sup>143</sup> E.g. Zhou Xiu Lan v. Taishin Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 100 Shan No. 205, Apr. 12, 2011); Chen Guang Chuan v. First Commercial Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 100 Shan-Geng(1) No. 53, Nov. 29, 2011); Wang Qiu Yue v. JihSun Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 100 Gin-Shan-Yi No. 7, Jan. 3, 2012).

help investors, but until courts clarify their position, it is not a panacea to investors' woes to sue a misselling bank.

## **D. Suitability Issue**

### **1. General Overview**

After the structured notes fiasco, the issue of an investor's suitability of making complex financial investments rose to the fore. The purpose of know-your-customer and suitability assessment is to ensure that customers are less likely to purchase an investment product that is not available to them. From the 310 structured note lawsuits, more than a third of cases involved disputes about the suitability issue.<sup>144</sup> The most common argument was that the structured note sold was too risky for a customer's risk appetite so that the product was not suitable. Among the 122 lawsuits that raised the suitability issue, plaintiffs in 72 cases specifically argued that banks failed to conduct know-your-customer process and in 74 cases plaintiffs argued that the products were unsuitable for them.

The "Regulations Governing Offshore Structured Products," issued in October 2010, require a bank to examine a retail investor's age, knowledge, investment experiences, financial situation and purpose of transaction to determine his risk profile before promoting a structured product.<sup>145</sup> Article 9 of the Financial Consumer Protection Act (FCPA), issued in 2011, further codifies the rule requiring a bank to "fully understand the information pertaining to the financial consumer in order to ascertain the suitability of those products or services to the financial consumer."<sup>146</sup> In particular, a firm must first know a customer's background and then evaluate a customer's financial condition, professional ability, risk appetite, and the suitability of a product or service.<sup>147</sup> These rules were developed during the period when the structured notes lawsuits emerged.

Like the product disclosure issue, the suitability issue is related to a bank's duty before a contract is made. In all but one case, plaintiffs sued for damages when they raised the suitability

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<sup>144</sup> See *supra* Part IV.A.

<sup>145</sup> Regulations Governing Offshore Structured Products art. 22, L. & Reg. DB (Taiwan).

<sup>146</sup> Financial Consumer Protection Act art. 9, L. & Reg. DB (Taiwan).

<sup>147</sup> Regulations Governing Offshore Structured Products art. 22, L. & Reg. DB (Taiwan).

argument.<sup>148</sup> The most popular causes of action are contractual duty of care (144 of 122 cases), tort (91 cases), and breach of contract (64 cases). However, whatever causes of action or litigation strategy a plaintiff chose, the suitability argument was rarely accepted Taiwan courts. Only in 5 cases courts accepted a plaintiff's suitability arguments.

Then, we must wonder why Taiwan courts seemed to be reluctant to hold that a bank breached its duty of care to a customer with regard to know-your-customer and suitability assessment. In the next two sections, we will first analyze investors' personal background illustrated in the structured notes judgments in order to have a clearer idea why courts did not award remedies on the ground of suitability. Then, we will identify shortcomings of the suitability doctrine under Taiwan law and consider whether product intervention is necessary to protect financial consumers from unsuitable products.

## **2. Investors' Personal Traits**

Were Taiwan courts more willing to hold in favor of a plaintiff if he is older, has less education, has less investment experience, or has less risk appetite? Those are personal traits that are targeted by regulators to be more susceptible to misselling and unsuitable products. While there is no empirical study in Taiwan to paint a picture of the background of structured note investors, structured note lawsuits may shed us some light.

### **a. Data Collection Problem**

However, it is difficult to acquire enough personal information from structured note judgments. On the one hand, many judgments did not specifically mention the investor's personal background. For example, in only 61 of the 310 lawsuits the courts specifically indicated the plaintiffs' education background. In other cases, we have no means to know if it was not been raised or argued by either party. This greatly limits our ability to conduct further analysis.

On the other hand, even if courts identify relevant information, sometimes it is still difficult to conduct a comprehensive analysis. For example, banks do not always classify clients or products in exactly the same way. One bank may classify customers into six categories and

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<sup>148</sup> C. v. Kaohsiung Bank, Sifayuan Faxue Ziliao (Kaohsiung Dist. Ct. Judgment 99 Hsiung-Jian No. 488, Jul. 23, 2010).

another might do it with only three.<sup>149</sup> As there is no uniform rule on how a bank should classify a customer and as banks do not publish their classification methodology, it is difficult for us to conduct a complete analysis. The difficulty gets worse when courts use descriptive words (e.g., conservative, growth, active, etc.) rather than a numerical system (e.g., from one to five, or one to six) to indicate the risk profile of a customer or a product. Given these difficulties, we will attempt to highlight some issues based on limited personal information extracted from the structured notes judgments.

## **b. Age**

First, is an older or minor investor more likely to win with regard to a structured notes lawsuit? The hypothesis is that an older investor should have retired or is close to retirement so that his investment goal should be preserving his assets rather than using his savings for more speculative purposes. Hence, speculative products should not be suitable for elder people. Also, minors can be presumed to be insufficiently educated, and perhaps incapable of investing in complex structured products. The Bankers Association also considered it a problem if an investor makes a first-time purchase of structured note when he was over 70 year-old.<sup>150</sup>

However, in only 32 of the 310 structured note lawsuits judges clearly mentioned the exact age or age group of the plaintiffs at the time they made their investment. Among these cases, 14 (43.75%) involved investors who were more than 70 years old at the time of investment. Another 9 cases (28.12%) involved investors older than 60 but under 70. In 8 cases the investors were middle-aged (between 30 and 60) and in only 1 case was an investor described as under 20 years old (and he was a minor).<sup>151</sup> As an elder investor might have some incentive to make his age known to support his suitability arguments, the sample data we collect might not represent the true distribution of plaintiffs' age of all 310 lawsuits.

Given the sampling bias, we find no statistically significant relationship between the age group and the final result of litigation by logistic regression ( $chi2 = 1.62, p = 0.20$ ). In fact, in

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<sup>149</sup> E.g. Taishin Bank classifies customers by a numerical system from 1 (the most conservative) to 6 (the most active). See e.g. Lin Hui Juan v. Taishin Bank, Sifayuan Faxue Ziliao (Tainan Dist. Ct. Judgment 100 Gin No. 2, Dec. 30, 2011).

<sup>150</sup> See the website of Banking Bureau:

<http://www.banking.gov.tw/ch/home.jsp?id=316&websiteslink=artwebsite.jsp&parentpath=0,5,315>.

<sup>151</sup> In this article, we code the age of these investors by age group, with those under 20 coded as "1," those between 20 and 29 as "2," and so on, until those older than 70 are coded as "7."

none of the 32 cases containing age information plaintiff won in the end. Thus, being old did not necessarily help to win a lawsuit with regard to structured note disputes. It worth mentioning that in the only case that involved a minor, the investment was actually made by his parent (though it was booked under his own name). The District Court judge held in favor of the minor/investor due to lack of capacity and authority, but this ruling was overturned by the Taiwan High Court (affirmed by the Supreme Court).<sup>152</sup> The final result seems to be sensible. Although the investment was made under the name of the minor, the money and the decision effectively came from his parent, who had full capacity and authority to make the investment. Nonetheless, this case is the sole case involving a minor so that we should not generalize court's rulings.

### **c. Education**

Second, did investors' education background influence the outcome of structured notes lawsuits? The hypothesis is that a well-educated investor should have more knowledge to make a sound financial judgment, and therefore misselling is less likely to occur. In contrast, less educated investors might lack sufficient financial literacy to protect themselves, making them more likely to be victims of misselling. The Bankers Association also considered it a problem if an investor's education level was junior high school (or lower) and he had no experience in the stock market.<sup>153</sup>

In only 61 of the 310 structured notes lawsuits courts clearly mentioned the highest education that the plaintiffs had received at the time of investment.<sup>154</sup> Among those cases, plaintiffs in 15 (24.59%) had received only elementary school education (up to about 12 years old), 6 (9.84%) had taken junior high school (up to about 15 years old), and 8 had senior high school education (up to about 18 years old). In the other 32 cases, the investors had received higher education, including 23 (37.70%) having bachelor's degrees, 6 (9.84%) with master's degrees and 3 (4.92%) with doctoral degrees.

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<sup>152</sup> A v. China Trust, Sifayuan Faxue Ziliao (Kaohsiung Dist. Ct. Judgment 98 Su No. 2113, Apr. 30, 2010), reversed by China Trust v. A Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 99 Shan No. 131, Jan. 11, 2011) and Chen Yian Han v. China Trust, Sifayuan Faxue Ziliao (Supreme Ct. Judgment 100 Tai-Shan No. 1029, Jun. 30, 2011).

<sup>153</sup> See *supra* note 150.

<sup>154</sup> For simplicity, if there is more than one plaintiff in one lawsuit, we would use the highest education of one of the plaintiffs as the benchmark.

By applying logistic regression analysis, we find no statistically significant relationship between receiving more education and winning a structured note lawsuit ( $\chi^2 = 0.38, p = 0.54$ ). If we treat those receiving higher education (from bachelor's degree to Ph.D.) as one group, we still find no statistically significant relationship between having higher education and winning a lawsuit (Fisher's exact = 0.74), or *vice versa*. In fact, out of the 61 cases that recorded education information, courts accepted the suitability argument in only 2 cases. Therefore, based on the limited information, Taiwan courts have not shown much sympathy for those who are less educated. Again, we should note that our sample size is limited and we should not exaggerate our findings.

#### **d. Investment Experiences**

Third, is a less experienced investor more likely to win in court if he suffers losses from structured notes? One rationale is that structured products are less likely to be suitable for inexperienced investors, because they might not understand the product or the financial market that well. Therefore, the likelihood of misselling could be higher if an investor lacks relevant investment experience. We might expect that a customer should be more likely to win a case under this circumstance. In contrast, we might presume that an experienced investor has adequate knowledge of a particular product and how it operates. Hence, it is less likely that an experienced investor would be able to excuse his own failure in reading contractual documents or assessing risks.

In the 310 structured note disputes, Taiwan courts specifically mentioned plaintiffs' prior investment experiences in only 112 cases.<sup>155</sup> More particularly, in 92 cases it was clear that the investor had purchased structured notes beforehand. In 49 cases, the plaintiffs had other investment experiences with mutual funds. In 8 cases the investors clearly had exposure to investment in the stock market, and in 3 cases the plaintiffs had tried investment-linked insurance policies before. However, in other cases we have no means to know whether an investor had any prior investment experiences, leading to many missing values. Since we do not possess sufficient information about whether a plaintiff truly lacked investment experience before purchasing structured notes, it is inappropriate to analyze the level of association between

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<sup>155</sup> If it is not clear from related judgments whether an investor has any prior investment experience, we treat it as a missing value and do not include it for analysis.

an investor's other investment experiences and the final result of structured note lawsuits. A simpler approach is to look at the overall odds of winning as shown in the table below:

**Table 6 Odds of winning and prior investment experiences**

<b>Situation</b>	<b>Total number of cases</b>	<b>Cases in which plaintiffs won by the end of 2012</b>	<b>Chance of winning in each category</b>
Overall	310	52	16.77%
Cases in which it is clear that a plaintiff had experience with structured notes	92	16	17.39%
Cases in which it is clear that a plaintiff had a variety of investment experiences (including structured notes, mutual funds, stocks and investment-linked policies)	112	16	14.29%

From the table above, we can see that the chance of winning does not vary greatly even if a plaintiff has invested in structured notes beforehand. This article suggests that it is not appropriate to exaggerate such a small difference. We will offer more reflections on the consideration of an investor's prior investment experiences later.

#### **e. Risk Profile and Risk Rating**

Fourth, two other important factors concerning the suitability assessment obligation are the method of profiling a customer's risk appetite and the method of risk rating for a product. Due to the difficulty of finding comparable information, we only have limited data available for coding and analysis. However, some clues may be found from two angles: customer risk profiles and the risk ratings of structured note products.

For analysis of customer risk rating, this article codes the profiles into three main categories based on common market perceptions: conservative, intermediate and active. For all court judgments in which the customer's risk rating description or numerical designation is not clearly indicated, that case is treated as a missing value. For product risk rating, this article

counts on the popular “risk return” (RR) classification of financial products that is commonly used by banks in Taiwan.<sup>156</sup> The RR classification system categorizes financial products into five categories from RR1 (lowest risk) to RR5 (highest risk).

In general, we find that in 90 (of 310) disputes, the investor’s risk profile was clearly indicated, including 62 (68.89%) falling within the “active investor” category, 16 (17.78%) in the intermediate category, and 12 (13.33%) in the conservative category. With regard to the products’ risk ratings, far less information is available. Among the 310 disputes, we can find usable information in only 39 cases, including 5 cases (20.51%) involving a product labeled as RR4, 19 (48.72%) labeled RR3, 5 (12.82%) labeled RR2, and 7 (17.75%) labeled as RR1.

What can we learn from these limited data? Assuming that the information we collect can represent the distribution of the whole population, it seems that there are far more “active investors” than intermediate or conservative investors combined (see the table below). However, the general position adopted by Taiwan court is that only low risk products should be promoted to conservative investors, and that an active investor should be allowed to buy all sorts of financial products.<sup>157</sup> Thus, an active investor should be less likely to succeed in arguing that an unsuitable product was sold to him, because he is supposed to be able to invest in even the riskiest product.

This expectation is validated by comparing final litigation results and the risk profiles of plaintiffs, as is shown in the table below:

**Table 7 Customers’ Risk Profile and Outcome of Lawsuits**

	Total cases	Plaintiff won (%)	Number of cases where courts accepted suitability argument
Conservative investors	12	4 (33.33%)	1
Intermediate investors	16	3 (18.75%)	0
Active investors	62	3 (4.84%)	1
Total	90	10 (11.11%)	2

<sup>156</sup> The system was developed by the Taiwan Banker’s Association. Using this system, we could trace the RR label given to a structured note product if it was clearly mentioned in the judgment. If the risk coding is not clear, then that case is treated as a missing value. See the general description by the Bank of Taiwan, [http://fund.bot.com.tw/z/glossary/glexp\\_5327.djhtm](http://fund.bot.com.tw/z/glossary/glexp_5327.djhtm).

<sup>157</sup> Chen, *supra* note 127, at 197 and note 166.

From the table above, we can see that the winning rate for active investors was far lower than for the other two categories, while the chance of winning for a conservative investor was considerably higher. There is a statistically significant relationship between a customer's risk profile and the final result of litigation (Fisher's exact = 0.007). Thus, it seems that conservative investors seem to be more likely to win a misselling lawsuit among our limited samples. However, we must also note that the suitability argument was still rarely accepted by courts so that the classification of a customer might not be the main factor affecting a judge's decision.

#### **f. Compound Effect**

Last, is there any compound effect discernible in the results of the structured notes lawsuits if we combine the customers' different personal characteristics? The answer to this question could be interesting, but there are very few judgments that give enough information on the various variables we use. For example, if we cross-reference age groups and customer risk profiles, we find sufficient information in only 13 of all 310 cases. There is no single case that gives all of the necessary information about a plaintiff's age group, educational background, earlier investment experiences and risk profile. Therefore, unfortunately, there is currently no meaningful way to analyze these plaintiffs' personal traits and their compound effects on the results of their litigation, unless we can further survey these plaintiffs.

### **3. Reflection on Suitability Issue**

What can we learn from the limited data shown in the previous section? While it makes sense for Taiwan's regulator to strengthen a bank's know-your-customer practice and assessment of suitability, structured note lawsuits offer some points for regulators to think about in the future.

First, how far should the court consider prior investment experiences when dealing with structured note lawsuits? In particular, how far could prior investment experiences other than in structured notes be transferred to the consideration of an investor's suitability for a structured investment product? Some judgments seemed to suggest that a customer's non-structured note experiences should be counted as his investment experiences without further explanation.<sup>158</sup> Given that mutual funds are widely popular investment vehicles in Taiwan and that the

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<sup>158</sup> See e.g. *A v. Far East Bank, Sifayuan Faxue Ziliao* (Taichung Dist. Ct., Sep. 30, 2009). See also Chen, *supra* note 127, at 195-196.

individual investors' participation in the local stock market is quite high,<sup>159</sup> it should not be difficult to find a structured note investor having some experiences investing in mutual funds or stocks.

To a certain extent, courts' position is sensible, as we should not ignore an investor's other investment experiences being part of his personal background. However, due to the different structure of off-shore structured notes, knowledge or experiences of investing in stocks or mutual funds may not be transferred to an investment in structured notes. As Taiwan law forbids offshore structured notes to refer to a local stock market,<sup>160</sup> it is much less likely that an ordinary investor in Taiwan would understand the underlying reference assets of a structured note if they are foreign equities or indices. Therefore, the purpose of requiring suitability assessment may be undermined if non-structured note experience can be taken into account without further qualification when conducting a suitability assessment.

In short, an investor's prior investment experience is an important benchmark to evaluate his ability to understand an investment and his suitability to a particular product. However, the real question is not only "whether a customer has some investment experiences", but also "how his prior investment experiences would affect the current investment decision". Unfortunately, Taiwan's regulator has not produced any specific rule concerning how a bank should consider an investor's prior investment experiences. The figures shown above might indicate that investors would be in a weak position if they already have experience investing in the local stock market, although they may not possess knowledge about offshore structured notes. From this light, the financial regulator should conduct further study to examine the effect of prior investment experience on the ability of an investor to make a proper decision in order to further substantiate the duty to conduct suitability assessment.

Second, another lesson is that Taiwan courts' analyses heavily focus on "risk".<sup>161</sup> The courts' logic is pretty simple: a product is not unsuitable if a customer's risk appetite is equal to

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<sup>159</sup> According to the Taiwan Stock Exchange, in the year of 2012, domestic natural individuals in Taiwan accounted for 30.72% of all purchase and 31.32% of all sales of shares traded in the stock exchange. Together, domestic individual investors accounted for over 60% of the annual turnover. See Taiwan Stock Exchange, Securities Trading Values by Type of Investors (year of 2012),

[http://www.twse.com.tw/en/statistics/statistics\\_list.php?tm=07&stm=031](http://www.twse.com.tw/en/statistics/statistics_list.php?tm=07&stm=031).

<sup>160</sup> Regulations Governing Offshore Structured Products art. 17(3), L. & Reg. DB (Taiwan).

<sup>161</sup> Stephen B. Cohen, *The Suitability Rule and Economic Theory*, 80 Yale L.J. 1604, at 1606 (1971).

or higher than the risk rating of the product he invests in.<sup>162</sup> This approach is certainly simple to apply, but in the end it might destroy the purpose of conducting suitability assessments before the sale of complex financial products.

On the one hand, it is probably easier to be classified as an “active investor” than a “conservative investor.” In fact, if an investor answers some questions in a more generous manner (e.g., the highest amount that he may accept as a loss, or his prior investment experiences), he may unconsciously increase the likelihood to be classified as an active investor, leaving him less likely to be a victim of misselling. If this is a common problem, then the suitability exercise may be not much more than a formality.

On the other hand, from the data described above, we also find that there was no single structured note labeled as RR5, and most products fell within the range of RR3 to RR4. This is contradictory to the public perception that structured notes are riskier than conventional investment vehicle. It means that even for intermediate investors, the chance of winning a lawsuit by raising the suitability argument was greatly limited, because investors were more likely buying a structured note that was not riskier than their risk profile. Nonetheless, we should be cautious in making a more general inference, as we only have limited data so far.

A further issue is what kind of investment products is suitable for a conservative or intermediate investor. If we follow the courts’ logic of matching a customer’s risk appetite with a product’s risk classification, it remains unclear whether a product with a RR3 label would be suitable for a conservative investor (or a RR4 product for an intermediate investor). This article argues that matching the risk profile of a product with the risk appetite of a customer is an important benchmark, but this should not be the only standard to determine the suitability of a complex financial product.

The fundamental problem is that the riskiness of a product and a customer’s risk appetite are measured by different factors. The former involves analysis of the underlying risks of a product, while the latter should take into account a customer’s financial condition, tolerance of risk, investment history and past investment experiences. The purpose of requiring a bank to consider a customer’s investment objective, knowledge and income, etc. may be lost if courts,

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<sup>162</sup> *Supra* note 157.

regulators and banks only focus on the simple label attached to a customer and the label given to the product he invests in.

From this light, regulators should conduct a survey of how a bank could classify a customer and factors that could affect a customer's suitability. This requires studies not only from finance sphere but also economics and psychology in order to understand more about a customer's mental state when making an investment decision. This should further help us to elaborate the suitability rule and to address problems we have seen from structured note judgments.

Third, similar to the product disclosure issue, one problem with the suitability issue is that an investor often has signed on a document confirming that the know-your-customer process has been complete or that he was aware of the fact that the risk profile of a product was higher than his risk appetite.<sup>163</sup> If the signature is authentic, the majority of courts would no longer inquire whether the know-your-customer or suitability assessment exercise has been properly conducted. This is similar to the doctrine of *estoppel*,<sup>164</sup> though Taiwan courts did not clearly use the term. As we have discussed earlier, this article agrees the majority position taken by Taiwan courts.<sup>165</sup> However, regulators should further require banks to specifically warn customers of the legal consequences of his signature on a contract to avoid banks exploiting this hole.

#### **4. The Necessity of Product Intervention?**

Given that the suitability of financial product is a major issue in structured note lawsuits and courts were reluctant to award remedies to a customer for a breach of the suitability rule, we might wonder whether the law should intervene more to protect investors from unsuitable financial products.

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<sup>163</sup> See e.g. *B v. Fubon Commercial Bank, Sifayuan Faxue Ziliao* (Taiwan High Ct. Judgment 98 Shan-Yi No. 2012, Aug. 24, 2010).

<sup>164</sup> In the UK, courts have developed the concept of contractual estoppels. See *Peekay Intermark Ltd. v. Australia and New Zealand Banking Group Ltd.* [2006] 2 Lloyd's Rep. 511 (C.A.); *Raiffeisen Zentralbank Osterreich A.G. v. The Royal Bank of Scotland Plc* [2010] EWHC 1392 (Comm. Ct.); *Springwell Navigation Corp. v. JP Morgan Chase Bank* [2010] EWCA Civ 1221. This doctrine has been adopted in both Hong Kong. See *DBS Bank (Hong Kong) Ltd. v. San Hot HK Industrial Co. Ltd.* [2013] H.K.C.F.I. 387 (C.F.I.).

<sup>165</sup> See *supra* Part IV.C.3.

The idea comes from a perception that retail investors are more akin to end-users of a product rather than simply investors.<sup>166</sup> Thus, some suggest that a “[c]onsumer is treated as incapable of informed consent to risk” and the “public sector intervenes paternalistically in the interests of fairness”.<sup>167</sup> In addition, it has been suggested that the complexity of many financial products poses substantial challenges to consumers, especially “in countries where financial literacy is low and where households have not gained long-term experience with making financial decisions.”<sup>168</sup> Therefore, it is arguable that financial consumers must be protected from other parties or even themselves.<sup>169</sup>

This gives rise to the idea of “product intervention”.<sup>170</sup> UK’s financial regulator recognizes that “product design and decisions made by product designers about how – and to whom – products will be distributed play a significant role in determining consumer outcomes.”<sup>171</sup> Thus, a focus on “these parts of the value chain [of a financial product] is necessary for consumer protection and as a means of stopping problems before they gain traction.”<sup>172</sup> Given that Taiwan courts rarely award remedies on the ground of suitability, one might suggest that further product intervention should be necessary to protect financial consumers from toxic financial products.

In Taiwan, one of the regulatory responses to the structured note saga is to require a self-regulator to review an issue of structured note before a bank can sell the product.<sup>173</sup> Regulators also reserve the power to ban a product if it may endanger the market.<sup>174</sup> To help a self-regulatory body, regulators published a guideline in 2010 to assist self-regulatory bodies to

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<sup>166</sup> Niamh Moloney, *The Investor Model Underlying the EU’s Investor Protection Regime: Consumers or Investors*, 13 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 169, at 173-174 (2012).

<sup>167</sup> Joanna Benjamin, *The Narratives of Financial Law*, 30 O.J.L.S. 787, at 799 (2010).

<sup>168</sup> Roman Inderst, *Retail Finance: Thoughts on Reshaping Regulation and Consumer Protection after the Financial Crisis*, 10 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 455, at 460 (2009).

<sup>169</sup> *Ibid.*, at 459-460.

<sup>170</sup> Moloney, *supra* note 166, at 181.

<sup>171</sup> FINANCIAL SERVICES AUTHORITY, PRODUCT INTERVENTION: FEEDBACK ON DP11/1, 2011, FS11/3, at para. 1.13 (U.K.).

<sup>172</sup> *Ibid.*, para. 1.14.

<sup>173</sup> Regulations Governing Offshore Structured Product art. 18-19, L. & Reg. DB (Taiwan).

<sup>174</sup> Regulations Governing Offshore Structured Product art 19(3), L. & Reg. DB (Taiwan)

review structured products.<sup>175</sup> The new regime for structured products follows a similar regime for offshore investment funds.<sup>176</sup>

The new prior review regime has some advantage. First, the approach is similar to find somebody to be a gatekeeper to filter and prevent unsuitable structured products from entering into the market. Second, the new regime has the benefit of having a credible third party institution reviewing a financial product without having the government's direct involvement. This may prevent the general public from having the impression that a certain financial product has the government's backing to be 'safe'. Third, by delegating the responsibility to a self-regulatory body, the financial regulator could still control the product intervention regime by monitoring the self-regulatory body that is responsible for product review.

However, the new regime also has some considerable problems. First, it is unclear how a self-regulatory body would review a structured product. By assigning the responsibility to a self-regulatory body, regulators seem to expect that the institution could review the merit of a product. However, it is doubtful whether the members of a review committee, who are normally scholars or professionals, will have sufficient understanding of the market and the product, including its pricing models and underlying assumptions, to conduct a meaningful review.

Though regulators have issued a guideline, it mainly deals with the formation of the review committee and certain procedural issues (e.g., the appeals process and costs).<sup>177</sup> Other key points in the guideline include the form of documentation,<sup>178</sup> the eligibility of the applicant<sup>179</sup> and information that should be disclosed (such as financial statements, reference prices and material changes in credit ratings).<sup>180</sup> There is no doubt that the self-regulatory body must review the risk level of a structured product.<sup>181</sup> The self-regulatory body could reject a product if it is too risky.<sup>182</sup> However, it is still unclear how it will review the risk level of a product. Without more concrete standards, it is hard to predict the effect of the prior review

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<sup>175</sup> Regulations of Review and Management of Offshore Structured Products (境外結構型商品審查及管理規範) art. 8 to 16, and 18-20, <http://www.rootlaw.com.tw> (Rootlaw 植根法律網, Chinese only) (Rootlaw)) (Taiwan).

<sup>176</sup> Regulations Governing Offshore Funds art.27, L. & Reg. DB (Taiwan).

<sup>177</sup> *Supra* note 175.

<sup>178</sup> *Supra* note 175, art 4 to 5, 17.

<sup>179</sup> *Supra* note 175, art 17.

<sup>180</sup> *Supra* note 175, art 6 to 7, 17.

<sup>181</sup> *Supra* note 175, art 17.

<sup>182</sup> *Ibid.*

regime. It may stifle financial innovation if a review committee is hostile toward a product that they do not understand well. In contrast, the product intervention regime may become not much more than a formality if they look no further than the form of product documentation. This represents a dilemma facing Taiwan’s prior review regime.

Moreover, it is also not clear about the responsibility that a self-regulatory body or committee members would assume. If they will be found liable for the failure of a product that they have reviewed, then it is foreseeable that self-regulatory bodies will have significant difficulty in finding suitable persons to conduct a meaningful review. In contrast, if there is no liability, there is very little control of the quality of a product review. This may undermine the overall effectiveness of Taiwan’s approach.

In sum, Taiwan law has adopted a certain form of product intervention by requiring a self-regulatory body to review a structured note before it is sold to investors. However, the regime has some defects that have to be clarified to make it more effectiveness in the future.

## E. Post-sale Issue

Overall, more than half of the structure note lawsuits involved issues regarding a breach of duties after a contract was made. Post-sale handling of a financial product may also raise important consumer protection concerns.<sup>183</sup> Details are shown in the table below:

**Table 8 Types of post-sale argument**

<b>Disputes</b>	<b>Total number (% of all cases with post-sale arguments)</b>	<b>Total number post-sale arguments accepted by courts</b>
1. Regarding redemption of notes (including notice, advice, handling of redemption, etc)	23 (14.38%)	4
2. Regarding margin call	1 (0.62%)	0
3. Regarding the handling of Lehman’s collapse	3 (1.88%)	0
4. Regarding notification of change of risk or reporting of trust asset	130 (81.25%)	11
5. Regarding conversion of investment	2 (1.25%)	0
6. Regarding settlement	1 (0.62%)	0
<b>Total</b>	<b>160</b>	<b>15</b>

<sup>183</sup> FINANCIAL SERVICES AUTHORITY, PRODUCT INTERVENTION, 2011, DP11/1, at 19 (Figure 2)(U.K.).

To support the post-sale argument, plaintiffs commonly relied on tort or contractual duty of care<sup>184</sup> to claim compensation.<sup>185</sup> It is apparent that courts rarely accept post-sale arguments. From the table above, most of post-sale issues concentrate on two main categories: redemption of notes and notification of change of risk. With regard to redemption of notes, the key legal issue is about the duty of a bank to advise a customer whether to redeem the notes when the market is down. There is no doubt that a bank should be responsible for its advice that it has offered to a customer. However, it is arguable a bank owes a duty to provide advice to a customer with regard to redemption if the contract does not provide such a duty.

This article argues that any duty imposed on a bank to advise its customer regarding redemption of structured notes should be clarified in contract rather than created by courts. Without specific contractual arrangement or regulatory rule, it is not prudent for courts to oblige a bank to provide advisory services based on a bank's duty of care in tort law or trust law. On the one hand, the provision of advisory services implies a bank assuming some risks. If courts widen a bank's post-sale duty from hindsight, it might create great legal uncertainties. On the other hand, any advice regarding redemption should be carefully considered and given. In fact, some investors may be better off by waiting for the financial crisis to be over rather than rushing to cash out their investment when the market plummets. Thus, forcing banks to offer advice to customers may be very risky for both banks and customers. Thus, this article suggests it is better to rely on contract to sort out a bank's duty to advise a customer; but regulators could regulate those advisory services with direct regulation or via a self-regulatory body (e.g. the Trust Association or Bankers Association).

Second, with regard to notification of change of risk, the key issue is whether a bank should have notified a customer immediately when Lehman collapsed or whether it is sufficient for a bank to notify a customer by periodical bank statement (or updating information via its website<sup>186</sup>). It is fairly likely that banks would be held liable if they failed to dispatch bank statements regular, as this is a statutory duty.<sup>187</sup> However, the majority of Taiwan courts took the

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<sup>184</sup> See *supra* Part.C.1.

<sup>185</sup> Out of the 160 cases with post-sale issues, plaintiffs relied on tort in 107 cases (66.88%) and contractual duty of care in 152 cases (95%).

<sup>186</sup> E.g. see the website of China Trust:

[https://www.chinatrust.com.tw/CTCBPortalWeb/toPage?id=TW\\_RB\\_CM\\_mfund\\_013001](https://www.chinatrust.com.tw/CTCBPortalWeb/toPage?id=TW_RB_CM_mfund_013001).

<sup>187</sup> Trust Law art. 31 and Trust Enterprise Act art. 19, L. & Reg. DB (Taiwan).

position that a bank's duty was fulfilled when it regularly sent out bank statement or updated its website.<sup>188</sup>

However, this article argues that the duty of a bank (as a trustee) should include a duty to inform customers of material change of risk in addition to regular bank statements. Thus, courts' majority position in this regard is unduly restrictive. As a trustee, a bank does receive reward for its services. Thus, a bank's obligation as a trustee should be more than merely sending out bank statements. Unlike mutual funds or stocks, structured notes are usually illiquid. The best source of information about a structured note comes from the selling bank. Moreover, the cost to send immediate notice should be reasonably low in the modern digital era. Thus, it is not an undue burden to require a bank to notify customers of a significant event as material as the collapse of Lehman.

Banks might argue that some information (e.g. collapse of Lehman) has been widely reported so that any reasonable investor should have known the information without a bank's notice. While this may be true, this article argues that an investor might not know the actual effect of a certain event (e.g. whether a certain event amounts to a default of notes or its impact on valuation). Banks should also be in a better position to understand and explain the terms of a structured note. Thus, it seems to be more efficient for a bank to notify a customer material change of risk.

However, it is intriguing to note that neither the Financial Consumer Protection Act in 2011 nor the Regulations Governing Offshore Structured Products in 2010 provides any rule regarding a bank's obligations after a contract is made other than a general duty to treat customers fairly.<sup>189</sup> The Trust Law or Trust Enterprise Act also does not add much clarity other than imposing a general duty of care on a trustee bank.<sup>190</sup>

Since courts have not shown much enthusiasm to substantiate a bank's duty as trustee by case law, regulators should pick up the lapse to further strengthen a bank's obligation to service a customer after sale of a financial product, in particular about redemption of an investment and

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<sup>188</sup> See e.g. C v. F Bank, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 98 Chong-Su No. 463, May 25, 2010); D v. Fubon Bank, Sifayuan Faxue Ziliao (Taipei Dist. Ct. Judgment 99 Su No. 2504, Oct. 6, 2010).

<sup>189</sup> Financial Consumer Protection Act art. 7, L. & Reg. DB (Taiwan).

<sup>190</sup> Trust Law art. 22 and Trust Enterprise Act art. 22, L. & Reg. DB (Taiwan).

prompt notification of material information. This is an area in which Taiwan law needs to be further reformed.

## **F. Sale Restriction Issue: Jurisdiction of Securities and Banking Regulation**

One specific argument in Taiwan is regarding the so-called sales restriction issue. Especially for those notes arranged by US-based banks, there is usually a clause in the prospectus specifying a restriction such as the following:

Taiwan Selling Restrictions: The Notes may not be sold or offered in the Republic of China (“R.O.C.”) and may only be offered and sold to R.O.C. resident investors from outside Taiwan in such manner as complies with Taiwan securities laws and regulations applicable to such cross border activities.<sup>191</sup>

This sales restriction provision was raised by plaintiff investors in 63 of the 310 structured note lawsuits. The purpose of the sales restriction seems to ensure that those offshore notes are not sold to American in order to circumvent U.S. securities regulations.<sup>192</sup> As there are quite a number of Taiwanese who have American passports, Green Cards or a U.S. connection, it is obvious that an American bank would have to prevent an issue of structured notes from being covered by US securities regulations to control the legal risk and compliance cost.

However, so far Taiwan courts have not accepted the sales restriction argument. In the 6 cases in which plaintiffs did win while raising this argument, courts based their decisions on other grounds. However, the sales restriction argument does raise an important issue that has been overlooked by regulators: the jurisdiction of securities regulation and banking regulation.

The main problem was that Taiwan courts did not treat an investment in offshore structured notes as an issue of securities in Taiwan. As mentioned above, it was the banks that were the nominal holders of the notes.<sup>193</sup> Thus, Taiwan courts commonly held that the sale of offshore structured notes via trust accounts did not amount to an issue of securities in Taiwan and thus there was no violation of the Securities and Exchange Act.<sup>194</sup> Most of the Taiwan

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<sup>191</sup> Taken from *B v. China Trust, Sifayuan Faxue Ziliao* (Taipei Dist. Ct. Judgment 99 Su No. 438, May 20, 2010).

<sup>192</sup> In particular, the sales restriction clause seems to be drafted in a way to help US banks to comply with Regulation S of the Securities and Exchange Commission, 17 C.F.R. 230.901.

<sup>193</sup> See *supra* Part II.B.

<sup>194</sup> See e.g. *Cheng Hong Zhi v. First Commercial Bank, Sifayuan Faxue Ziliao* (Taiwan High Ct. Judgment 101 Gin-Shan No. 14, Dec. 5, 2012); *Standard Chartered Bank v. Lai Deng Xian, Sifayuan Faxue Ziliao* (Taiwan High Ct.

courts conveniently decided that the sales restriction clause had not been breached, because the notes were sold to banks rather than individual investors. How these notes were repackaged in Taiwan was a different concern.<sup>195</sup> However, if we look at the substance, court's ruling in this regard is equal to saying that the domestic investors who paid the money for the notes were not "investors" in the sense of being noteholders.

Although not documented, bureaucracy may be the main reason behind why the securities regulator has turned a blind eye on the offer of structured notes via banks' trust department. The main financial regulator (i.e. the Financial Supervisory Commission) is in fact a combination of three main bureaus<sup>196</sup> before they merged into one in 2004.<sup>197</sup> While the fact that a foreign issuer raises funds by issuing structured notes to Taiwan banks<sup>198</sup> might indicate that the arrangement should be within the jurisdiction of the Securities and Futures Bureau (as the regulator of the capital market), the domestic side of the transaction (i.e. placing an investment via a non-discretionary trust via a trust account) belongs to the jurisdiction of the Banking Bureau. When the structured notes saga occurred, the Securities and Futures Bureau would be more than happy to push side their responsibility, while the Banking Bureau was put into a hot seat.

This article argues that Taiwan courts' ruling to avoid applying securities regulations to offshore structured notes might avoid legal uncertainties and might prevent from opening a floodgate for lawsuits. Had Taiwan courts treated structured notes investment as issuing securities in Taiwan, virtually all structured notes would have become illegal securities and it might have endangered some banks' capital adequacy. Given the magnitude of the structured note saga, this seems to be a sensible result.

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Judgment 100 Shan-Yi No. 1127, Jul. 31, 2012); Taishin Bank v. Lin Zhi Cen, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 100 Shan-Yi No. 880, Jun. 5, 2012).

<sup>195</sup> For example, Hua Yun Zhou v. China Trust, Sifayuan Faxue Ziliao (Taiwan High Ct. Judgment 98 Chong-Su No. 731, Jan. 31, 2011). See also Chen, *supra* note 158, 204-205.

<sup>196</sup> They are the Banking Bureau, Insurance Bureau and Securities and Futures Bureau, each regulating banking, insurance and securities sectors in Taiwan. See website of Financial Supervisory Commission: [http://www.fsc.gov.tw/en/home.jsp?id=50&parentpath=0,1&mcustomize=onemessage\\_view.jsp&dataserno=20956&aplistdn=ou=org,ou=one,ou=english,ou=ap\\_root,o=fsc,c=tw&toolsflag=Y](http://www.fsc.gov.tw/en/home.jsp?id=50&parentpath=0,1&mcustomize=onemessage_view.jsp&dataserno=20956&aplistdn=ou=org,ou=one,ou=english,ou=ap_root,o=fsc,c=tw&toolsflag=Y).

<sup>197</sup> See website of Financial Supervisory Commission: <http://www.fsc.gov.tw/ch/home.jsp?id=17&parentpath=0,1,11>.

<sup>198</sup> See *supra* Part II.B.

However, regulators should rethink its regulatory structure in the future, as Taiwan courts' majority position would have serious implications on regulatory policy. In the worst case, Taiwan courts' position and the bureaucracy may open the door for financing through a shadow banking system. This has been an apparent problem in China.<sup>199</sup> After all, foreign banks did tap in the savings account of local investors. If we compare with Hong Kong or Singapore, new financial consumer protection rules in those two countries fall within securities regulation.<sup>200</sup> This offers a light for Taiwan's regulator.

## V. Concluding Remarks

In conclusion, this article explores and analyzes 310 structured note lawsuits in Taiwan between 2000 and 2013. We find that the Taiwan courts were generally reluctant to hold for retail customers. New regulatory rules rightfully address some problems flowing from the structured note saga. However, there are some lessons that regulators in Taiwan or in other countries could learn from Taiwan's structured note lawsuits.

First, given that investors' low expected recovery rate from any dispute resolution channel (including the judicial system), regulators should consider other ways to ensure that banks have enough incentives to bargain with a foreign issuer to recover as much as possible for local investors. Setting up an alternative dispute resolution channel would not solve all the

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<sup>199</sup> See *supra* note 8.

<sup>200</sup> In Hong Kong, the Securities and Futures Ordinance has been amended to require all new unlisted structured products to be authorized by the securities regulator and a new Code on Unlisted Structured Investment Products has been published in 2010. See Securities and Futures (Amendment) Ordinance 2012, Ord. 9 of 2012, <http://www.gld.gov.hk/cgi-bin/gld/egazette/index.cgi?lang=e> (The Government of the Hong Kong Special Administrative Region Gazette (HONG KONG GAZ.)) (H.K.); Code of Unlisted Structured Investment Products, [http://en-rules.sfc.hk/en/display/display\\_main.html?rbid=3527&element\\_id=3465](http://en-rules.sfc.hk/en/display/display_main.html?rbid=3527&element_id=3465). In Singapore, the Securities and Futures Act and the Financial Advisers Act has been amended in 2012 to strengthen investor protection in addition to earlier rules published by the Monetary Authority of Singapore. See Securities and Futures (Amendment) Act 2012, No. 34 of 2012, <http://statutes.agc.gov.sg/aol/search/display/view.w3p?page=0;query=DocId%3A%22bf93d34a-1452-448d-9af6-3cc2b8595c49%22%20Status%3Apublished%20Depth%3A0%20TransactionTime%3A20140120000000;rec=0> (Singapore) and Financial Advisers (Amendment) Act 2012, No. 35 of 2012, <http://statutes.agc.gov.sg/aol/search/display/view.w3p?page=0;query=Id%3A12f23440-3bd1-42e5-bf16-75712b379cf6%20Depth%3A0%20Status%3Apublished%20Published%3A26%2F12%2F2012;rec=0;resUrl=http%3A%2F%2Fstatutes.agc.gov.sg%2Faol%2Fsearch%2Fsummary%2Fresults.w3p%3Bpage%3D0%3Bquery%3DId%253A12f23440-3bd1-42e5-bf16-75712b379cf6%2520Depth%253A0%2520Status%253Apublished%2520Published%253A26%252F12%252F2012> (Singapore).

problems. In addition, regulators should reconsider its regulatory structure to recognize that offshore structured notes were equal to offering securities in Taiwan.

Second, this article supports the courts' majority position in dealing with product disclosure, suitability and a customer's signature. On this basis, regulators should further require banks to ensure that customers have full awareness of the consequences of signing on a contract. A new statutory cause of action should help investors to sue for compensation. However, causation will remain an issue that has to be clarified.

Third, with regard to suitability, the approaches taken by courts and regulators overly emphasizes on matching the risk appetite of a customer to the risk profile of a product, while a more pressing issue is to substantiate the suitability assessment by clarifying how a bank could consider an investor's prior investment experiences and when a customer could be classify as an active investor.

Fourth, it is unfortunate that courts and regulators miss out the chance to substantiate a bank's duty *post* selling a financial product. This is an area where regulators and legislators should pick up from structured note judgments. Otherwise, an important piece has been missing from the picture of financial consumer protection.

In conclusion, it was unfortunate that many investors in Taiwan suffered from offshore structured notes. While Taiwan courts' majority position could be justified, those lawsuits offer us some light on the protection of financial investors. We hope that Taiwan regulators will pick up the pieces from our empirical survey and China, where the market for wealth management is booming, may also learn from the woes across the Taiwan Strait.