

# The Governance Mechanism Defects and Optimization Strategies of Securities Investment Funds in China

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**Abstract:** Securities investment funds are a product of the socialization and professionalization of investment. They represent not only the innovation and development of financial products but also the optimization and reform of the financial system. China's securities investment funds have made significant progress, playing a crucial role in improving the structure of China's securities market and enhancing the governance of listed companies. The issuance of the 'Provisional Measures for the Administration of Securities Investment Fund Management' has effectively accelerated the rapid development of China's securities investment fund industry, making it a significant player in the current market. However, despite the rapid growth of securities investment funds, they still face issues with governance mechanisms, which hinder their innovative development. This study analyzes these governance deficiencies and proposes optimization strategies.

**Keywords:** securities investment fund; governance mechanism; optimization strategy

## 1. Introduction

The rapid development of securities investment funds in our country has become a significant force in the market. According to the Securities Investment Law, contractual funds can theoretically establish a comprehensive framework for checks and balances and governance among the three parties involved, based on trust legal relationships. However, an examination of the current governance mechanisms of securities investment funds in our country reveals different situations. Issues with internal fund governance and external environments have hindered the development of these funds. By improving internal mechanisms and optimizing the external governance environment for investment funds, we can promote the comprehensive development of the governance mechanisms of securities investment funds.

## 2. Defects in the governance mechanism of China's securities investment funds

### 2.1 Internal governance defects form institutional risk sources

Currently, there are certain deficiencies in the corporate governance structure of fund management companies in our country. Due to the shareholder system, these companies often face the issue of 'dominance by a single shareholder', leading to a tendency towards 'insider control' within the company, which seriously affects the development of the governance mechanisms of securities investment funds[1]. Additionally, the independent directors and supervisors of fund management companies are primarily nominated and appointed by major shareholders and senior executives, lacking independence and thus failing to effectively fulfill their supervisory roles. Furthermore, according to existing laws, regulations, and fund contracts, the fund custodian is responsible not only for safeguarding assets but also for overseeing the fund manager. However, in practice, the effectiveness of fund governance and supervision is poor due to the custodian's limited authority, making it difficult to supervise relevant personnel, leading to a lack of responsibility. Moreover, the custodian's independence is weak, preventing it from fully performing its supervisory functions during the supervision period. Generally, fund managers directly use their seats to execute trading operations on the exchange without reporting to the custodian, resulting in delayed data and information, which makes it difficult for the custodian to promptly determine whether investment activities are in compliance with regulations.

### 2.2 External environmental defects restrict the development of investment funds

The securities market in our country lacks effective risk management methods, and the market is relatively underdeveloped, leading to deficiencies in the external governance environment of securities investment funds, which hinders their development. Currently, the investment options in our securities market are limited, and the range of fund portfolio choices is not broad enough, significantly increasing the potential risks of asset portfolios. Moreover, due to market influences, securities investment funds struggle to select appropriate hedging tools, thereby reducing their ability to withstand risks and increasing stock market volatility. Most listed companies in our securities market have low profitability and lack

strong investment value. Furthermore, some companies have incorrect development philosophies, making it difficult for securities investment funds to select suitable enterprises, thus exacerbating investment risks. From a legal perspective, the laws regulating securities investment funds in our country are relatively limited, and there are insufficient provisions addressing certain issues of securities investment funds, which affects the formation of their governance mechanisms[2].

### **2.3 Defects of fund holders and low functional understanding**

Currently, the absence of a representative to safeguard the interests of fund holders means that meetings are only convened when significant issues arise. This results in a lack of effective oversight mechanisms for daily fund operations. Fund holder meetings often become mere formalities, lacking in-depth analysis of systems and regulations, which hinders the development of governance mechanisms in securities investment funds. Fund holders primarily rely on these meetings to oversee fund managers, but in practice, they face numerous challenges and lack practical operability, making it difficult for them to fulfill their roles effectively. Typically, the large number of fund holders disperses voting rights, making it challenging to achieve a majority vote. Additionally, attending these meetings is costly in terms of time and money, which can disrupt the daily lives of fund holders. Furthermore, fund holders have a weak sense of rights protection; most are focused on short-term profits and lack long-term vision and comprehensive consideration.

## **3. The optimization strategy of the governance mechanism of China's securities investment funds**

### **3.1 Improve the internal mechanism of securities investment**

To optimize the governance mechanism of China's securities investment funds, it is essential to first improve the internal mechanisms of securities investment, closely monitor the structure of shareholder contributions, thereby balancing shareholders and achieving a balanced corporate interest structure[3]. To further reduce insider control, promote employee career development, and ease the conflict of interests between management and shareholders, an employee shareholding system should be established within fund management companies. Additionally, a permanent body representing the interests of the holders should be set up to oversee the daily operations of fund management companies. Furthermore, two-thirds of the members of the trust committee should be external independent individuals to ensure the committee's fairness and impartiality. Moreover, China's securities investment fund governance mechanism should establish a fund margin system to penalize those who violate their duties, effectively preventing fund managers from breaching trust.

### **3.2 Optimize the external governance environment of investment funds**

To improve the governance mechanism of China's securities investment funds, it is essential to first enhance the legal framework in the external governance environment, focusing on internal monitoring and external oversight within the fund industry[4]. Currently, Chinese laws primarily describe departmental regulations, lacking detailed provisions on equity incentives and portfolio structures for fund management companies. Therefore, it is necessary to propose practical measures to address these gaps. Secondly, the quality of listed companies in the securities market should be improved to enhance their investment value. In the context of globalization, China's securities investment fund market needs to optimize its structure by actively introducing private enterprises to the stock market, thereby broadening the range of asset choices for investment funds. Additionally, the financial derivatives market should be vigorously developed to help mitigate risks associated with securities investment funds. By developing financial products within the securities investment fund market, innovative products can be created, which will improve the environment for China's securities investment funds and promote their healthy development. Furthermore, it is necessary to draw on advanced international fund supervision models and innovate and optimize them according to local conditions to refine the governance mechanism of securities investment funds. Through macro-regulation and guidance from the fund market regulatory authorities, the internal supervision system of the funds can be further enhanced.

### **3.3 Strengthen the governance function of the fund holders' general meeting**

The governance mechanism of China's securities investment funds needs to enhance the functions of the fund holders' meeting, improve the independence of fund holders, and enable them to propose their own motions in the meeting, thereby optimizing and rectifying the governance mechanism of securities investment funds[5]. Additionally, the fund holders' meeting should enhance the decision-making power of fund holders by establishing corresponding laws to define this right, thus enhancing the influence and decision-making power of fund holders. Given that fund holders are typically dispersed and mobile, it is necessary to regularly hold fund holders' meetings to maintain their voting rights. Furthermore, under certain circumstances, the voting rights of fund holders can be separated to increase the concentration of voting rights, thereby

addressing the current issue of dispersion in the governance mechanism of China's securities investment funds. Moreover, the awareness of rights protection among fund holders is a crucial foundation for the development of the governance mechanism of China's securities investment funds. By promoting fund knowledge and integrating professional design with the public, the financial management awareness of the public can be effectively enhanced. At the same time, fund managers should proactively solicit votes from fund holders on major events, using online forums, Weibo, and other platforms for communication and exchange, effectively strengthening their rights protection awareness.

## 4. Conclusion

Securities investment funds, in essence, are a financial system or arrangement that optimizes and improves the traditional financial system structure. This has significantly influenced the development of the financial system and the economy. The governance mechanisms of securities investment funds in our country have deficiencies in internal, external, and fund holder aspects. By improving internal controls and optimizing the external environment, these issues can be effectively addressed, thereby enhancing the competitiveness of the entire financial system and market. In addition, the maturity of the capital market determines the function and role of securities investment funds, and listed companies are the cornerstone of market development, so it is necessary to innovate and develop the market and companies to ensure the stable development of the governance mechanism of securities investment funds.

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