

The Normative Approach How to Financial Derivatives Transaction Innovation Reshapes Directors' Fiduciary Duties: From a Chinese Perspective*

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〈국문초록〉

글로벌 금융 혁신이 가속화됨에 따라 파생상품 거래가 지닌 고도의 레버리지 구조, 시장 간 연계성 그리고 복합적인 설계 방식은 중국 「회사법」 제180조에 규정된 이사의 신인의무 체계에 다차원적인 영향을 미치고 있다. 정태적인 규제 프레임워크는 거래 과정에서 발생하는 동태적 위험을 효과적으로 포섭하지 못한다. 이로 인해 이해상충의 다층화와 영역 간 규제 조정의 필요성이 증대되면서, 충실의무상 이해상충의 식별 기준 불명확성, 주의의무에 대한 전문적 판단 기준의 부재, 정보공시의 투명성 부족 등 제도적 한계가 노정되고 있다.

본 연구는 중국의 법제 환경과 금융시장 실무를 분석의 출발점으로 삼아, 위험 통제를 핵심으로 하고 이해관계자 보호를 우선시하며 규제 집행을 중심으로 논의를 전개한다. 특히 '위험 관련 의무'의 법적 핵심을 명확히 하고, 공법과 사법 간의 연계를 강화하며, 사법적 심사에 단계화된 판단 기준을 제시함으로써, (1) 신인의무와 금융 규제 규칙 간의 정합성을 제고하고, (2) 의무 기준을 보다 정밀하게 구체화하며, (3) 거래 전 과정에 걸친 포괄적 규제 보호 체계를 구축하는 실천적 경로를 제시한다.

본 논문은 중국 「회사법」상 정태적인 신인의무 체계를 개혁하고 회사법과 금융법의 교차 영역에서 이론적 논의를 심화하는 것을 목적으로 한다. 나아가 금융 규제 정책 수립에 대한 시사점을 제공하고, 사법 판단의 일관성을 제고하며, 금융기

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관의 내부 거버넌스를 개선하는 데 기여하고자 한다. 궁극적으로 본 연구는 금융 혁신의 역동성과 시장 질서의 안정적 거버넌스 간의 균형을 도모하는 데 그 의의를 둔다.

주제어 : 금융 파생상품 거래 혁신, 중국 이사의 신인의무, 규범 재구성, 위험 관리, 협력적 거버넌스

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I. Issues Spotting

Against a backdrop of accelerating global financial innovation, derivatives have become essential tools for resource allocation and risk hedging in China's financial markets,¹⁾ often implemented via nested structures and leverage amplification. However, high leverage, cross-market interconnectedness, and dynamic risk profiles of these transactions pose multidimensional challenges to the fiduciary-duty framework for directors under China's traditional corporate law. Article 180 of the 2023 amended Company Law sets out the basic framework for directors' duties of loyalty and diligence (fiduciary and care obligations).²⁾ The provision, however, was designed for traditional commercial operations and does not fully address legal issues specific to derivatives trading. Although the Futures and Derivatives Law impose compliance obligations on derivatives markets,³⁾ it

1) Zhu Yue, Research on the Banking Sector Financial Derivatives Risk Management—Based on the Credit Suisse and Bank of China Examples,⁶ Zhejiang Finance 520(2022) at 38.

2) Article 180 of the Company Law of the People's Republic of China stipulates that directors, supervisors and senior management personnel of a company have a duty of loyalty towards the company and should take measures to avoid conflicts of interest between their own interests and those of the company. They shall not use their positions to seek improper benefits. Directors, supervisors, and senior management personnel of a company have the duty of diligence in performing their duties. They should exercise reasonable care as a manager typically should in the best interests of the company.

3) For example, Articles 12, 13, 14, and 15 of the "Futures Trading and Derivatives Law of the People's Republic of China".

is not yet fully integrated with corporate-law duties of directors, producing unclear liability boundaries in complex derivatives transactions. For example, in off-balance-sheet arrangements such as credit-default swaps, structured transactions can leave creditors' claims inadequately secured. Judicial practice often struggles to determine director liability because existing standards (for example, "reasonable person" or comparable benchmarks) are not calibrated to dynamic market risks. This gap exposes weaknesses in rules on risk-tier disclosure and in mechanisms for isolating conflicts of interest.⁴⁾

Abroad, common law jurisdictions have also conducted discussions on directors' duties in the context of financial market supervision and the distinctive features of derivatives. In common law jurisdictions dominated by case law, typified by the U.S. state of Delaware, the precise boundaries of directors' duties are highly dependent on the evolution of judicial precedents. For instance, Delaware case law, through such cases as *Smith v. Van Gorkom*, emphasizes that directors must make an informed business judgment in material transactions (a failure to exercise due care may strip them of the protection afforded by the business judgment rule).⁵⁾ Meanwhile, the oversight liability /duty to monitor established in *In re Caremark* (Delaware Court of Chancery, 1996)⁶⁾ and subsequently affirmed by the Delaware Supreme Court in *Stone v. Ritter* (2006) has incorporated directors' affirmative obligations in respect of compliance, information reporting and internal control systems—particularly when red flags or systemic control deficiencies are identified—into the scope of liability arising from breaches of the duty of loyalty or bad faith.⁷⁾ In recent years, with the judicial application of the "Caremark doctrine" continuing to evolve in cases such as the *Marchand* line of decisions,⁸⁾ academic circles have

4) SHI Hui-Rong, MING Lang-lang, Study on the Behavior Standard of the "Trustee-director" of Shares-trusts—Balance between the interests of the corporation and beneficiaries,⁹ *Hebei Law Science*, 311 (2019) at 14.

5) *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

6) *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959,960-972 (Del. Ch. 1996).

7) *Stone v. Ritter*, 911 A.2d 362,364 – 373 ((Del. 2006).

8) *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019).

engaged in extensive debates over two key issues: first, whether directors should be subject to a more stringent duty to maintain effective monitoring and information systems; and second, what circumstances may constitute bad faith or a breach of the duty of loyalty.

In particular, for financial derivatives characterized as transactional, highly leveraged, cross-market and structured in nature, the aforementioned judicial reasoning—centering on the review of monitoring systems, reporting channels, and matters that directors have been or ought to have been informed of—is frequently cited in practical legal practice. A classic example illustrating the catastrophic losses stemming from directors’ failure in oversight and inadequate risk control is the Nick Leeson incident at Barings Bank.⁹⁾

Consequently, China’s traditional fiduciary framework—premised on homogeneous shareholders and simple capital structures—struggles to accommodate the new legal dynamics introduced by derivatives transactions. These dynamics include intensified shareholder - creditor conflicts, increased uncertainty about future claims, front-loaded risk decisions, and delayed recognition of profits and losses. Domestic legal scholarship on these topics remains limited. Current regulations neither define bespoke standards for fiduciary conduct in derivatives trading nor clarify the dynamic scope of due diligence when decisions carry high market risk. Disclosure regimes currently lack robust “look-through” standards for nested or layered structures. Insufficient coordination between financial-regulatory rules and corporate-governance mechanisms leaves directors without clear guidance, creating institutional gaps that undermine protection of investors and creditors’ rights. How can we elucidate the intrinsic link between derivatives’ characteristics and the dynamic duties of directors in China? How can regulatory “look-through” requirements be translated into concrete obligations for Chinese directors? How can duty standards and liability-determination mechanisms be established and tailored to special transaction scenarios? How can effective coordination be achieved between corporate

9)] Report of the Board of Banking Supervision: Inquiry into the Circumstances of the Collapse of Barings, H.C. 673 (1995).

law and financial regulatory rules to prevent systemic risk? Resolving these issues is essential to advance the rule of law in China's financial markets and to preserve orderly corporate governance.

II. Analysis of the Driving Forces Behind the Reshaping of Directors' Fiduciary Duties in China through the Characteristics of Financial Derivatives Trading

Part I identifies the tension between innovations in financial derivatives trading and China's traditional fiduciary-duty framework for directors. This tension arises from the systemic effects of derivatives' distinctive features—such as high leverage, nested (layered) positions, and cross-market interconnectedness—on traditional norms governing directors' duties. It is compounded by the inherent limitations of China's existing fiduciary-duty regime to address novel transactional forms and dynamic market risks. Therefore, a thorough analysis of derivatives' core characteristics and structural innovations, together with a clear assessment of compatibility challenges under Chinese corporate law, is a necessary prerequisite for designing an integrated regulatory framework that aligns directors' fiduciary duties with financial-market regulation.

1. Systematic Deconstruction of Financial Derivatives Trading Characteristics

Innovation in derivatives trading is reflected not only in growing transaction volumes but, more fundamentally, in how core instrument features and structural designs transform traditional commercial-transaction models. Article 2 of the Futures and Derivatives Law of the People's Republic of China defines financial derivatives as standardized or non-standardized contracts traded under specific rules and procedures and based on underlying instruments such as futures, options, swaps, or their

combinations. The provision affirms derivatives' contractual character while implicitly recognizing their complexity and market interconnectedness. Systematic analysis of these characteristics is therefore essential to understanding how derivatives reshape contractual and fiduciary obligations.

1) Multidimensional Perspective on the Essential Characteristics of Trading

Financial derivatives trading is characterized primarily by three features: leverage, cross-market interconnectedness, and algorithm-driven execution. Together, these features create a substantive challenge to the fiduciary duties of corporate directors in China.

First, leverage is a central feature of derivatives. Leverage—implemented via margin requirements and equity multipliers—amplifies both gains and losses. Consequently, trading outcomes can diverge markedly from the capital initially invested. Chinese financial regulation imposes explicit constraints on leverage. For example, the Commercial Bank Capital Management Measures set minimum leverage requirements for banks—commonly interpreted around a 4% floor—while the Administrative Regulations on Futures Trading require futures firms to collect customer margins at or above exchange-mandated levels. In practice,¹⁰⁾ however, structured products can hide leverage through multi-layered nesting. Leverage multiples for some over-the-counter instruments may substantially exceed explicit regulatory thresholds. High leverage implies that a single managerial decision can produce outsized gains or catastrophic losses within a short period. Traditional “reasonable-prudence” standards are ill-suited to these rapid, high-stakes risks. Directors therefore require finer risk-forecasting tools and a higher standard of decision-making rigor to fulfil their fiduciary duties.

Second, cross-market interconnectedness in derivatives markets fractures traditional boundaries between capital, money, and commodity markets,

10) LI Zhan feng, BAI Xue-Mei, An Empirical Study on Capital Regulation and Capital Supplementary Behavior of Commercial Banks in China: Based on Data of China's Listed Banks in Transitional Period New Capital Management Measures, *Journal of Dongmei University of Finance and Economics* 121(2019) at71.

thereby creating channels for cross-market risk transmission. For example, CSI 300 index futures exhibit strong price co-movement with their underlying constituent stocks; Chinese government bond futures closely reflect movements in interest-rate markets; and foreign-exchange forwards are tightly linked to the spot FX market. Volatility in one market can rapidly propagate to other markets via derivative transactions.¹¹⁾ Article 36 of the PRC Futures and Derivatives Law requires institutions that engage in derivatives trading to establish reporting mechanisms and cross-market risk-management systems. However, Article 36 does not set out explicit, operational duties that specify corporate directors' responsibilities for cross-market risk control. This interconnectedness requires directors to adopt a cross-market perspective, encompassing capabilities for identifying cross-market risks and implementing integrated risk management. Yet, traditional fiduciary norms under the PRC Company Law do not contain targeted, operational standards for cross-market decision-making.

Finally, algorithmic-driven trading is a defining feature of derivatives markets in the digital-economy era. Technologies such as smart contracts and quantitative trading models are widely used in pricing, execution, and risk-control functions. Chinese regulators have adopted a cautious regulatory stance toward programmatic/algorithmic trading and have issued measures that govern reporting, order submission, direct-market access, and risk controls; however, these rules principally focus on market-level controls and reporting and do not comprehensively define corporate directors' oversight obligations for algorithmic compliance. The automation and opacity of algorithmic systems reduce opportunities for direct human intervention in trading decisions. Compared with traditional manual trading, directors face difficulty in maintaining end-to-end oversight—from model design and parameterization to order execution and post-trade audit. Consequently, fairness, transparency, and controllability of algorithmic risks have emerged as principal fiduciary concerns for directors.¹²⁾ For example, biased parameter

11) Feng Guo, Zhang Yang, A Study on the Structural Predicament of Bond Market Internationalization and Its Solutions, *3 Social Science Front* 297(2020) at 192.

12) Zhong Wei, Qian Cheng, Optimization Paths of the Reporting System for Program

settings in quantitative models can induce systematic trading errors and model-risk amplification. Yet, directors currently lack clear, standardized procedures for reviewing algorithmic models, which undermines the applicability of traditional “human-decision-oversight” conceptions of the duty of care.

2) Typical Forms of Innovative Transaction Structures

Beyond their core characteristics, innovations in derivatives transaction structures further increase the complexity of fulfilling fiduciary and compliance obligations. In the Chinese market, common innovations include multi-layered nested structures, portfolio-strategy structures, and cross-border linkage structures; each raises directors’ demands for decision-making capacity and duty standards.

First, multi-layered nested structures are a principal design for structured products. By stacking underlying assets with multiple derivative layers, these structures generate distinct risk - return tranches (senior, mezzanine, junior). In China’s interbank market, CDS are often packaged with asset-backed securities (ABS) to form nested structures; underlying assets can include credit receivables and bonds. China’s NAFMII rules and related interbank guidance require relevant disclosure of CDS transaction structures and transaction information. In practice, multi-layer nesting often reduces visibility into underlying assets, hindering directors’ ability to assess asset quality and risk exposures.¹³⁾ For example, a bank’s CDS product may hold real-estate credit exposures through a three-tier nested arrangement. Directors may perceive only the surface transaction structure during approval, lacking the information needed for precise judgments about underlying default risk.¹⁴⁾ Traditional fiduciary duties (e.g., conflict identification and duty-of-care risk assessment) are difficult to apply effectively

Trading in the Securities and Futures Markets,⁵ Securities Market Herald 394(2025) at 39.
13) Xu Jingyi, The Direction of Domestic CDS Index Development, 11 Financial Market Research 126(2022) at 79-82.

14) Robert F.Schwartz, Risk Distribution in the Capital Markets: Credit Default Swaps,¹² Fordham J. Corp. & Fin. L. 167 (2007) at 176.

to such structural complexity.

Second, portfolio-strategy structures combine multiple derivative instruments to form complex trading strategies. Examples include options strategies (bull spreads, straddles) and hedging portfolios that combine futures and swaps. The Futures and Derivatives Law and related regulatory rules require institutions to maintain trading strategies and risk-management systems, but they do not set detailed, operational standards specifying directors' review obligations for portfolio strategies. Risks from portfolio strategies are not the arithmetic sum of individual instrument risks. Rather, these strategies generate interactive effects—hedging, amplification,¹⁵⁾ and risk transfer—that require directors to have multidimensional financial expertise. For instance, a listed firm may use a “futures + options” portfolio to hedge commodity price exposure. Directors should evaluate hedging effectiveness, the strategy's maximum potential exposure, and the availability and enforceability of stop-loss mechanisms. Traditional fiduciary rules typically do not mandate such specialized technical judgment by directors, complicating the assessment of compliance for these decisions.

Third, cross-border linkage structures are an important innovation under financial globalization. Chinese institutions use cross-border derivatives to hedge FX risk and access international markets; common forms include cross-border FX forwards and offshore commodity derivatives. These transactions implicate multiple jurisdictions' laws, regulatory regimes, and market practices. For example, institutions commonly employ the ISDA (or NAFMII/ISDA-based) master agreements as transaction frameworks while also complying with China's cross-border supervisory measures and the counterparty jurisdiction's rules (e.g., capital, leverage, and data-transfer requirements).¹⁶⁾ Cross-border structures impose multiple compliance pressures, requiring directors to consider Chinese corporate and financial

15) Lynn A. Stout, *Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives*, 48 *Duke L.J.* 701 (1999) at 110.

16) McNamara C M, Metrick A, *The Lehman Brothers Bankruptcy F: Introduction to the ISDA Master Agreement*, 1 *Journal of Financial Crises* 1, 2019(1) at 137.

law alongside relevant foreign regulatory regimes. For instance, if a securities firm's overseas subsidiary enters cross-border interest-rate swaps, directors must assess compliance with domestic capital-adequacy rules, foreign leverage limits, and cross-border data and reporting requirements. Traditional fiduciary duties do not provide detailed, operational guidance for coordinating cross-border compliance, leaving practical gaps in directors' guidance.

2. The Adaptability Dilemma of Traditional Fiduciary Duties for Directors

The structural features and innovations of financial derivatives trading have fundamentally weakened the applicability of traditional fiduciary duties for directors in China. China's fiduciary framework is centered on directors' duties of loyalty and diligence under the Company Law and is supplemented by sectoral rules such as the Code of Corporate Governance for Listed Companies and the Commercial Bank Corporate Governance Guidelines. However, that framework was designed for traditional physical operations and straightforward commercial transactions and thus faces significant challenges when applied to financial derivatives trading.

1) Static Limitations of the Regulatory Framework

The regulatory framework for traditional fiduciary duties is markedly static. Its assumptions about applicability, the methods for fulfilling duties, and the liability-determination logic are ill-suited to the dynamic and complex character of derivative transactions.

First, the regulatory presumption of homogeneous shareholder interests has become outdated; conflicts of interest are now more complex and multi-dimensional. Traditional fiduciary duties are premised on shareholder primacy: they assume shareholder interests are uniform and treat directors' core obligation as protecting collective shareholder value.¹⁷⁾ Article 180 of

17) Berle, *Corporate Powers as Powers in Trust*, 7 Harv. L. Rev.44(1931) at 1049.

the Company Law imposes duties of loyalty and diligence on directors, which have traditionally been interpreted with reference to shareholder value protection. By contrast, derivative trading involves a more diversified set of corporate stakeholders. The interests of shareholders, creditors, derivative holders, and financial consumers can diverge substantially. For example, a firm that uses high-leverage derivatives to pursue short-term shareholder returns can materially increase creditors' default exposure. Derivative holders—who may become future creditors—often lack explicit legal protections or clearly defined duties owed to them. Although some scholars in China propose expanding the class of protected beneficiaries,¹⁸⁾ the Company Law and implementing regulations do not explicitly define directors' obligations to creditors or derivative holders. Consequently, a shareholder-centric, static framework struggles to reconcile conflicts among diverse stakeholders.

Second, there is a tension between the point-in-time focus of duty fulfillment and the continuous nature of transaction risks. Traditional duties commonly concentrate on discrete decision points in transactions. For example, when a board passes a resolution, directors must meet their loyalty and diligence obligations; liability assessments typically focus on whether standards were met at that decision point. Chinese statutory and judicial practice commonly assess director liability by asking whether reasonable care was exercised at the decision point; they frequently lack explicit rules imposing continuing duties during a transaction's life. By contrast, risks from derivative transactions are continuous throughout the contract lifecycle. From execution and day-to-day management to termination and settlement, risk exposures evolve dynamically. For instance, a five-year FX swap entered by a listed company can experience substantial changes in risk exposure as exchange rates fluctuate over time. Risk assessments at the decision stage cannot capture the full spectrum of evolving risks. Traditional duties rarely require continuous monitoring during a transaction's lifetime, producing a regulatory gap in ongoing risk

18) Jiang Daxing, The Change of Directors' Duties by ESG: Evolution from Business Judgment to Social Judgment, 4 China Legal Science 240(2024) at 88.

management.

Third, there is insufficient coordination between prudential regulatory rules and corporate-law obligations. Derivative transactions are governed both by financial regulatory statutes and by corporate law. Chinese regulatory instruments—most notably the Futures and Derivatives Law and banking statutes—impose prudential risk-management requirements on financial institutions that trade derivatives. The Futures and Derivatives Law includes provisions that protect close-out netting and single-agreement mechanisms (e.g., provisions in Articles 32 - 35), while detailed prudential requirements for institution-level risk systems are elaborated in accompanying regulatory rules and bank-level guidelines. However, these prudential requirements are not always aligned with corporate fiduciary duties; they do not clearly specify how regulatory risk controls translate into directors' legal obligations under corporate law. In practice, directors may satisfy regulatory metrics yet still be accused of breaching fiduciary duties under the Company Law. Inconsistent standards between regulators and corporate law can create compliance dilemmas for directors and boards. For example, a commercial bank may meet statutory capital adequacy requirements set out in commercial bank capital rules but still incur losses from defective derivative strategies, giving rise to governance and liability issues. In practice, the lack of uniform criteria for assessing breaches of directors' duty of care underlines the limitations of static regulatory frameworks when reconciling prudential regulation with corporate-law duties.

2) Challenges in Specific Obligation Dimensions

Beyond structural limitations, specific elements of traditional fiduciary duties for directors encounter distinct challenges in the context of financial derivatives trading. Existing norms governing loyalty, diligence, and disclosure obligations struggle to accommodate the demands posed by such novel transactions.

First, fiduciary duties face practical difficulties in identifying and preventing conflicts of interest. Article 181 of the Company Law lists

certain prohibited behaviors for directors (for example, misuse of company assets and improper related-party dealings). The provision's core objective is to prevent directors from exploiting their positions for private gain. However, conflicts of interest in derivatives trading are frequently concealed and structurally complex, making traditional prohibitions inadequate. First, implicit related-party transactions can be difficult to detect. Ulterior nesting of derivative contracts can mask related-party relationships; for example, a director's relatives may control a counterparty through multi-tiered shareholdings. Conventional related-party review procedures often fail to uncover these hidden connections. Second, the transmission pathways for conflicts can be highly indirect and intricate. Directors may not receive direct personal benefits from a derivative decision, yet the decision could indirectly harm the company while advantaging third parties (e.g., sustaining unfavorable trades to protect a related counterparty). Current supervisory rules and exchange measures identify related parties mainly via direct affiliations and specified relationships; they do not always capture hidden or indirect connections arising from complex derivatives structures. This gap creates ambiguity about the standards directors must meet to comply with their fiduciary duties in derivatives contexts.

Second, the duty of care faces challenges in aligning required professional competencies with board-level decision-making. Although the duty of care requires directors to exercise "reasonable prudence," the Company Law does not prescribe concrete, task-specific standards for that concept. By contrast, corporate governance guidelines for listed companies require that directors possess professional knowledge and experience appropriate to their responsibilities. Derivative transactions require advanced financial knowledge, quantitative modelling, and specialized risk assessment, imposing demands on directors' expertise that often exceed those required for ordinary commercial transactions. In practice, many directors lack specialized derivatives expertise and therefore rely on external advisors or internal risk teams for technical assessments.¹⁹⁾ Traditional fiduciary duties

19) Xu Yiguo, Wang Zengwu, From Far East Center to Global Center: Evolution and Transition of Shanghai International Finance Center -- The Historical Wisdom and

generally do not set specific standards for how directors should assess or verify such professional advice. For example, a board may approve a structured derivative based primarily on a risk report prepared by an external financial institution. Subsequent material omissions in the report can lead to substantial losses. In such situations, it is difficult to determine whether directors satisfied their duty of care because no clear rules prescribe the scope of directors' verification of professional reports or the minimum level of expertise expected of them. Moreover, the 2019 Minutes of the National Courts' Civil and Commercial Trial Work Conference provide guidance on the adjudication of commercial disputes, but do not set special, sector-specific review standards for high-risk derivatives transactions; this limits the specificity in liability assessments.

Third, disclosure obligations are challenged by insufficient transparency and limited interpretability. Both the Securities Law and the Futures and Derivatives Law require disclosure of certain information related to derivatives by issuers and relevant institutions, aiming to protect stakeholders' information rights. Nevertheless, complex product structures and nested instruments hinder transparent disclosure; conventional disclosure formats often fail to meet stakeholders' substantive information needs. First, multi-layered structuring can impede adequate disclosure of underlying assets. For example, where asset-backed securitizations are wrapped with credit-default swaps, disclosed documents may not enable investors to understand the credit specifics of underlying assets. Existing measures on information disclosure for listed companies do not generally require penetrative disclosure of deeply nested or complex derivative structures. Besides, disclosed information frequently lacks interpretability for non-specialist stakeholders.²⁰⁾ Technical terminology and quantitative metrics used in derivatives typically exceed ordinary investors' comprehension. Directors are typically not obliged to translate technical disclosures into

Realistic Choice of Developing the Standard Gold Ma,1 Journal of Hebei University of Economics and Business 42(2021) at101.

20) Zhu Quan, Han Gang, Reflections on the Upsurge of Enterprises Asset Securitization,1 South China Finance 509(2019)at 69-74.

plain language, which can render disclosure formal rather than informative. While the Futures and Derivatives Law requires disclosure of transaction risk characteristics, the statute and implementing rules do not always specify the hierarchical detail or precise scope for such risk disclosures, leaving room for divergent interpretations. Consequently, directors face a disclosure dilemma: insufficient disclosure may incur liability, whereas overly detailed disclosure may imperil commercially sensitive information.

III. The Fundamental Concept of Reshaping Directors' Fiduciary Duties in China Through Financial Derivatives Trading

Part II analyzes the compatibility challenges between the characteristics of financial derivatives trading and the fiduciary duties of Chinese directors. At the core of this dilemma is that traditional norms fail to address dynamic transaction risks, diverse conflicts of interest, and cross-sector regulatory coordination. To reshape directors' fiduciary duties normatively, we must first establish foundational principles aligned with the nature of financial derivatives trading. We propose a three-dimensional framework: (1) centered on risk management, (2) oriented to stakeholder protection, and (3) supported by regulatory oversight.

1. Risk Management as the Core

High leverage and cross-market linkages inherent in derivatives trading make risk management the central consideration when reshaping directors' fiduciary duties. Traditional obligations are limited because they do not incorporate full-cycle risk management into directors' duties. Accordingly, a dynamic risk-management approach should be adopted. This requires upgrading mechanisms for adjusting and evaluating duties, enabling precise responses to transaction risks.

1) Establishing a Dynamic Duty Adjustment Mechanism

A dynamic duty-adjustment mechanism must move beyond static, compliance-oriented thinking. It should incorporate factors such as market environment shifts and risk-transmission dynamics into duty assessments so that directors' fiduciary duties evolve in step with transaction risks. The duty framework under Article 180 of the PRC Company Law does not embed a dynamic adjustment mechanism. By contrast, Article 35 of the Futures and Derivatives Law requires financial institutions engaged in derivatives trading to establish sound risk-management systems, including clearly defined risk limits and stop-loss measures. This provision provides a regulatory basis for dynamizing directors' obligations. Dynamic adjustments to duties must cover the entire derivatives transaction lifecycle. Specifically, during the ongoing management phase, the frequency of risk monitoring should be adjusted according to market volatility. If underlying-asset price fluctuations exceed preset thresholds, emergency measures—for example, margin calls and hedge-strategy adjustments—should be initiated. In the consequence-management phase, liability obligations should be calibrated to loss magnitude to prevent “point-in-time compliance” from obscuring cross-period risks.²¹⁾ Concurrently, quantitative metrics—such as capital-adequacy and leverage ratios, as stipulated in China's Commercial Bank Capital Management Measures—should be used as benchmarks for dynamic duty adjustments. When transactions push these metrics toward regulatory red lines, directors' duty of prudence should automatically intensify.

2) Multi-dimensional Upgrading of Risk Assessment Mechanisms

Upgrading risk-assessment mechanisms requires replacing experience-based methods with integrated systems that combine quantitative models and qualitative judgment, and that pair internal evaluation with independent external oversight. Article 41 of the PRC Futures and Derivatives Law requires disclosure of transaction-related risk characteristics, which provides

21) He Guo sheng, Chen Fu, On the Optimization of the Current Regulatory Mechanism for Financial Derivatives in China,¹² Academic Exchange 249 (2014) at110.

a legal basis for enhancing risk-assessment systems. At the quantitative level, directors should deploy tools such as Value-at-Risk (VaR) models and stress tests to run multi-scenario simulations covering market, credit, and liquidity risks in derivatives transactions. In line with the disclosure requirements set out in the Rules for Credit Default Swap Business in the Interbank Market,²²⁾ directors should produce quantifiable risk-assessment reports. For example, CDS transactions should undergo stress testing to estimate counterparty-default probabilities and potential losses under extreme stress scenarios. For external oversight, engage legally qualified third-party assessors to perform look-through analyses, focusing on underlying-asset quality and risks from nested or layered structures in structured derivatives. Third-party assessment reports should be required supporting documentation for board-level decisions on derivatives transactions. The Corporate Governance Code for listed companies recommends that boards establish risk-control committees charged with supervising risk assessments for derivatives trading. Such committees enhance assessment objectivity and outcome credibility and reduce the risk that internal evaluations become perfunctory.

2. Stakeholder Protection Orientation

The ultimate objective of risk management is to protect the legitimate rights and interests of all stakeholders. Derivatives trading involves multiple stakeholder groups, including shareholders, creditors, and retail financial consumers. Divergent stakeholder interests require that directors' fiduciary duties incorporate mechanisms for balancing competing interests. This approach preserves the dynamism of financial innovation while mitigating the transmission of systemic and counterparty risks to stakeholders.

22) Xue Zhicheng, Ma Shuya, Analysis of the Legal Challenges in the Development of Financial Derivatives in China, *Law Science Magazine* 27(2008) at33-35.

1) Balancing Shareholder Long-Term Value Preservation and Financial Consumer Rights

To preserve shareholders' long-term value while protecting financial consumers, directors should avoid short-term speculative strategies, focus derivatives use on risk-hedging, and ensure consumers' rights to clear information and fair dealing. The fiduciary duty set out in Article 180 of the Company Law emphasizes safeguarding corporate interests, understood principally as the protection of shareholders' long-term value.²³⁾ Accordingly, directors should refrain from excessive speculative derivatives trading aimed at short-term gains and should comply with the Futures and Derivatives Law (e.g., Article 40) on trading strategies and requisite risk-management systems. Guided by the Securities Law's disclosure principle, directors must ensure that disclosures are interpretable and accessible, avoiding excessive technical jargon or fragmented presentation that would undermine consumers' right to informed choice. For example, in structured wealth-management products, disclosures should use plain language to explain the product's risk level, return-calculation methodology, and possible loss scenarios. Building on duties of independent directors in corporate-governance guidelines, boards should designate an independent director or committee specifically to oversee consumer-protection issues in derivatives trading, including a formal veto or escalation right over transactions that materially harm consumer interests. Concurrently, financial-innovation guidelines and suitability rules for commercial banks require institutions to implement suitability-assessment procedures when marketing or selling complex products. Directors should ensure that derivatives products are offered only to clients whose risk profiles match the product's risk level, thereby avoiding unsuitable sales of high-risk products to investors lacking the capacity to bear such risks.

2) Institutional Design for Systemic Risk Prevention

Preventing systemic risk requires that directors, when performing their

23) Eric J. Gouvin, Resolving the Subsidiary Director's Dilemma, 1 *Hastens LJ.* 47(1996) at 287, 297.

fiduciary duties, consider both the company's interests and the wider impact of its transactions on financial-market stability. Institutional design should aim to interrupt risk transmission channels between institutions and across markets. Article 36 of the PRC Futures and Derivatives Law requires the establishment of centralized reporting and cross-market risk management arrangements, which supply a statutory basis for systemic-risk prevention. Company directors should lead the design and implementation of mechanisms to contain risk transmission. For transactions with pronounced cross-market linkages (e.g., stock-index futures, cross-border FX forwards), directors should develop dedicated contingency plans that specify stop-loss trigger thresholds, escalation and resolution procedures, and clear allocation of responsibilities. Consistent with the Commercial Bank Law and prudential capital rules, firms should establish dedicated risk reserves for derivatives positions as a buffer against systemic exposure, thereby preserving resilience under extreme stress. Moreover, if derivative activity may trigger systemic risk, directors have an obligation to ensure timely reporting to relevant regulators. Directors should ensure that risk assessments and remediation plans are submitted promptly and transparently to authorities under China's major-matters reporting framework for financial institutions.²⁴⁾ Boards should adopt explicit resolutions that prohibit speculative derivatives trading likely to amplify market volatility or systemic risk, thereby realigning derivatives use with hedging objectives.

3. Ensuring Regulatory Penetration

Effective stakeholder protection depends on robust and coherent regulatory frameworks. Because derivatives trading spans sectors and markets, barriers between regulatory oversight and corporate governance should be reduced. Ensuring regulatory reach requires a multi-tiered, coordinated mechanism to translate high-level principles into concrete, enforceable obligations.

24) Fu Wang, Fan Lihong, Obligation of Financial Institutions to Disclose Information and Risk in OTC Derivatives Transactions,⁹ *Journal of Law Application* 342 (2014) at 75.

1) Building a Vertical Integration System

Establishing vertical linkage requires a hierarchical obligation-transmission chain (statute → regulatory rules → articles of association) to secure consistency across legal and internal governance tiers. As foundational law, the Company Law should articulate core principles of directors' fiduciary duties in a manner that guides downstream regulatory and corporate rules. Specialized statutes—e.g., the Futures and Derivatives Law and the Commercial Bank Law—should set out specific directors' obligations for derivatives trading, thereby translating generic regulatory goals into concrete legal duties. Departmental and regulatory measures (for example, administrative rules governing cross-border derivatives) should refine operational standards and clarify compliance procedures for these duties. Articles of association, customized to a firm's business profile, should convert abstract legal requirements into enforceable internal governance rules.

For example, the risk-limit provisions in Article 35 of the Futures and Derivatives Law should be operationalized in articles of association, delineating directors' approval authorities and procedures for approving excesses. Capital adequacy rules (e.g., the Capital Management Measures for Commercial Banks) should be mapped to core internal metrics that directors use when evaluating derivatives trades,²⁵⁾ ensuring alignment between trading decisions and prudential mandates. The vertical linkage framework should clarify normative priority: where internal rules conflict with regulatory requirements, the latter—consistent with applicable law—take precedence. Where statutory or regulatory norms are ambiguous, articles of association should supply precise operational details to complete a logically coherent obligation chain.

2) Establishment of a Routine Communication Mechanism

Establishing a routine communication mechanism requires removing information barriers between internal corporate governance and external

25) Xiong Yu-Lia, Supervision of OTC Financial Derivative Dealer in Our Country: Path Selection and System Perfection, 12 Shanghai Journal of Economics 24 (2012) at 68.

supervision so that directors promptly receive regulatory guidance, and regulators accurately understand transaction risks. Under the PRC Futures and Derivatives Law, directors should regularly submit derivatives transaction risk-assessment reports to regulators, in line with applicable reporting rules and templates. Such reports should contain core elements: transaction objectives, quantified risk exposures, hedging strategies,²⁶⁾ and compliance status. Reporting frequency should be proportionate to transaction scale and risk level: high-risk activities require monthly reports; ordinary transactions may be reported quarterly. Leverage regional financial-innovation pilot programs (regulatory sandboxes) to establish direct communication channels between company directors and regulators. For complex or novel derivatives transactions, directors should consult regulators in advance to clarify obligation boundaries and compliance requirements and proceed only after achieving a regulatory understanding or agreement. For example, within regulatory sandboxes, directors can discuss compliance standards for algorithmic trading and risk-management protocols for smart contracts with regulators to clarify compliance benchmarks and containment safeguards.²⁷⁾ Besides, the routine communication mechanism should also include a risk-warning information-sharing protocol. When regulators identify rising systemic risks, they should issue timely risk alerts to relevant directors; directors should then adjust trading strategies and tighten risk controls accordingly. Conversely, companies should promptly report significant counterparty risk vulnerabilities to regulators to facilitate timely supervisory intervention and prevent contagion.

26) Zheng Huila regulations for the credit derivatives trade in the US and some enlightenment,³ Securities Market Herald 224 (2011) at 11-18.

27) Chen Chun, The effects of financial derivatives transactions,⁴ Dongyu Tribune 36 (2025) at 160.

IV. Financial Derivatives Trading Reshapes the Institutional Framework of Directors' Fiduciary Duties in China

The three-dimensional principles set out in Part III offer normative guidance for reshaping directors' fiduciary duties in China. However, implementing these principles requires a robust institutional framework as the necessary foundation. The complexity and dynamism of derivatives trading demand that the institutional framework move beyond singular, traditional rule-design models. Instead, the framework should adopt a "trinity" architecture comprising (1) a theoretical core, (2) a coherent normative system, and (3) judicial and enforcement tools.

1. Theoretical Dimension: Innovation in Legal Theory

The traditional "fidelity - diligence" dichotomy in Chinese corporate law is inadequate for derivatives transactions because it fails to cover the full lifecycle of risk inherent in these activities. A fundamental renewal of the legal-theory core, centered on explicit "risk-related obligations," is necessary. Such renewal would enable a systematic upgrade of theoretical frameworks, evaluation standards, and application scenarios, thereby providing robust legal support for institutional design and enforcement.

1) Breaking Through the Traditional Theoretical Framework

The traditional shareholder-primacy framework reduces fiduciary duties to two separate obligations—loyalty and diligence—which is inadequate for managing the complex conflicts of interest and dynamic risk-management demands of derivatives trading. Article 180 of the PRC Company Law continues this dichotomous logic and does not explicitly address the interconnected and continuous nature of duties in innovative financial contexts. To move beyond this framework, it is essential to center directors' duties on explicit "risk-related obligations." Under this model, the duty of loyalty targets conflict-of-interest isolation in risk decision-making;

the duty of diligence requires professional prudence in risk identification and assessment; and the duty of risk management spans the entire transaction lifecycle, including hedging and mitigation measures. These three duties are mutually reinforcing and indispensable. For example, in structured derivatives, directors should: (1) use fiduciary safeguards to prevent hidden related-party risks; (2) apply rigorous, evidence-based risk assessments under the duty of care; and (3) manage inter-period risk transmission from nested structures through continuous risk-management obligations. This approach addresses the limitations of traditional, compartmentalized duty frameworks.

2) Transformation of Duty Evaluation Standards

Traditional evaluation standards focus on “point-in-time compliance,” asking whether directors satisfied statutory procedures and duties of care at the decision point. This static focus conflicts with the inherently continuous nature of risks in derivative transactions. Therefore, evaluation standards should evolve toward “full-cycle risk management,” requiring directors to assume ongoing obligations across: (a) the contract-decision phase; (b) the ongoing-management phase; and (c) the consequence-resolution phase of derivative transactions. During the contract-decision phase, directors should fulfill risk-identification obligations by assessing core factors, including counterparty credit risk and underlying-asset volatility. In the ongoing-management phase, directors should execute hedging obligations by dynamically adjusting trading strategies in response to market changes, ensuring exposures remain within predetermined limits. In the consequence-resolution phase, directors should implement loss-allocation obligations: adopt reasonable measures to limit loss escalation and disclose material circumstances fully to stakeholders.²⁸⁾ Article 41 of the PRC Futures and Derivatives Law requires disclosure of certain transaction-risk characteristics and thus represents a legislative move toward full-cycle risk-management transparency. Transforming obligation-evaluation standards

28) Li Cheng, Cai Dajian, *Financial Derivatives: Theoretical Analysis and Financial Regulation*, 14 *Statistics & Decision* 314 (2010) at 121-124.

operationalizes that legislative intent into concrete theoretical and practical guidance.

3) Theoretical Application in Typical Transaction Scenarios

Theoretical innovations must be applied to representative trading scenarios to demonstrate practical value. In CDS transactions, the “risk-correlation obligation” implies that directors should engage qualified third-party assessors to evaluate underlying asset quality at contract initiation, monitor counterparty credit changes during the term, and promptly activate loss-mitigation mechanisms on default warnings—thereby avoiding the blind spots of point-in-time compliance. In cross-border derivatives, the theory clarifies directors’ obligations for cross-border compliance coordination and lifecycle risk assessment. Directors must comply with administrative measures governing cross-border financial derivatives and assess legal risks posed by overseas counterparties and jurisdictions. This requires balancing commercial objectives and compliance costs through lifecycle risk assessments and documented decision-making.²⁹⁾ For algorithm-driven quantitative trading, the duties require directors to oversee algorithmic models across their lifecycle. This oversight should include compliance reviews during model development, continuous monitoring and parameter recalibration during operation, and documented emergency response procedures for abnormal activity—each squarely falling within risk-related obligations. This approach helps fill regulatory and theoretical gaps in Chinese corporate law concerning technology-driven trading.

2. Institutional Dimension: Normative Construction Through Public-Private Law Synergy

Theoretical innovations should be translated into operational rules through institutional norms. Financial derivatives trading is governed concurrently

29) Xiong Yulian, Information Asymmetry and Risks of Over-the-Counter Financial Derivatives: A Discussion on Regulatory Reforms in the United States, 7 Jiangxi Social Sciences 32(2012) at 72-77.

by China's corporate law, financial regulatory statutes, and both public- and private-law norms. The core of this institutional framework is to harmonize public and private law, resolve normative conflicts, and establish a rules system with clear hierarchical order and logical coherence.

1) Regulatory Synergy at the Public Law Level

China should reinforce public-law provisions to supplement and refine directors' fiduciary duties under financial regulation, thereby fostering regulatory synergy with corporate law. Article 35 of the Futures and Derivatives Law sets out risk-management requirements for financial institutions engaging in derivatives trading. Building on this foundation, a "Special Clause on Directors' Duties in Derivatives Trading" could be introduced to clarify directors' substantive review obligations for complex instruments. Such a clause would address core elements including the authenticity of underlying assets, the reasonableness of leverage ratios, and the feasibility of hedging strategies.³⁰⁾ Specifically, the Commercial Bank Law could adopt this approach for commercial banks.

Given the high-risk character of commercial-bank derivative transactions, the law should refine directors' risk-control responsibilities by translating quantitative metrics from the Capital Adequacy Management Measures for Commercial Banks—such as capital adequacy and leverage ratios—into concrete review benchmarks for directors' fiduciary duties. Additionally, regulators could issue industry guidelines—for example, the CSRC could publish "Guidelines on Directors' Duties in Listed Companies' Derivatives Trading"—to articulate operational standards for directors in transaction approval, risk monitoring, and disclosure, thereby addressing gaps in legal detail.

From the perspective of foreign legislative and judicial practices, in the realm of regulation and information disclosure, regulatory authorities in common law jurisdictions have adopted pragmatic regulatory rules to supplement the gaps in corporate/directors'duties, specifically addressing the

30) LI Minghui, Research on the Legal Regulation of Financial Derivatives Transactions,8 Commercial Research 424(2012) at 205-210.

high leverage and cross-market contagion risk inherent in derivatives.

For example, the disclosure rules of the U.S. Securities and Exchange Commission (SEC)—such as Regulation S-K Item 305 on the “quantitative and qualitative disclosure of market risk”³¹⁾—mandate that companies disclose in their 10-K/10-Q filings the market risks, leverage effects and risk management measures arising from derivative instruments and similar exposures. This places material derivatives-related risks within the scope of directors’ and management’s obligation to make full disclosure to investors. At the EU level, Regulation (EU) No 648/2012 (EMIR) and the trading and transparency rules under MiFID II/MiFIR impose mandatory requirements on over-the-counter (OTC) derivatives, covering trade reporting, central counterparty (CCP) clearing and post-trade transparency. One of the core objectives is to enhance the visibility of derivatives positions and associated risks both to regulators and the broader market, thereby providing an institutional framework to facilitate directors’ performance of their duties, risk assessment and disclosure obligations. In the UK, corporate governance and financial regulatory regimes—including the UK Corporate Governance Code issued by the Financial Reporting Council (FRC) and the Prudential Regulation Authority (PRA)’s specific expectations for bank boards regarding risk governance and oversight of risk models and risk management—also emphasize that directors bear ultimate responsibility for the system of material risk management, internal control and information disclosure.

Against the backdrop of derivatives’ high leverage and complex structures, the aforementioned rules essentially constitute external mandatory constraints on directors’ obligation to establish systematic risk management mechanisms and implement transparent, penetrating information disclosure practices. These rules mitigate the limitations of the traditional corporate law framework, which relies primarily on ex post facto accountability for directors’ conduct.

31) SEC Regulation S-K Item 305 (Quantitative and qualitative disclosures about market risk).

2) Institutional Innovation at the Private Law Level

At the private-law level, China should utilize articles of association and civil-law rules to integrate effectively with public-law regulations. As the company's primary governance instrument, the articles of association should translate public-law requirements into specific director obligations tailored to the firm's business profile.

For example, listed companies could specify decision thresholds for derivative transactions in their articles, requiring high-leverage trades to receive approval from at least two-thirds of the board and mandating independent directors to provide special opinions. Innovation in directors' liability insurance is also essential. Introducing specialized "derivative-transaction liability insurance" clauses that clearly define coverage scope and exclusions would protect directors who perform their duties and incentivize standardized conduct through contractual terms. Moreover, by systematically interpreting Article 509 of the Civil Code on ancillary obligations, duties such as risk disclosure and ongoing notification in derivative transactions can be subsumed within directors' fiduciary duties, allowing private-law rules to address transaction-specific features precisely.

3) Pathways for Resolving Regulatory Conflicts

To prevent conflicts arising from the plurality of China's public- and private-law regulations, clear resolution mechanisms should be established. First, the principle that special laws take precedence over general laws should be affirmed. In the context of derivatives trading, provisions on directors' obligations in special statutes—such as the Futures and Derivatives Law and the Commercial Bank Law—should prevail over the general provisions of the Company Law. Second, a coordinated mechanism for regulatory interpretation should be established. Where public-law regulatory metrics conflict with corporate-law duty standards, judicial interpretations or guiding precedents should articulate bridging rules.

For example, the Minutes of the National Courts' Financial Trial Work Conference could state that directors' decisions conforming to financial regulatory metrics may constitute important evidence of having satisfied

due-diligence obligations. However, non-compliance with regulatory metrics should not automatically be equated with a breach of duty; instead, a comprehensive assessment of transaction purpose and decision-making procedures is required. Finally, a regulatory-sandbox pilot mechanism should be established. Within designated pilot zones, regulators could permit financial institutions to test novel derivative transactions.³²⁾ Chinese regulatory authorities and judicial bodies should collaborate to delineate the boundaries of directors' duties. After sufficient pilot experience has been accumulated, the scheme should be expanded gradually to balance tolerance for innovation with regulatory constraints.

3. Tool Dimension: Operationalizing Judicial Adjudication

The enforcement of institutional rules ultimately depends on judicial adjudication. The specialized and technical nature of financial derivatives trading has produced an “adjudication dilemma” in Chinese judicial practice. Judicial adjudication tools should be developed that are tailored to the specific characteristics of these transactions. Adopting tiered review standards and flexible application rules can improve both the practicability and fairness of adjudication, thereby strengthening the binding effect of institutional rules.

1) Establishing Graded Review Standards

To accommodate differences in transaction complexity, establish a two-tier review framework: formal review followed by substantive review. For low-complexity instruments (e.g., standard futures and simple forwards), courts should apply formal review standards. The review should focus on whether directors followed statutory procedures—for example, board resolutions and the preparation and review of risk-assessment reports. Where procedures are complete and show no evident impropriety, courts should

32) Wang Yinggui, Commercial Bank Financial Derivatives Trading and Risk Management—Taking Société Générale and Other Banks as Examples, 8 Journal of Modern Finance 10(2008) at 33-37.

treat fiduciary duties as satisfied. For complex instruments (for example, structured or nested derivatives and highly leveraged OTC trades), substantive review standards should be applied. Directors of Chinese companies should provide: (1) documentation verifying underlying assets; (2) quantitative model-validation reports for hedging strategies; and (3) independent third-party assessment opinions. Judicial authorities should assess the substantive prudence of decisions together with relevant statutory provisions—e.g., provisions of the Futures and Derivatives Law—while considering standards for the reasonableness of trading strategies. Industry standards (for example, the ISDA Master Agreement and comparable NAFMII standards) may be used as reference material to assist judicial review and reduce technical barriers for courts.

2) Flexible Application of the Business Judgment Rule

The business-judgment rule—a core mechanism for balancing directors' decision-making authority and judicial oversight — should be flexibly adapted to the particular features of derivatives trading. Although the traditional business-judgment rule protects directors' reasonable discretion, the high-risk profile of derivatives warrants proportionate strengthening of judicial scrutiny. Drawing on comparative experience and the Conference Minutes' guidance, the rule's application could be conditioned on demonstrable steps: comprehensive risk assessment, consultation with qualified professional institutions, and the establishment of effective risk-control mechanisms for derivative transactions. Transactions that clearly exceed a company's stated risk tolerance, or are demonstrably speculative, should not qualify for exemption even if procedural requirements were met. Moreover, exceptions to the business-judgment rule should be explicitly enumerated. The rule should not apply where transactions involve conflicts of interest, inadequate disclosure, or breaches of mandatory regulatory provisions. This approach prevents improper exemption of directors' liability and thereby balances managerial incentives with appropriate legal constraints.

V. Regulatory Pathways for Reshaping Directors' Fiduciary Duties in China Through Financial Derivatives Trading

The framework's implementation depends on concrete, actionable regulatory pathways. Because derivatives trading spans multiple sectors and is shaped by China's legal context, the regulatory pathway should be organized around three core principles: coordination, refinement, and end-to-end coverage. This approach aims to integrate fiduciary duties with financial regulatory requirements effectively. By calibrating fiduciary-duty standards to specific transaction features, the approach constructs a comprehensive regulatory framework covering pre-transaction, intra-transaction, and post-transaction phases. This ensures that any restructuring of duties is grounded in both legal rationale and practical feasibility.

1. Coordination Mechanism Between Fiduciary Duties and Regulatory Rules

Derivative transactions in China are governed by company-law provisions and by financial regulatory statutes and rules. The primary task of the regulatory pathway is to resolve conflicts and gaps between these normative regimes and to establish a coordinating mechanism that makes them complementary. This requires translating regulatory requirements into concrete elements of directors' fiduciary duties, thereby promoting an integrated application of public-law and private-law norms.

1) Transformation and Integration of Judgment Criteria

Regulatory quantitative metrics and compliance requirements should be interpreted as judgment criteria for directors' fiduciary duties, thereby mitigating the lack of granularity in corporate-law standards. Article 35 of China's Futures and Derivatives Law supports the enforceability of master-agreement close-out netting and more broadly sits within a statutory framework that emphasizes institutional risk management;³³⁾

relevant provisions and implementing rules also require firms to adopt risk-management systems, set risk limits, and maintain loss-mitigation arrangements. These regulatory obligations can inform a judicial review standard for the duty-of-care: courts should examine whether directors considered compliance with applicable risk limits when making transaction decisions. If directors' decisions cause a firm to exceed regulatory metrics (for example, leverage ratios or capital adequacy thresholds) without reasonable justification, such conduct may constitute a breach of the duty of care. Capital adequacy and liquidity-coverage requirements under China's capital-management measures should be core considerations for directors of commercial banks and can serve as objective benchmarks when assessing reasonable prudence. For example, when approving structured derivative transactions, directors of commercial banks should verify whether the transaction's capital and risk profiles comply with supplementary capital adequacy requirements. Failure to perform a reasonable verification of compliance with regulatory capital and liquidity requirements can support a finding of breach of the duty of care. Industry guidelines (for example, CSRC and industry-association instruments and draft rules concerning derivatives and OTC practices) can serve as reference points to clarify directors' compliance obligations. This produces a multi-tier assessment framework—legal principles, regulatory metrics, and industry guidelines—that gives directors clearer guidance on how to fulfil their obligations.

2) Introduction and Application of “Safe Harbor” Provisions

To balance financial innovation with directors' liability constraints, legislatures or regulators should consider introducing targeted “safe-harbor” provisions. Such provisions would provide conditional liability relief for diligent directors, reducing the risk that excessive liability discourages legitimate transactional innovation. Aligned with China's regulatory sandbox initiatives and the pro-innovation objectives of the Futures and Derivatives Law, a safe-harbor application should meet three conditions: First, the

33) Ba Shusong, Sun Xingliang, Return from Complex to Simple: Outlook on the Development of Global Financial Derivatives Markets, 6 *Shanghai Finance* 371(2011) at 5-9.

transaction's purpose must be risk-hedging and not primarily speculative. Second, directors must have completed adequate compliance processes, such as commissioning third-party compliance assessments, holding documented expert review meetings, and presenting risk-assessment reports to the supervisory board. Third, they must have established any required special risk reserves and made full disclosure of transaction risks. For example, if financial institutions engage in novel OTC derivatives within a regulatory sandbox and directors can demonstrate compliance with the above conditions, directors may be afforded limited liability relief for losses arising from extreme market events. The precise scope and limits of any safe-harbor provision should be clarified through judicial interpretation and/or regulatory guidance. Priority application could be given to innovative scenarios—such as cross-border derivatives and algorithmic trading³⁴⁾—subject to a dynamic adjustment mechanism that revises application conditions as markets and regulatory practices evolve. This approach aims to balance tolerance for financial innovation with effective risk prevention and control.

2. Calibration and Refinement of Obligation Standards

While a coordination mechanism can resolve regulatory conflicts, precise calibration of fiduciary standards requires tiered, scenario-based rules tailored to transaction features and common case types. This approach avoids the drawbacks of one-size-fits-all regulation.

1) Establishing a Two-Tier Review Standard

To address varying transaction complexity, establish a two-tier review standard: (1) formal compliance and (2) substantive prudence. This structure aligns fiduciary duties with transaction-specific risk profiles. At the formal-compliance tier, directors should follow statutory procedures and

34) LI Minghui, Research on the Legal Regulation of Financial Derivatives Transactions, 8 Commercial Research 424(2012) at 205-210.

internal governance processes—for example, board decision procedures reflected in corporate governance codes for listed firms—so that transaction proposals receive documented deliberation, retention of risk-assessment reports, and explicit independent-director opinions. For example, in standard futures transactions, formal-compliance requirements may be satisfied where directors have followed the prescribed procedures and no evident impropriety exists. At the substantive-prudence tier, for high-leverage or multi-layered structured transactions, directors must go beyond procedural checks and perform substantive reviews: verify the authenticity and quality of underlying assets; assess the reasonableness of leverage multiples; and validate the feasibility of hedging strategies. Substantive evidence—such as independent third-party assessment reports and quantitative model-validation documentation—should be retained as part of the corporate record. Substantive-prudence standards can be anchored in Civil Code provisions—e.g., Article 509 (ancillary obligations during contract performance) and Article 132 (prohibition of abuse of rights)—thereby operationalizing “reasonable prudence” into concrete review duties for complex transactions.

2) Specification of Duties in Special Scenarios

Different derivative scenarios place different demands on directors' duties; therefore, duty specifications should be tailored to scenario-specific characteristics and risks. For high-leverage transactions, directors should in particular: (a) commission legally qualified third-party reviewers to assess transaction structure compliance; (b) record clear transaction objectives, maximum exposure limits, and stop-loss triggers in board resolutions; and (c) submit periodic (e.g., quarterly) risk-monitoring reports to the supervisory board. For multi-tier structured transactions, directors must enhance disclosure: publish the composition of underlying assets, the channels of risk transmission across tiers, plausible default scenarios, and loss-allocation mechanisms,³⁵⁾ so stakeholders can assess the transaction's risk profile. For algorithmic trading, directors should implement algorithm-

35) Zhao Haiyi, Risk Control in Financial Derivatives Trading: Institutions and Laws—A Legal-Economics Analytical Framework, *6 Hebei Law Science* 27(2009) at 21-24.

oversight duties: pre-deployment review of model compliance and controllability; real-time anomaly monitoring and procedures for prompt manual intervention; retention of operation logs and post-trade risk assessments; and clear allocation of liability for algorithm-related losses. These duties can be formalized in specialized regulatory guidance or industry standards, giving directors clear, scenario-specific compliance checklists.

3) Normative Coordination through Interpretive Approach

To reconcile different normative regimes, adopt a systematic interpretive approach that links the Company Law, financial regulatory statutes, and the Civil Code into a coordinated framework. The loyalty and diligence duties under Company Law Article 180 should be interpreted to incorporate relevant Futures and Derivatives Law requirements, clarifying how those duties apply in derivatives contexts. The Civil Code's good-faith principle (and ancillary obligations) can fill gaps and provide a default basis for supplemental director obligations where specific rules are silent. For example, a failure to fulfil ongoing risk-disclosure obligations in derivatives deals may ground a finding of breach based on the Civil Code's good-faith and ancillary-obligation principles. For example, concealment of risks through multi-layer nested structures may not always trigger a direct breach of a narrowly formulated Company-Law provision. However, by applying the Civil Code's prohibition on abuse of rights together with the Futures and Derivatives Law's look-through supervision and risk-management requirements, a director's lack of diligence may be established in such cases. Concurrently, the Supreme People's Court could issue guiding cases or judicial interpretations to clarify interactions among statutes, thereby promoting consistent adjudication and reducing regulatory conflict.

3. Establishing a Comprehensive Regulatory Framework

The refinement of fiduciary-duty standards depends on a full-chain implementation mechanism that connects prevention, monitoring, and

accountability. A comprehensive regulatory system should be established to integrate pre-transaction prevention, real-time monitoring, and post-event accountability, thereby aligning internal governance with external supervision.

1) Embedding and Refining Internal Systems

Internal corporate governance systems constitute the immediate basis for directors' compliance with their duties under Chinese law. Derivatives-related obligations should be embedded in the articles of association and in internal governance rules to ensure contractual and organizational enforceability. Articles of association should specify decision-making rules for derivatives. For high-leverage or complex transactions, firms may require super-majority board approval (e.g., two-thirds)³⁶, and recorded independent-director objections should be given decisive weight. Establish a dedicated derivatives risk-control committee composed of director members with financial expertise and external specialists to oversee risk assessment, approval workflows, and ongoing supervision. Directors' and officers' (D&O) liability insurance should be optimized so that policy terms explicitly address derivative-related operational and decision-making risks where insurable under law.

Insurer exclusion clauses should be clarified so that intentional misconduct and gross negligence are explicitly excluded from coverage, consistent with insurance practice. The insurance framework should be designed to incentivize standardized, documented compliance practices rather than to create blanket indemnities. Financial institutions should implement specialized training programmes on derivatives for directors and senior managers. In line with existing training guidance for listed-company directors and senior managers, directors should regularly complete courses on derivatives, regulatory obligations, and risk management to maintain competence.

36) Xiong Yulian, Rules Development and Supervision Reform for OTC Financial Derivatives, 2 ECUPJL Journal 75(2011) at 144-150.

2) Comprehensive Regulatory Mechanisms Covering Pre-transaction, During-transaction, and Post-transaction Phases

Pre-transaction prevention should require three core tasks: (1) quantitative risk assessment (e.g., VaR and stress tests); (2) counterparty due diligence and qualification checks; and (3) documented hedging and stop-loss plans with explicit triggers and execution procedures. Real-time monitoring should emphasize dynamic measurement and control of exposures using automated systems and escalation protocols. Directors should ensure that real-time risk monitoring systems are established and that governance protocols assign clear oversight responsibilities and escalation paths. Predefined emergency measures (e.g., position reduction, trading suspension, or manual intervention) must be triggered automatically or by rapid escalation when preset thresholds are breached. Monthly risk-status reports on derivative activities should be submitted to the board and supervisory bodies. Where incidents meet regulatory criteria for major events, institutions must follow the financial-sector major-event reporting rules, including rapid follow-up reports (generally within 24 hours). Post-event accountability should define liability tiers (intentional misconduct, gross negligence, ordinary negligence) and apply a two-tier review that combines procedural compliance and substantive prudence; safe-harbor rules may be used to protect diligent decision-making. Facilitate accessible redress by preserving shareholder derivative-action mechanisms and creditor litigation channels, and by clarifying standing and procedural rules under Company Law and securities statutes. Ensure that judicial remedies under the Company Law and the Securities Law remain accessible, with procedural guidance for derivative suits and investor relief. Establish coordination mechanisms whereby regulatory bodies and judicial authorities share findings and, where appropriate, refer matters for joint enforcement, subject to clear procedural safeguards and evidence standards.

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[Abstract]

The Normative Approach How to Financial Derivatives
Transaction Innovation Reshapes Directors' Fiduciary Duties:
From a Chinese Perspective*

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With accelerating global financial innovation, the high leverage, cross-market interconnections, and complex structuring of derivatives trading have exerted multidimensional effects on China's director fiduciary-duty regime under Article 180 of the Company Law. A static regulatory framework cannot accommodate the dynamic risks of transactions. Multiple conflicts of interest and the need for cross-domain regulatory coordination have exposed institutional problems: unclear identification of loyalty conflicts, the absence of professional standards for the duty of diligence, and inadequate transparency in information disclosure. This paper is grounded in the Chinese legal context and financial-market practice. It centers on risk control, prioritizes protection of stakeholders, and relies on regulatory enforcement. By clarifying the legal core of "risk-related obligations", strengthening coordination between public and private law, and proposing a graduated standard for judicial review, the paper outlines a practical approach to: (1) align fiduciary duties with regulatory rules, (2) refine duty standards precisely, and (3) provide comprehensive, chain-wide regulatory safeguards. This paper aims to reform the static fiduciary-duty framework in China's Company Law and to enrich theory at the intersection of company

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law and financial law. It seeks to inform financial-regulatory policy, promote greater uniformity in judicial decisions, and improve internal governance of financial institutions. Ultimately, these measures intend to balance the dynamism of financial innovation with orderly market governance.

Keywords : Financial derivatives transaction Innovation, Chinese director fiduciary duties, Norm reshaping, Risk management, Collaborative governance

