Designing Institutions for Enforcing Corporate and Securities Laws in Hong Kong and Singapore

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Abstract

Current scholarship emphasises the correlation between strong capital markets and institutions that robustly enforce corporate and securities laws. Yet, the issue of the optimal design of institutions so as to achieve the twin aims of deterrence and compensation remains controversial. In particular, what is the right mix of public and private enforcement? Should the Western models of enforcing corporate and securities laws be used as a basis for reforms globally, bearing in mind that Asian jurisdictions (outside of Japan) generally have concentrated shareholdings and their stock exchanges have ambitions for attracting global listings? This study examines these issues by focusing on Hong Kong and Singapore, two leading international financial centres in Asia. Post-Asian financial crisis of 1997, partly influenced by the Western models, Hong Kong and Singapore have changed their laws to strengthen the private enforcement framework. At the same time, regulatory enforcement activities have also been significant. The question is whether these reforms and enforcement activities succeed in reaching the afore-mentioned objectives in dealing with the twin challenges of highly concentrated shareholdings and the complexities of dealing with foreign listings, where such challenges are not present in the same scale as the US and the UK. Based on our study of breaches of directorial duties and corporate disclosure violations involving listed companies from 2000 to 2015, we find that (1) public enforcement dominates over private enforcement in Hong Kong and Singapore; and (2) there exist important, but limited, substitutes to private enforcement: securities regulators use public enforcement to obtain compensation for investors and shareholders file requisitions to remove the errant directors. Our study is relevant to those jurisdictions considering the design of an optimal institutional framework for enforcement in the capital markets and illustrates that transplantation of the Western models of institutions may not always work as intended.

1 Introduction

A great deal of attention has been placed in recent scholarship on how intensely corporate governance rules in the world are enforced.[1] The choice in any given jurisdiction on the optimal manner of enforcement, whether by public agencies or private investor and whether through civil, criminal or hybrid means, is important as the level of enforcement is now increasingly viewed as vital in achieving deterrence and investor compensation, which are essential in promoting deep and liquid securities markets.[2] Proponents of private enforcement of corporate and securities laws, particularly, La Porta et al, have argued, pointing to the United States (US), that empowering investors to bring action against defendants engaged in market misconduct is associated with strong securities markets.[3] Others have argued that the measure of shareholder litigation is not meaningful and that public enforcement is a much more significant contributor, pointing to the United Kingdom (UK).[4]

A limitation of the current scholarship on enforcement is that it is mainly focused on the Western jurisdictions (particularly in the US and the UK) which are characterised by markets with diffused shareholdings among their publicly listed companies, whose main aims are to address the agency costs that exist between managers and the shareholders.[5] Some of the scholarship focuses on the European Union (EU) more broadly and on countries such as Australia.[6] In contrast, there are few studies on enforcement in jurisdictions with concentrated shareholdings in Asia, where, outside of Japan, the main concerns of agency costs are between the controlling and minority shareholders and the challenge is to find the appropriate strategy to control these costs.

In this paper, we examine the *ex post* enforcement strategies in Hong Kong and Singapore, which are two international financial centres in Asia and which rank highly in protection of minority rights and enforcement scores in international rankings.[7] Hong Kong and Singapore are good choices to study as their publicly listed companies[8] are dominated by concentrated shareholdings.[9] Both are common law jurisdictions with strong judiciary and have

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[1] *See, e.g.*, Coffee JC Jr. (2007); Jackson HE and Roe MJ (2009); La Porta R et al. (2006); Armour J et al. (2009).

[2] See La Porta R et al. (2006), ibid.

[3] See La Porta R et al. (2006), ibid.

[4] See Armour J et al. (2009).

[5] For diffusion and concentration of shareholdings of major Western and Asian jurisdictions, see La Porta R et al. (1999). However, in both the US and UK, not all the companies have diffused ownership and there are publicly listed companies with blockholders. See e.g. Holderness CG (2009) (for US) and Reddy BV (2017) (giving UK examples).

[6] E.g. see the literature cited Enriques L et al. (2017), pp. 261-262 (for France, Germany and the UK); see Hedges J et al. (2016); Gilligan G et al. (2015) (for Australia).

[7] CLSA, CG Watch 2016 (Singapore and Hong Kong scoring 63 and 69 respectively for enforcement, which are the highest among the Asian jurisdictions. In comparison, Australia scores 68.). See also World Bank, *Doing Business 2017: Hong Kong* and *Doing Business 2017: Singapore*, on protecting minority investors, available at www.doingbusiness.org (accessed 1 September 2017).

[8] As at December 2015, Hong Kong and Singapore have 1886 and 769 companies listed on their respective stock exchanges. Source: World Federation of Exchanges.

[9] For evidence of concentration of shareholdings in Singapore, see Chen C et al. (2017) (based on a sample of 103 SGX-listed companies, the data shows approximately 66% of the Singapore companies have beneficial owners over 30%). For Hong Kong, see Carney RW and Child TB (2013) (based on a sample of 158 SEHK-listed companies,

highly developed stock markets. Both also have significant proportions of foreign listings in their stock markets.[10] Since the Asian financial crisis of 1997, both jurisdictions also seek to strengthen the private enforcement framework. In Singapore, the statutory compensation scheme for market misconduct was introduced in 2002 via the Securities and Futures Act (SFA). In 2013, Singapore liberalised the availability of the statutory compensation scheme, which makes it easier to obtain compensation for corporate disclosure violation by removing the ceiling of recovery.[11] In 2014, the statutory derivative action was extended to listed companies incorporated in Singapore.[12] In Hong Kong, since 2004, the statutory derivative action allows shareholders to pursue corporate claims against corporate insiders, even when the insiders did not wish to bring such claims.[13] In both jurisdictions, the objective of the strengthening of the private enforcement framework is stated to increase investor protection, which is seen as vital for strong securities markets.[14] We choose to focus on *ex post* enforcement strategies which may lead to sanctions or compensation orders (such as prosecutions, administrative actions or civil proceedings), rather than *ex ante* enforcement strategies (such as stock exchange queries or clarifications) to ensure the manageability of data.

While there are single study jurisdictions examining various aspects of *ex post* enforcement in Hong Kong[15] and Singapore,[16] and more recently, a comparative study on shareholder derivative actions,[17] these studies present aggregated data of public and/or private enforcement separately. This paper presents a new dataset on Hong Kong and Singapore *ex post* enforcement data on directorial misconduct and corporate disclosure violations, by examining each instance of private (and concurrent/subsequent public) or public (and concurrent/subsequent private) enforcement action, the defendants that are pursued, the outcomes of these actions (including sanctions imposed, the beneficiaries of compensation) and the length of time that the proceedings took to resolve. This paper also presents new evidence on the existence of an important functional equivalent of private enforcement, that is, shareholder requisitions on resolutions linked to governance failures.[18] In sum, our study presents a richer account on how public and private enforcement works in the two countries.

We seek to answer the following questions. First, how robust is private and public enforcement of corporate and securities laws in Hong Kong and Singapore? Such enforcement is vital to the functioning and integrity of securities market. We are particularly interested in what has been the impact, on investor compensation, of legislation in both countries that seek to strengthen private investor action in the enforcement of directorial duties and corporate

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the data shows 55.1% are controlled by families (controlling at least 20%) and 27.2% are controlled by state (controlling at least 20%).

[10] As at 31 December 2015, Hong Kong and Singapore have 1770 (out of 1886 or 94%) and 286 (out of 769 or 37%) companies respectively listed outside the jurisdiction of listing. Source: World Federation of Exchanges.

[11] Securities and Futures (Amendment) Act 2012, discussed in Wan WY and U Varottil (2013).

[12] Companies (Amendment) Act 2014 (Act 36 of 2014) s 146 (Singapore), removing the definition of "company" in Companies Act s 216A(1) that limited the application of derivative action to unlisted companies.

[13] Companies Ordinance, ss 732 and 733.

[14] Monetary Authority of Singapore (1998) Report of the Corporate Finance Committee: The Securities Market Final Recommendations; Hong Kong Exchanges and Clearing Limited (2002) Consultation Paper on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues.

[15] Donald DC and Cheuk P (2017); Chan GYM (2014); Mezzanotte FE (2017).

[16] Wan WY (2008).

[17] S Tang, 'Rethinking the 'Theory in Books' for Derivative Actions: Evidence from Singapore and Hong Kong', on file with authors.

[18] For substitutes to private enforcement in the UK, see Armour J et al. (2009).

disclosures,[19] and whether there are any gaps in the enforcement strategies. Second, are there any functional substitutes to private enforcement by shareholders? The answers to the first and second questions will enable us to formulate the appropriate policy recommendations for reforms on the enforcement framework.

We focus on two kinds of misconduct which pose the greatest challenges to the securities markets and where there can be both public and private enforcement in corporate and securities laws in Hong Kong and Singapore: corporate disclosure violations and breaches of directorial duties. We have not included insider dealing, market manipulation or use of fraudulent or deceptive devices in this study as they can be carried out not only by corporate insiders but also by third parties and do not often involve harm to the listed company. We have also excluded liability when the company is trading while insolvent. We refer to public enforcement as enforcement that is initiated by government actors, such as securities regulators, public prosecutors and private organization with quasi-public functions such as stock exchanges. For example, we regard reprimands made, and remedial actions required, by stock exchanges as part of public enforcement. Private enforcement refers to actions that are initiated by private parties acting in their own interests.[20]

On enforcement of directorial duties, our data shows that private enforcement by shareholders (in the form of derivative actions) is very rare in both countries. If there is private enforcement, it is left mostly to the company directors and/or liquidators. In particular, in Singapore, despite the extension of the statutory derivative claims for listed companies incorporated in Singapore in 2014, such claims are rare, with only one case.[21] Public enforcement is far more significant in both countries. In Singapore, public enforcement is exercised through criminal prosecution or stock exchange sanctions. In Hong Kong, public enforcement is carried out by the Securities and Futures Commission (SFC) or stock exchange.[22]

On the enforcement of corporate disclosure, there are small but important differences in the approaches that Hong Kong and Singapore have undertaken. While the securities legislation in both countries provide for compensation for disclosure violations, in Hong Kong, the securities regulator has wide-ranging powers under the public enforcement framework not only to punish the wrongdoers but also to recover compensation for aggrieved investors.[23] In Singapore, such powers of recovering compensation are not explicitly conferred on the regulator but the legislation on the "books" has a statutory compensation scheme, which is comparatively more favourable to investors seeking to enforce corporate disclosure violations than at common law.[24] However, despite the measures to improve the availability of investors to access private enforcement, public enforcement of corporate disclosure laws is more prevalent than private enforcement in both countries. In Hong Kong, private enforcement by investors is low but the gap is partially filled by public enforcement obtaining substantial compensation for investors in selected cases. In

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[19] It is outside the scope of this article to discuss the appropriate *ex ante* regulation to secure compliance. For a discussion on *ex ante* regulation in Hong Kong, see GYM Chan (2014).

[20] Our definitions of public and private enforcement follows of Armour J et al. (2017), ch 2.

[21] See discussion in n 83 and accompanying text.

[22] See discussion in Section 2.5.2 below.

[23] See discussion in Section 2.5.3 below.

[24] Ibid.

Singapore, while the securities legislation "on the books" allows investor claims, civil claims continue to be very rare. However, there is an avenue of using indirect compensation through the creative use of the settlement process in public enforcement, which has been used recently by the securities regulator.

Investor compensation for corporate disclosure violations also prompt the further question: who should be the beneficiaries and defendants of these enforcement actions? In these cases, the errant directors would have made the statements on behalf of the listed firms, so, in theory (and subject to the requisite intention), both of the errant directors and the listed firms could be held liable criminally or civilly. Here, we find that there are small but significant differences in law in action in Hong Kong and Singapore. In Hong Kong, both the listed firms and the errant directors or officials are subject to stock exchange criticisms and substantial civil pecuniary orders for disclosure violations. In particular, SFC, more often than not, seeks to hold both of the listed firm *and* the directors or officials liable to compensate the investors who suffer losses.[25] When the listed firm is liable, it raises the *circularity problem* in securities litigation, which refers to the fact that innocent existing shareholders who did not contribute to the securities fraud bear the costs of compensation to the investors who lost value. In Singapore, while both the listed firms and the directors are subject to stock exchange criticisms, the trend shows that *only* the directors and officials are subject to civil pecuniary orders and/or prosecution. Further, the beneficiaries of compensation are the listed firm itself, rather than the investors.

Our findings for Hong Kong and Singapore on the state of private enforcement prompt the further question, that is, are there substitutes for private enforcement (apart from shareholder litigation or investor action)? We find that significant minority shareholders do use the mechanism of reputational sanction, by filing shareholder requisitions to remove the errant directors or voice their unhappiness with governance failures.

We then discuss the normative implications of our study on achieving the twin goals of investor compensation and optimal deterrence. First, it is likely that private enforcement will remain rare, given the procedural problems such as the costs, lack of an active plaintiffs' attorney bar, the difficulties of obtaining discovery and the free-rider problem. Thus, in Singapore, we argue that there is a case for the securities regulator to enforce such breaches of directorial duties given that the existing regulatory strategies only relate to imposing criminal sanctions and shareholder-initiated derivative actions for compensation are rare. The availability of civil sanctions will also increase the regulatory toolkit that the securities regulator has and incentivises wrongdoing directors to negotiate a compensation settlement with the listed company. Second, on individual or corporate claims and/or liability for corporate disclosure violations, we argue that investor compensation and optimal deterrence should be the goals for civil non-penalty liability and criminal/ civil penalty respectively. Thus, in the case of Singapore, where the defendants enter into consent orders and offers to pay compensation, the proper beneficiaries should be the investors who suffered loss, and not the company. Greater consideration should also be made to impose criminal and/or civil penalties on the listed companies. In the case of Hong Kong, in the securities regulator's enforcement actions, only the wrongdoing directors (as distinct from the listed companies) should be obligated to pay compensation.

[25] See the discussion relating to the enforcement proceedings on CITIC, n 107 and accompanying text.

More generally, our study not only contributes to the debate on the theory of private enforcement by La Porta et al,[26] but also to the other major theoretical debate in corporate law on legal transplantation. We also demonstrate that the transplantation of US-driven paradigm of the primacy of private enforcement of securities litigation may not have the effects found in the country of origin. Our research will be of interest to jurisdictions seeking to improve the powers of the regulators or their enforcement framework.

There are certain limitations to our study. First, our study focuses only on the formal enforcement. As the literature has pointed out in the context of the UK, informal enforcement (such as behind the scenes consultations with the regulators) is important.[27] However, informal enforcement is not readily observable in Hong Kong and Singapore except with in-depth interviews with the regulators and practitioners, which will have to be the subject of separate research. Second, we can only investigate those enforcement actions reported by the listed firms or the media or in the form of judgments issued by the courts. We are not able to study any private settlement with individual investors or private reprimands given by the regulators. Third, we are not able to say based on our study whether Hong Kong and Singapore have reached optimal levels in respect of public enforcement; a low volume of enforcement is ambiguous because it can indicate an ineffective regulator or a clean market and conversely a high volume of enforcement can indicate an effective regulator or a rigged market.[28] However, we can, and do, point out gaps in the enforcement strategies when we compare and contrast these strategies in the two countries, with reference to the US and the UK.

The rest of the paper is structured as follows. Section 2 of this paper examines the theoretical framework of enforcement. Section 3 presents data on enforcement of corporate disclosure violations and breaches of directorial duties and explains how the gaps in private enforcement have been partially filled by the securities regulator taking enforcement actions to obtain investor compensation. Section 4 examines the availability of other functional substitutes for private enforcement. Section 5 sets out the lessons and normative implications and Section 6 concludes.

2 Literature Review and the Theoretical Framework of Enforcement

2.1 Literature review and objectives of effective enforcement

To assess the intensity of enforcement of corporate and securities laws, that is, law in "action", scholars have measured the exercise of regulatory discretions and oversight of public capital markets by using various proxies, including the proportion of the budget spent on enforcement[29] and relationship between the budget and staffing numbers of the enforcement agency.[30] However, the chief limitation of using the above-mentioned 'inputs' data is that the securities regulators in

[26] La Porta R et al. (2006).
[27] Armour J (2008).
[28] Jackson HE and Roe MJ (2009).
[29] Coffee JC Jr. (2007).
[30] Jackson HE and Roe MJ (2009).

Hong Kong and Singapore generally aggregate the data for financial services generally and do not disclose the proportion spent actually on enforcement of securities misconduct in their budget and staffing numbers. While the former Financial Services Authority (FSA) in the UK has collected and published data relating to enforcement of securities markets obtained from the Singapore and Hong Kong regulators directly, the last collection (and publication) was in 2006. [31] Since that date, there have been significant developments to the securities markets in both countries, including the influx of listing of mainland Chinese firms,[32] as well as rise in demand for enforcement services.[33]

Thus, instead of looking at how public regulators exercise the resources allocated to them, we measure intensity through 'output' in the form of public enforcement by regulators and private enforcement by the listed companies and their shareholders. By looking at a number of factors, including number of actions and the outcomes of these actions, we can draw certain cross-country comparisons as to enforcement intensity and what both countries can learn from each other.

Our findings contribute to the existing literature relating to enforcement in Hong Kong and Singapore in the following ways. First, Donald's Hong Kong data for the period 2006 to 2012 shows that the public enforcement of corporate and securities laws is much more central than private enforcement.[34] In a closely related study, Donald and Cheuk have examined an updated dataset containing the public enforcement strategies of the Hong Kong regulators using the aggregate data of enforcement actions.[35] Our study differs from these two earlier studies in that we examine the circumstances surrounding each reported case of corporate disclosure violation and/or breach of directorial duties and then trace the outcome (whether it takes the form of sanction, remedies or delisting). In this way, we can trace whether there has been both public and private enforcement for the same listed company and/or its directors. Our study enables us to determine whether the mix of enforcement strategies (both private and public) are adequate in the circumstances. Second, our study adds to the study by Mezzanotte on statutory derivative action in Hong Kong, in that we additionally cover oppression actions, which have their foundations on unfair conduct by controlling shareholders (who are usually either directors themselves or are able

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[31] The Financial Services Authority in the UK had collected data from ten jurisdictions (including Singapore (MAS) and Hong Kong (SFC)) as to the amounts that were allocated to securities enforcement and publicly disclosed such data, but the latest was as at 2006. See FSA, Annual Report 2006, Appendix 1 (Cost of Regulatory Authorities in other Jurisdictions). The data from an earlier study of the FSA, Annual Report 2004, was used as the basis of the study done by Jackson HE (2007) and Jackson HE and Roe MJ (2009).

[32] For example, in Hong Kong, as at 2005, 18.5% of the Mainboard listed companies on SEHK were mainland Chinese firms, constituting 48% of the aggregate market capitalisation of all Mainboard listed companies. By 2015, 53.8% of the Mainland listed companies on SHEK were mainland Chinese firms constituting 63.7% of the aggregate market capitalisation of all Mainboard listed companies. Source: Hong Kong Exchanges and Clearing Limited (2006) HKEX Fact Book; Hong Kong Exchanges and Clearing Limited (2016) HKEX Fact Book 2016. In Singapore, mainland Chinese companies constituted approximately 7.2% of all of the listed SGX firms in 2004 and the figure rose to 20% by 2011: source: Reuters Staff (2011) (reporting 41 mainland Chinese firms in 2014), J Kwok, 'Are S-chips still a possible play?' *The Straits Times* (Singapore, 25 December 2011), and calculations from World Federation of Exchanges.

[33] Lam A (2017), ch 17 (describing the between 2007 and 2014, the investigation workload increased by 240% and litigation work increased by over 500%).

[34] Donald DC (2013), ch 5.

[35] Donald DC and Cheuk P (2017).

control the appointment of directors).[36] Third, in prior work, Wan finds that shareholder litigation for corporate disclosure violation is generally rare in Singapore, based on the data available prior to 2008.[37] This study extends the study to oppression actions and breaches of directorial duties and updates the dataset to 2015. It also covers the cases involving significant regulatory actions taken post-2008.

2.2 Public enforcement by regulators

For publicly listed companies with concentrated shareholdings, the biggest corporate challenges are the misconduct by directors, who are often appointed by the controlling shareholders. An active enforcement by regulators can not only deter market misconduct but also carry many advantages, including obtaining investor compensation. For example, in certain jurisdictions, such as Australia,[38] the regulator is expressly conferred powers to commence litigation to obtain compensation for the listed company and/or the investors. In the UK, the regulator has the express power to order restitution for market abuse and has recently exercised such power in favour of the investors of Tesco.[39] In the US, there exists the "fair fund" which allows the SEC to designate civil penalties recovered to benefit defrauded private investors.[40] In Section 3 below, we demonstrate how the securities regulator in Hong Kong and Singapore have used the powers under the securities laws to obtain investor compensation.

Allowing the regulator to have a range of possible sanctions which can be imposed on the wrongdoers gives the flexibility to calibrate the severity of the sanction to the misconduct, in a way that compensatory damages will be unable to do so. For example, many jurisdictions provide not only for criminal sanctions for wrongdoing but also civil penalty orders which carry a lower burden of proof and yet can be set at appropriate levels for both deterring the particular defendant and the public at large.[41] In Australia, the civil penalty framework has allowed the regulators to set the standards for boardroom behaviour in duty of care cases; for instance, in the *Centro* case, the outcome of the decision required directors (including non-executive directors) to read and comprehend the accounts before they give their opinion. At the same time, the decision imposed a relatively light civil penalty for contravention, so as not to risk over-deterring directorial conduct.[42]

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36 Mezzanotte FE (2017).

37 Wan WY and Varottil U (2013), ch 16.

38 ASIC Act, s 50. See Bentley N (2016).

39 FSMA, s 384; the power was exercised recently in connection with the false or misleading statement by Tesco. See Financial Conduct Authority (2017) Final Notice: Tesco plc and Tesco Stores Limited.

40 Sarbanes Oxley Act, s 308; see discussion in Velikonia U (2015); Cox JD and Thomas RS (2003).

41 Eg Hedges et al (2017) (for Australia).

42 *ASIC v Healey* [2011] FCA 717. In that case, errors were found in the 2007 annual reports of Centro Properties Group (CNP) and Centro Retail Group (CER). In the case of CNP, the report failed to disclose some A$1.5 billion of short-term liabilities as they were wrongly classified as non-current liabilities, and failed to disclose guarantees of short-term liabilities of an associated company of approximately US$1.75 billion that had been given after the balance sheet date. In the case of CER, the 2007 annual reports failed to disclose some A$500 million of short-term liabilities that had been classified as non-current. The audit committee and a major auditing firm had signed off on the accounts. The Australian Securities and Investment Commission (ASIC) brought enforcement proceedings against the chief executive officer (CEO), the chief financial officer (CFO) and the six non-executive directors. All of the directors were held to have contravened section 180 of the Australian Corporations Act 2001 (which sets out the statutory duty of care of directors). However, when it came to the penalties, the court imposed a fine of A$30 000 on

Additionally, directorial disqualification may be imposed to remove unsuitable directors from assuming offices. In less serious cases, a public reprimand or warning, coupled with undertakings by the listed company or its directors to change their conduct, may be sufficient. In Section 3 below, we present evidence on how the securities regulators in Hong Kong and Singapore have utilised the range of sanctions to deter misconduct and identify some of the gaps in this respect.

Further, the regulator usually would have wide-ranging powers of investigation, which can be used in ways that are not present in private enforcement. In Hong Kong and Singapore, where there is a high proportion of foreign listings, the regulator is more likely to be successful in seeking cross-border regulatory cooperation in investigation and gathering evidence, which is not available to private investors when they are seeking to bring actions against directors who are outside the jurisdiction of listing. The regulator is able to exercise its powers to send a signal to what it perceives to be in the public interest, which is not the case in private litigation, and overcome the collective action problem faced by shareholders in bringing private securities litigation.[43] In certain situations, the regulator can through censures or reprimands, bring about a change in behaviour of the wrongdoing parties.

The downside of primary reliance on public enforcement is, however, that it is dependent on the size of the regulator's budget in enforcement. Where resources are scarce, as are often the case, the regulator is likely to choose enforcement cases which are relatively straightforward, where there is public interest (such as a high degree of publicity),[44] and these actions are not necessarily in the investors' interests.

2.3 Private Enforcement

For the limitations mentioned in the preceding section, public enforcement cannot be the sole means for regulating all of the breaches of directorial duties and corporate disclosure violation. Private enforcement is also necessary as explained below. For breaches of directorial duties, in theory, the boards of companies should be bringing these actions against the wrongdoing directors. In practice, however, these actions are usually brought only with newly constituted boards of directors or liquidators where there are company funds to pursue such litigation. If the boards do not take actions, the only options are for the shareholders to exercise private actions. In many common law jurisdictions, including the UK,[45] Australia,[46] Hong Kong and Singapore,[47] the company law allows shareholders of listed companies to compel the companies to bring the actions through the statutory derivative actions. For corporate disclosure violations, due to the

Centro's former CEO, and a two year managerial disqualification order on its former CFO. No penalties were imposed on the non-executive directors.

43 The collective action problem exists because the costs of bringing the lawsuit are likely to be greater than shareholder claimant's pro rata benefit.

44 Eg see Cox JD and Thomas RS (2003) (in the context of the US Securities and Exchange Commission).

45 Companies Act 2006 (UK), s 260-264.

46 Corporations Act 2001 (Aust), Part 2F.1A (ss 236-242).

47 See discussion in Section 2.5 below.

problems that claimants face when they sue the defendants at common law for false or misleading statements made to the securities markets,[48] UK,[49] Hong Kong and Singapore[50] have enacted legislation to enable investors to obtain statutory compensation from the listed companies and/or their directors.

Private enforcement by investors or shareholders (whether directly or in the form of derivative actions) carries a number of benefits. Not only are investors compensated for the damages resulting from the wrongdoing, it can operate to deter wrongdoing due to the threat of liability. There is a substantial body of literature that has argued that private parties have far better incentives to bring actions than do regulatory bodies, and are thus more effective in enforcement than public enforcers.[51] Likewise, it has been argued that private enforcement has contributed to a robust securities market in the US.[52]

However, in many jurisdictions outside of the US, private enforcement does not address all of the investor compensation issues; smaller shareholders tend to suffer the collective action problem in listed companies, and typically are not interested in commencing litigation. The civil procedure rules play an important part as well, as a rule that requires the loser to pay the winner's costs, coupled with a lack of an active plaintiff attorneys' bar and securities class actions, will tend to discourage the smaller shareholders from bringing the action. Even when shareholders are willing to bring the actions, the availability of an optimal discovery mechanism is important to these shareholders.[53] Thus, it remains an empirical question as to whether investors actually receive the appropriate compensation, notwithstanding the law "in the books".

2.4 Differences between breach of continuous disclosure obligations and breaches of directorial duties

Breach of continuous disclosure obligations cases raise different enforcement issues from breaches of directorial duties in at least two aspects. First, there are at least two choices as to the beneficiaries of compensation in corporate disclosure violations: either the company or the investors. Proponents of the former view have argued that the corporate governance rationale should prevail and the fraud should be treated as fraud against the company; thus, the proper plaintiff should be the company, and there are creative ways to deal with issues of causation and remoteness.[54] Proponents of latter view have argued that the listed company usually would not have suffered any direct losses unless the disclosure violation is accompanied by breaches of directorial duties and the listed company had covered up such breaches.[55] In the absence of corporate disclosure violations not accompanied by directors' breaches of duties, the losses are suffered by investors

48 See discussion in Wan WY (2009); Wan WY (2008); Paul Davies QC (2007).
49 Ibid.
50 See Appendix 2.
51 Eg La Porta R et al. (2006).
52 Ibid.
53 Gorga E and Halbertam M (2014).
54 Eg Tjio H (2009).
55 Eg Wan (2008).

who have traded in the shares in ignorance of the contravention. Thus, in these cases, the parties who have suffered losses are the investors who bought into the company in ignorance of the bad news (and not the listed company).

Second, and unlike breaches of directorial duties, the possible defendants for corporate disclosure violations, whether in a criminal, civil penalty or action for civil remedies, include both the listed firms and the investors. In criminal or civil penalty actions, the regulator can choose whether to proceed only against the individuals or against the listed company, even though the company is deemed to have committed the false or misleading disclosure or engaged in material non-disclosure. It has been argued that from the perspectives of the companies and their managers, they would prefer criminal corporate liability because it deflects sanctions away from managers.[56] Thus, for effective deterrence, liability should be imposed on the managers, rather than the companies. In our study, we seek to test the strategies of the securities regulator in Hong Kong and Singapore in preferring to impose criminal or administrative liabilities on companies or their directors.

For civil actions, the solution for private securities litigation reached in the UK is that sellers and purchasers of securities can sue the listed company (but not directors) for fraudulent disclosures and delays in disclosures.[57] In the US, while sellers and purchasers have direct rights of actions against the listed company and directors[58], in practice, only listed companies pay the damages and individual directors and officials do not end up paying. Compensation by the listed companies to the investors therefore raises the classic "circularity" problem, which refers to the fact that innocent existing investors who did not contribute to the securities fraud bear the costs of compensation to the investors who lost value.[59] The circularity problem may be less pronounced in Hong Kong and Singapore where the vast majority of the public companies have concentrated shareholding. When the listed company is held liable for corporate disclosure violations (usually with the cognizance of the errant controlling shareholders), these errant controlling shareholders will also suffer since the value of their shareholding will also fall correspondingly. Nevertheless, the circularity problem is not eliminated as minority shareholders in the public companies, who are not privy to the wrongdoing, will also suffer a fall in the value of their shareholdings as a result of the compensation. Thus, this would suggest that it should be the errant directors who should be compensating the investors, and not the company. We seek to test whether this is in fact the case in Hong Kong and Singapore.

2.5 Public Enforcement in Hong Kong and Singapore Markets

2.5.1 Background and the enforcement authorities

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56 Khanna V (2004).

57 FSMA, s 90A (allows purchasers of securities to sue the listed issuer for statutory compensation for fraudulent (not negligent) periodic misstatement). See Paul Davies QC (2007) at [18].

58 Securities Exchange Act of 1934, s 20(a).

59 The circularity problem is discussed in Coffee JC (2006). Cf Fisch JE (2009).

We begin with a measure of the listed companies and market capitalization in the two countries. Hong Kong and Singapore have an aggregate of 1,866 and 769 listed companies as at 2015.[60] A significant proportion of listed companies in the stock exchanges of two countries are foreign listings.[61] Hong Kong's market capitalisation is about five times that of Singapore's (USD3,184 billion (Hong Kong) and USD640 billion (Singapore)).

The securities regulators in Hong Kong and Singapore are the Securities and Futures Commission (SFC) and the Monetary Authority of Singapore (MAS) respectively. The SFC and the MAS investigate breaches of the Securities and Futures Ordinance (SFO)[62] and the Securities and Futures Act (SFA)[63] respectively and are able to institute proceedings for civil penalties against persons who have infringed the market misconduct provisions in the securities legislation of Hong Kong and Singapore respectively,[64] including proceedings before the Market Misconduct Tribunal (MMT) (in Hong Kong).[65] As to criminal proceedings, in Hong Kong, the SFC is able to bring criminal prosecutions in the Magistrate's courts, with the Department of Justice bringing more serious cases in the District Courts and Courts of First Instance.[66] In Singapore, criminal investigations relating to market misconduct and breaches of directorial duties can also be jointly conducted by the Commercial Affairs Department and the MAS, and criminal prosecutions are brought by the Attorney-General's Chambers in the name of Public Prosecutor.

Additionally, we should also mention the role of the stock exchanges, which has the role of investigating and taking disciplinary action against the issuers and their directors if there is a breach of the listing rules, including those relating to failing to act in the interests of the company as a whole and/or its shareholders (in the case of Hong Kong).[67] In the case of SEHK, the SEHK is able to impose a range of sanctions, including issuing a reprimand, remedial actions (such as requiring the listed company to appoint a compliance adviser), direct a trading suspension[68] and cancelling the listing.[69] In Singapore, for breaches of listing rules generally, until recently, the SGX only has the power to issue a reprimand or delist the company in the worst cases of non-compliance.[70] However, in October 2015, the listing rules were amended to allow the SGX to have a wider range of enforcement powers, including imposing an administrative fine not exceeding S$250,000 or impose restrictions or conditions that the issuers may undertake.[71] Additionally, it

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60 Statistics are obtained from the World Federation of Exchanges. Market capitalisation figures are from the World Federation of Exchanges.

61 The statistics from World Federation of Exchanges, as at December 2015, shows that 37% of the companies listed on SGX are foreign companies. In respect of Hong Kong, as at October 2016, only 13% of the companies listed on SEHK are incorporated under Hong Kong law.

62 Securities and Futures Ordinance L.N. 12 of 2003, 1 Apr 2003.

63 Securities and Futures Act, Cap 289, 2006 rev ed.

64 See Monetary Authority of Singapore (2016) Capital Markets Enforcement. For the role of the Securities and Futures Commission, see http://www.sfc.hk/web/EN/about-the-sfc/our-role/, accessed 1 July 2017.

65 The Market Misconduct Tribunal (MMT) imposes civil sanctions on the parties.

66 See Lam A (2017).

67 Eg SEHK listing rules, rule 3.08 (GEM listing rules, r 2.06).

68 SEHK listing rules, rule 2A.09 (GEM listing rules, r 3.10).

69 SEHK listing rules, rule 2A.08 (GEM listing rules, r 3.09).

70 Singapore Exchange (2014) Reinforcing the SGX Listings and Enforcement Framework.

71 SGX listing rules, Chapter 14.

is possible to offer composition of up to S$10,000 for breaches of listing rules that are comparatively minor or administrative in nature.[72]

2.5.2 Breaches of directorial duties

Appendix 1 summarises the consequences relating to breach of directorial duties. In particular, the minority shareholder has the option to take the statutory derivative action and/or pursue the unfair prejudice remedy in both jurisdictions. We have included unfair prejudice remedies in our study in line with other scholars as petitions often include conduct by directors who are appointed by the controlling shareholders.[73] Civil and criminal sections are provided, as well as the consequences for breach of the criminal provisions.[74]

2.5.3 Disclosure violations

Appendix 2 summarises the consequences for making of false and misleading statements, and failure to make the appropriate disclosure, to the securities markets.[75]

3 Enforcement of Disclosure Violations and Breaches of Directorial duties in Hong Kong and Singapore Markets

3.1 Methodology

We use a combination of case studies as well as hand collect a dataset of cases where enforcement proceedings have been taken out against publicly listed companies and/or their directors for corporate disclosure violations and breaches of directorial duties (only for directors) during the 16-year period from 2000-2015. The outcomes of these cases are compiled as at 31 May 2017. We choose 2000 as this is shortly after the Asian financial crisis of 1997 and this 16-year period covers the period pre-and post-global financial crisis of 2007/2008. The relevant legislative provisions for contravention are set out in Appendices 1 and 2. Our sources of information on breaches of directorial duties and corporate disclosure violation is from the enforcement actions taken by the Commercial Affairs Department (CAD),[76] MAS and SFC, which are publicly disclosed, news articles from major financial presses and announcements from the firms. As the MAS only publishes on its website the enforcement proceedings for a period of the most recent five years, we supplement the information from Singapore National Archives website.

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72 Ibid.

73 Other studies including unfair prejudice include Donald DC and Cheuk P (2017).

74 Appendix 1 does not include the disciplinary sanctions that are imposed by the relevant stock exchanges.

75 Appendix 2 does not include the sanctions that are imposed by the relevant stock exchanges.

76 Commercial Affairs Department is the principal law enforcement agency for the investigation of white-collar crime in Singapore, including market misconduct.

For the regulatory actions undertaken by the stock exchanges, our sources of information are the *ex post* enforcement actions taken by the SEHK and SGX; we include only cases where there is a formal disciplinary action (such as a reprimand). We have excluded other cases such as stock exchange queries or clarifications on the grounds that they relate to *ex ante* engagements. While we acknowledge that such *ex ante* engagements are important means of enforcement of corporate and securities laws, due to the large volumes of such queries and clarifications and in view of the fact that these engagements could span a range of situations, such as unusual trading volumes or prices, where there may not be wrongdoing on the part of the listed companies or its directors, we decide to focus only on *ex post* enforcement. The time period is the eight-year period from 2008 to 2015 due to data availability; for Singapore, at the time of collection of the data, the SGX website only includes the actions since 2008 and such information is not found in the Singapore National Archives. To ensure comparability, we have only included enforcement actions undertaken by SEHK for the period 2008 to 2015.

Public enforcement actions are also supplemented by judicial decisions reported on LexisNexis, Lawnet (Singapore) and Hong Kong Legal Information Institute (Hong Kong) and decisions reported by the Market Misconduct Tribunal (MMT). We exclude cases involving trading while the company is insolvent and the failure by the directors or controlling shareholders in disclosing their interests (or changes thereof) unless such failure is also attributed to the listed companies. Each listed company which has been involved in disclosure failure or breaches of directorial duties concerning itself or its director is grouped as one case. In other words, where separate legal proceedings are taken against the listed company or its director, all the legal proceedings are grouped together as one case.

Private enforcement actions involving breaches of directorial duties and/or corporate disclosure cases are obtained from the reported judgments in the case law databases mentioned above. Breaches of directorial duties are cases that amount to contraventions of the relevant provisions set out in Appendix 1 and duties imposed under the respective stock exchanges' listing rules (in the case of Hong Kong).[77] Corporate disclosure failures are cases that amount to contraventions of the relevant provisions set out in Appendix 2 and/or the disclosure obligations imposed under the listing rules. We supplement our database of private enforcement actions with filings by the listed companies which have announced that they have taken actions against the directors for breaches of their duties.

Our aggregate sample of cases from prosecutions, securities regulator-initiated and stock exchange enforcement actions against the listed companies and/or their directors yield a total of 115 cases, of which the breakdown between public and private enforcement is set out in Table 1 below.

Table 1: Classification of cases according to public and private enforcement

	Hong Kong		Singapore	
Type of proceedings	Number of cases	Percentage	Number of cases	Percentage

[77] SEHK listing rules, r 3.08 (GEM listing rules, r 5.01); SGX listing rules, r 135(5).

Public enforcement only	71	89.87%	30	83.33%
Private enforcement only	6	7.59%	4	11.11%
Both public and private enforcement	2	2.53%	2	5.56%
Total number of actions	79	100%	36	100%

3.2 Analysis of Key findings

3.2.1 Low levels of private enforcement but investor remedies are obtained through public enforcement

Based on Table 1, we find that private enforcement is comparatively much lower than public enforcement in both countries.[78] Out of the 14 cases involving either private enforcement exclusively or an overlap of private and public enforcement, all of them relate to breaches of directorial duties. In so far as corporate disclosure violations are concerned, there are no reported judgments for damages filed at common law or pursuant to the applicable statutory schemes under the SFO[79] (in Hong Kong) or the SFA (in Singapore).[80] Our study is consistent with what other scholars have reported that all the actions instituted for corporate disclosure violations in Hong Kong and Singapore has been public enforcement actions.[81]

Insofar as the 14 cases are concerned, two cases in Hong Kong[82] and one case in Singapore[83] involve shareholders of a listed company bringing statutory derivative claims against the directors or management for breach of directorial duties. Unfair prejudice actions involving listed companies are also rare; they comprise five cases:[84] one was brought by a minority shareholder of SGX-listed companies (which was successful in the High Court but overturned on

[78] For a discussion on the landscape of derivative claims in Hong Kong (including involving unlisted companies), see Donald DC and Cheuk P (2017) (who also include a discussion on unfair prejudice claims), Mezzanotte FE (2017).

[79] SFO ss 108, 281, 305, 307Z and 391.

[80] SFA, ss 234 and 236.

[81] See Donald DC (2013) at 74 (Hong Kong); Wan WY (2008).

[82] *Tsang Wai Lun Wayland v Grand Field Group Holdings* [2009] 3 HKC 81 (statutory derivative action); *Hong Kong Zhongxing Group Company v Grand Field Group Holdings* [2014] HKCU 2729 (statutory derivative action); *Veron International v RCG Holdings* [2015] HKCFI 1246 (statutory derivative action) (unreported). The two Grand Field decisions are counted as one case.

[83] *Chua Swee Keng v E3 Holdings* [2015] SGHC 22. (This was a derivative action taken after the company was delisted from SGX but we have included this case as it relates to a derivative action in respect of conduct of senior management of the company while it was listed on SGX).

[84] There is one case on common law unfair prejudice action that was extended to listed companies but we have excluded it as it does not deal with breaches of directors' duties or corporate disclosures: *Luck Continent v Cheng Chee Tock Theodore* [2012] HKEC 567 (Hong Kong).

appeal) in Bermuda;[85] two actions were brought in Hong Kong[86] and two actions remain pending before the Bermuda and Hong Kong courts respectively as at time of writing.[87] Six cases involve civil proceedings brought by the listed firms against the wrongdoing directors for breaches of directorial duties (they are not derivative actions). All of them are actions brought by the liquidators of the companies or by the newly constituted boards of directors.

Table 1 shows that there is little overlap between private litigation and public enforcement actions, suggesting that evidence gathered through public enforcement does not lead to private litigation, unlike the situation in the US. [88] The rarity of the private enforcement actions against directors may be explained by the difficulties in gathering evidence against the wrongdoing directors, even when public regulatory enforcement actions have commenced. Two recent cases in Hong Kong and Singapore in our dataset highlight the problems that are faced by new boards of directors or liquidators in bringing the actions against the errant directors, particularly those involving foreign listings, quite apart from the difficulty of service of proceedings on the errant defendants. The first is *Celestial v PWC*,[89] which involve an S-Chip[90] and which has gone into liquidation. In that case, the liquidators wanted to obtain the financial statements from the auditors in order to investigate suspicious transactions that were uncovered,[91] likely with the intention was determining whether appropriate legal actions could be taken against the management or other wrongdoers.[92] However, the auditors refused to allow the liquidators to have access to the papers relating to Celestial's trade dealings, affairs and property, and the liquidators commenced proceedings to demand production of these documents and ultimately prevailed at the appellate level.[93] The second is *China Shanshui v SFC*, where the new board brought an action against the SFC to order the discovery of its (China Shanshui's) own documents in correspondence with the regulators in order to establish civil claims against the former directors.[94]

Given the fact that there appears to be little private enforcement occurring, the question that arises is whether there are any substitutes to enable the listed companies or the shareholders to be compensated in the case of contravention? In the next two sub-parts, we explain how public enforcement has filled the gap in private enforcement in selected cases.

Breaches of directorial duties

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85 *Kingboard Chemical Holdings v Annuity and Life Reassurance* CA 24 of 2015 (Supreme Court, Bermuda).

86 *Passport Special Opportunities v Esun Holdings* [2011] 4 HKC 62 (breach of directors' duties, seeking injunction); *Able Success Asia v China Packaging Group Company Limited* [2014] HKCU 1316 (it was argued that an open offer was unfairly prejudicial).

87 They are *In the matter of Full Apex Holdings* [2012] SC (Bda) 9 Com (6 February 2012) (on striking out action) and *In the matter of Bank of East China Holdings* HCMP 1812/2016, on file with authors.

88 Cf Thompson R and Thomas R (2004) (for US, finding that private suits with parallel SEC proceedings settle for significantly more than private suits without such proceedings).

89 *PricewaterhouseCoopers LLP v Celestial Nutrifoods Ltd* [2015] 3 SLR 665.

90 An S-Chip company is a mainland Chinese private enterprise listed in Singapore, whose operations and assets are found in China.

91 *PricewaterhouseCoopers LLP v Celestial Nutrifoods Ltd* [2015] 3 SLR 665, para 2.

92 In the end, the lawsuit was brought by the liquidators against certain former directors: see G Leong, "Ex Directors of Celestial Nutrifoods Being Sued" *Straits Times*, 16 March 2016.

93 Companies Act, s 285.

94 *China Shanshui Cement Group v Zhang Caikui* [2017] HKCU 169.

In Singapore, at present, there is no power granted to any regulator to enforce breaches of directorial duties in order to obtain compensation for the listed company. However, in Hong Kong, the gap in private enforcement is partially filled by SFC taking out selected enforcement proceedings which have resulted in orders for compensation for investors. Table 2 sets out the list of cases, within our sample period, where the SFC has taken out section 213 and/or 214 of the SFO proceedings in connection with breaches of directorial duties and were successful in obtaining compensation, whether through court orders or settlement proceedings: five involved the payment of substantial compensation by the wrongdoing defendants to the listed companies, one requires the wrongdoing director to execute a deed of guarantee to procure the recovery of accounts receivables owing to the listed company and one is an order for the company to commence civil proceedings against the wrongdoing directors.

Table 2 – Compensation orders or consent orders entered into pursuant to enforcement proceedings pursuant to section 213 and/or section 214 of the SFO*

Listed companies	**SFO**	**Year**	**Compensation amounts or consent/ court orders**	**Currency**	**Underlying causes of action**
Styland Holdings	Section 214	2012	85,950,000	HKD	Breach of directorial duties (entering into transactions that benefitted chairman and wife)
China ASEAN Resources	Section 214	2012	10,700,000	HKD	Breach of directorial duties (payments to third party suppliers connected to the CEO)
First China Financial Network Holdings	Section 214	2015	18,692,000	RMB	Breach of directorial duties (breach of duty of care, skill and diligence in causing the company to pay out monies when it was not obliged to do so, and thereby indirectly benefitting one of the directors)
First Natural Food Holdings	Section 214	2017	84,880,000	HKD	Breach of director's duties (embezzlement of funds)+
GOME Electrical Appliance Holdings	Section 213	2014	420,608,765	HKD	Breach of directorial duties (causing the company to repurchase shares held by directors without disclosure)
Rontex International Holdings	Section 214	2010	Ordered company to bring civil proceedings	NA	Breach of directorial duties (breach of the duty of care, skill and diligence in causing the company to enter into transactions that result in losses to the company)

Hanergy Thin Film Power Group	Section 214	2017	Executive chairman executed deed of guarantee to procure that the parent company and its affiliates repay outstanding amounts owing to Hanergy	NA	Breach of directorial duties on the part of the chairman (conflict of interests)

Source: SFC enforcement news, available at http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/

* We exclude from the Table the cases where the SFC has announced that it has commenced section 214 proceedings but where the cases are still pending as at 31 May 2017.

+ While there was a finding that there was false or misleading statement that was issued, no order for compensation was made in respect of the market misconduct.

We make the following observations. First, insofar as compensation orders for specific sums that were made under section 214 shown in Table 2, there is no discount to the provable losses arising from the breaches of directorial duties in the cases. The lack of discount is not surprising because where there is a dispute as to causation or mitigation of losses, *Re Styland Holdings* has held that the court generally would not make the order for payment of compensation under s 214 but direct that the company bring the action.[95] *Rontex* was such a case where the court directed the company to bring the action against the errant directors.[96]

The outcome relating to the lack of discount stands in contrast with the outcomes of class action derivative suits in the US. In the US,[97] class action suits incentivise derivative claims to be brought by investors against the companies and/or directors. However, the sums recovered in derivative actions are usually strike suits and represent only a small fraction of recovery,[98] though a later study demonstrates that derivative actions have become more important as litigation agency costs have been lowered.[99] In Hong Kong, although the sample size of successful recovery is small, the damages that are ordered are significant and they represent the losses of the listed companies (with no discount on provable losses).

Second, in all of the orders for compensation made against the defendants who are directors, these are orders made against the executive directors who are in positions of conflict of interests or who have otherwise embezzled company's funds. Only one case, Rontex International Holdings, involved allegations of the lack of care, skill and diligence; this was a case brought against executive directors. None of these cases involves independent directors being held liable

95 See *Re Styland Holdings* [2012] CFI 312; [2012] 2 HKLRD 325 (the court holding that it would make not make compensation losses in respect of certain investments improperly entered into due to issues of causation), para 142-145.

96 In the matter of *Rontex International Holdings* [2010] HKCU 622.

97 Klausner M (2009); Armour J (2012) at 305.

98 Romano R (1991).

99 Thompson R and Thomas R (2004).

for losses of the company. However, this is not to say that independent directors will escape the consequences of their lack of care, skill and diligence; recent public enforcement actions have been brought against independent directors by the SFC where the directors face the possibility of disqualification.[100]

Corporate disclosure violations

Insofar as matters relating to violations of corporate disclosures are concerned, the lack of private enforcement actions has been partially filled by the securities regulator in bringing enforcement actions that result in compensation orders being made in Singapore and Hong Kong. The following examples set out how the MAS and SFC have secured or attempted to secure investor compensation in Singapore and Hong Kong respectively.

In Singapore, section 324 of the SFA, which is similar to the freezing order under section 213 of the SFO, is a powerful tool. While it is narrower in scope than its Hong Kong counterpart (see below) as it does not provide for the court to make restoration orders to the position prior to the contravention, it is a powerful leverage to get the defendant to negotiate a consent order that would benefit the investors indirectly. In China Sky, the MAS first obtained a freezing order against the director cum controlling shareholder for breach of sections 199 and 203 (disclosure violations) in respect of his assets in Singapore.[101] In order to resolve the proceedings, the defendant agreed to a consent order to pay the civil penalty of S$2.5 million and to surrender 10% of his shareholdings to the company as compensation for his wrongdoing. [102] Thus, the beneficiaries of the surrender of the shares is the company or its existing shareholders. Due to the nature of the consent order, investors and shareholders will not be able to separately file statutory compensation claims against him.[103] The approach of China Sky is similar to that taken in the previous case of China Aviation Oil; although it was an insider trading case, the parent company of China Aviation Oil engaged in insider trading offered to surrender some of its shareholding (that it would receive in a debt equity swap) to compensate the shareholders of China Aviation Oil for their losses in connection with the insider trading.[104]

In Hong Kong, it is possible for the securities regulator to bring proceedings, on behalf of investors, to recover compensation under section 213 and/or 214 of the SFO for contraventions of the disclosure obligations. In addition to an earlier case involving Hontex for the making of false and misleading statements in a prospectus circulated in connection with the initial public

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[100] WY Wan et al, "Managing the Risks of Corporate Fraud: the Evidence from Hong Kong and Singapore", copy on file with authors.

[101] *MAS v Huang Zhong Xuan* [2013] SGHC 242.

[102] See MAS, "Former China Sky CEO Huang Zhong Xuan pays civil penalty of $2.5 million and offers to surrender 10% of his shareholdings in China Sky" (12 February 2015). As for the value of the shares surrendered, it is not stated in the press released but based on 15,416,121 shares surrendered and on the average of the closing price of China Sky shares for the 3 months prior to the trading suspension on 18 November 2011, the 10% would amount to S$1.467 million.

[103] SFA, s 236(1)(b). It is possible, but unlikely, that the plaintiff investors can bring actions at common law against the defendant.

[104] MAS, 'MAS takes civil penalty enforcement action against China Aviation Oil Holding Company for insider trading' (19 August 2005).

offering,[105] there are two recent instances of the exercise of such power, concerning Greencool Technology and CITIC. In Greencool, the SFC obtained an injunction against Gu, the former chairman and CEO, of Greencool, in respect of the false and misleading financial statements made by Greencool. This injunction is to preserve the assets held for the benefit of Gu pending the trial where the SFC is seeking remedial orders for the 1,300 shareholders who purchased the Greencool shares when the financial statements were misstated.[106] The case remains pending as at the date of writing.

In CITIC, the SFC sought to hold the listed company and its directors liable to pay HK$1.9 billion to the 4,500 investors, representing the difference in the price of the shares at which the shares were trading when the false or misleading statement was made and when the true position was disclosed.[107] The case was discontinued when the statements were not demonstrated to be false and misleading. However, had the SFC succeeded, the beneficiaries would be the 4,500 investors (and not the company) and the defendants would be the listed company and its wrongdoing directors. In contrast, as seen in the Singapore's China Sky example, the beneficiary was the company and the defendant was only the wrongdoing director.

Finally, we offer an explanation why in Singapore, claims for investor compensation for false or misleading statement or material non-disclosure remain rare, in spite of the reforms to strengthen the private enforcement framework in 2013.[108] In 2013, the SFA was amended to remove the ceiling of recovery, which had applied to limit the damages to the gains or losses avoided by the listed company. Post-amendment, investors can theoretically bring statutory compensation actions for losses they incurred (without being constrained by the limitation) if reliance can be proven. However, the new requirement of reliance also means that it is significantly more difficult to run a class action lawsuit by investors who have traded on the false or misleading statement or non-disclosure. In comparison, in US, the fraud on the market theory presumes that the market prices reflect all available material information; this facilitates the bringing of securities class actions because it obviates the requirement of the plaintiffs to independently prove that they have relied on the statements.[109]

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105 SFC, "Hontex ordered to make $1.03 billion buy-back offer over untrue IPO prospectus" (20 June 2012).

106 Securities and Futures Commission (2014) Court extends freezing injunction against Greencool's former chairman.

107 Securities and Futures Commission (2014) SFC commences proceedings against CITIC, its former chairman and executive directors. See also South China Morning Post (2014) SFC launches legal action against Citic to demand compensation for investors.

108 See n 11.

109 See *Basic Inc v Levinson* 485 US 224 (1988). It was held that in that case that the class of plaintiffs who had traded in securities was not required to show individual reliance on the alleged misstatements. Instead, its reliance on public material misrepresentation was presumed, though such presumption was rebuttable. The fraud on the market doctrine is premised on the economic theory that is based on the efficient capital markets hypothesis. See *Basic Inc v Levinson* 485 US 224 (1988), 241–42.

3.2.2 Intensity of public enforcement for breach of directorial duties and corporate disclosure violations

Out of the 115 cases in our sample, 105 cases involve public enforcement actions (whether exclusively or mix of private and public enforcement actions). We provide breakdown of the public enforcement actions, according to the regulatory agencies, as to whether they involve breaches of directorial duties and/or corporate disclosure violations, in Figures 1 and 2. Where a case raises both breaches of directorial duties and corporate disclosure cases, we count them separately. Thus the total number of actions in Figures 1 and 2 will be more than 105.

[Insert Figures 1 and 2: Types of public regulatory actions for public enforcement]

Breaches of directorial duties

As can be seen in Figure 1, the majority of the cases in Hong Kong (52.6%) involving breaches of directorial duties (whether exclusively or mixed with corporate disclosure violations) are enforced by the SFC via sections 212, 213 and/or 214 of the SFO. Recent cases demonstrate that the SFC does take out proceedings pursuant to section 214 of the SFO to disqualify independent directors who are reckless or negligent.[110] Criminal prosecutions against directors are few (three cases) and they involve offences under the Theft Ordinance or conspiracy to defraud on the part of the executive directors. [111] Out of all of the concluded proceedings brought by the SFC involving breach of directorial duties, 13 out of 15 cases involve the imposition of directorial disqualification. Thus, the evidence in Hong Kong is that criminal enforcement involving pecuniary penalties or imprisonment is reserved for the most egregious breaches of directorial duties. Most of the other cases are brought with a view to disqualify the directors.

In Singapore, as can be seen in Figure 1, the most common method of enforcing breaches of directorial duties (whether exclusively or mixed with corporate disclosure violations) is in the form of stock exchange enforcement actions (15 cases). While there were only three criminal prosecutions, two cases were brought in connection with breaches of directorial duties for failing to act diligently and one involved breach of duties in connection with the prospectus. The former two cases had attracted widespread media attention.[112] In one of the two cases, the directors eventually had their convictions quashed for other reasons.[113] It is significant that the two prosecutions involved executive and independent directors; in the case of the latter, they were not alleged to have been fraudulent. Thus, the picture is that criminal prosecutions exist but is far less prevalent than stock exchange regulatory actions. Though the sample size is small, there is a noticeable gap in the enforcement of directorial duties (by comparing the number of criminal prosecution and stock exchange enforcement actions).

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110 WY Wan et al 'Fraud" (referring to Greencool, AcrossAsia and Hanergy).

111 Eg *HKSAR v Chan Hoi Lam* (Climax); *HKSAR v Ma Bo Kee and others* [2010] HKCFI 2255 (Moulin Global Eyecare); *HKSAR v Tsang Wai Lung Wayland* [2013] 1 HKC 389 (Grand Field)

112 Eg Chan A (2014).

113 See Today (2014).

Corporate Disclosure Violations

Insofar as matters relating to corporate disclosure violations (whether exclusively or mixed with directorial duties), in Hong Kong, as can be seen in Figure 2, the most common method of enforcement is stock exchange enforcement sanction (37 cases), followed by SFC-initiated proceedings (29 cases). Between 2003 and 2015 (the end date of our database), out of the SFC-initiated actions, the SFC has proceeded by way of criminal prosecution under section 386 of the SFO (six concluded cases) relating to breaches under section 384 of the SFO relating to the making of false or misleading statements.[114] Since 2013, when the statutory backing to the disclosure of price sensitive information rules come into force, the SFC has brought four cases before the MMT. The rest of the SFC-initiated proceedings were brought under section 213 or 214 of the SFO.

In contrast, in Singapore, as can be seen in Figure 2, the most common method of public enforcement is by the stock exchange (18 cases), followed by criminal prosecutions (8 cases) and MAS-initiated proceedings for civil penalties (3 cases). For the criminal prosecutions, only three cases involve the imposition of custodial sentences and the rest all involve only fines.

Thus, in Hong Kong, post-2013, there appears to be a preference for the regulators to move away from criminal prosecutions and instead enforce via civil sanctions or restorative provisions under section 213 or 214 of the SFO. In contrast, in Singapore, while the sample size is small, criminal prosecutions are more prevalent over civil penalties. The MAS, in determining whether to proceed with civil penalty proceedings, has stated that it takes into account a number of factors including evidential burden, severity of misconduct, impact on market and whether it delivers a fair and proportionate sanction.[115] Under the SFA, civil penalties are set higher than the criminal fines,[116] indicating that deterrence remains the central focus. In one case (China Sky), the civil penalty which the defendant consented to was S$2.5million,[117] which is considerably higher than the maximum fine of S$250,000. However, the other two cases on civil proceedings by MAS yield a much more modest amount ($75,000) and in another case, a warning.

3.2.3 Individual and corporate liability

In cases involving corporate disclosure violations, the regulator has the choice between the action against the individual corporate official or the listed company or both. We are interested to know how the regulator exercises its choices. As such, we only focus on cases that are corporate disclosure violations (without regulatory actions being brought for directorial misconduct). Table 3 set out the public enforcement actions against the companies and/or individuals in the corporate disclosure violations only.

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[114] These six cases are brought after the 'dual-filing' system came into force in 2003; pursuant to the dual filing system, a listed company is required to file with SFC the ongoing disclosure materials issued pursuant to the listing rules. Thus, statutory backing is given to the disclosure regime so that SFC can institute proceedings against the listed company in respect of the filings made with the SFC. See Chan GYM (2014) n 116.

[115] MAS (2016), para. 7.8.

[116] See Appendix 2 on the civil penalties and criminal fines.

[117] See n 102 above.

Table 3 Public enforcement actions Against Companies and Individuals for Exclusively Corporate Disclosure Violation*

Panel A – Hong Kong

	Companies only	Companies and individuals	Individuals only
Prosecution only	0	0	0
SFC only	1	9	3
SEHK only	3	18	0
Prosecution and SFC	0	0	0
SFC and SEHK	0	0	0
Total	4	27	3

Panel B – Singapore

	Companies only	Companies and individuals	Individuals only
Prosecution only	0	0	5
MAS only	1	0	0
SGX only	3	1	0
SGX and MAS	1	0	1
Other	0	0	1
Total	5	1	7

* These are cases where regulatory proceedings have been proceeded with against the defendants, and we have included both proven and unproven cases. Unproven cases include those where the convictions have been quashed on appeal as they indicate the regulatory strategies of the relevant regulator.

Here we find similarities between the two jurisdictions in that for criminal prosecutions, only the individuals are targeted. This clearly indicates that the predominant objective of criminal prosecution is that of deterrence of the individual directors. In particular, in Singapore, in *Auston v PP*, enforcement action was taken out against the company and the individuals involved, and the High Court observed that the CEO and CFO were really culpable (and reduced the fine for the company).[118] The sample size for MAS is small (three cases); one involves a warning (with no pecuniary penalty). The more recent case is targeted at the individual only and is likely to indicate the trend towards targeting only individuals in Singapore, even for civil penalty cases.[119] In contrast, the SFC in Hong Kong has proceeded against both the companies and individuals in the majority of the cases (9 out of 13 cases).

[118] [2007] SGHC 219.

[119] This occurred in China Sky where only the defendant director was the subject of MAS enforcement action for making false or misleading statement. See n 102.

3.2.4 Other issues of enforcement: sanctions, length of time to resolve

Table 4 sets out the outcomes of public enforcement actions for corporate disclosure actions and breaches of directorial duties. Table 5 sets out the length of time the concluded cases take to be resolved. In these two tables, we have combined both corporate disclosure actions and breaches of directorial duties due to the large overlap of the cases and the fact that in these cases, the regulator often has a choice to proceed either with corporate disclosure violation or breach of directorial duties. As can be seen in Table 5, the most common sanction is the reprimand and/or bringing about governance changes in both jurisdictions. In Hong Kong, the second most common sanction is the disqualification order followed by criminal fine/imprisonment. In Singapore, the second most common sanction is the criminal fine followed by custodial sentence/disqualification. The number of disqualification orders is likely to rise given that the amendments to the statutory framework to impose disqualification orders in breaches of the SFA were implemented in 2015.

On the time taken to resolve the matters, as Table 5 shows, the majority of the public enforcement actions concluded within two years from the date of commencement of the investigation or discovery of the contravention.[120] This would suggest that the plaintiff investors should ordinarily not be time-barred and are able to commence proceedings based on the findings of the public enforcement actions.[121] Further, in Singapore, the SGX, in a significant number of cases, required the listed company to conduct a special audit to investigate the allegations of wrongdoings and ordered that the summary of the special audit reports be published, which can be used to support findings of contraventions.[122] Yet, when we compare the enforcement proceedings in Table 1, there is little overlap between private and public enforcement. Thus, the outcomes in Table 5 reinforce the explanation that the lack of overlap is due to the various problems found in private enforcement actions listed in Section 2.3 above, including the collective action problem and the unfavourable civil procedure rules, and not due to the fact that the public enforcement actions take too long to conclude.

Table 4: Number and Type of Sanctions Imposed for All Cases

Type of sanctions	Hong Kong	Singapore
Cases with single sanction		
Reprimand and/or governance changes	35	18
Custodial sentence	4	1
Criminal fine	5	4
Disqualification[+]	13	0
Winding up of company	1	0

[120] We have not included 10 cases in Singapore where although there is strong evidence of outright fraud (such as misappropriation, outright inaccuracies of accounts) but are unresolved as at end of 2016. All of them are S-Chips and it is likely that there are difficulties locating the wrongdoing directors and/or controlling shareholders.

[121] Under s 234 of the SFA, the time-bar to bring the claim for statutory compensation is 6 years from the date of completion of the dealing or trading in which the loss occurred.

[122] In our sample, 8 out of 36 Singapore cases (or 22.2%) publish the special audits (or summary thereof).

Civil penalty and disgorgement	2	1
Cases with multiple types of sanctions		
Custodial sentence + disqualification[+]	1	1
Custodial sentence + criminal fine	0	1
Reprimand + disqualification[+]	0	1
Disqualification + civil penalty	2	1
Others	1	0
Total [&]	64	28

[+] In "disqualification" cases, we include not only cases where the court has disqualified the defendant director but also (1) where the defendant has undertaken not to be a director or in management of listed companies, and (2) the stock exchange has specified that its approval (the stock exchange's) is required for the appointment of the particular defendant.

*We do not include compensation ordered by the courts as "sanctions". This information is found in Table 2.

[&]We exclude 13 cases which are pending as at 31 May 2017 or where the actions were unsuccessful or where convictions were imposed but quashed subsequently

Table 5: Length of time to resolution for concluded cases (public enforcement) – all cases

Panel A: Hong Kong

Type of regulatory action	Number of cases				
	Time taken to resolution 2 years or less	Time taken to resolution 3 to 4 years	Time taken to resolution 5 to 6 years	Time taken to resolution more than 6 years +	Total
Prosecution only	0	0	1	3	4
SFC only	13	5	4	2	24
SEHK only	32	2	2	0	36
Prosecution and SFC	1	0	0	0	1
SFC and SEHK	0	0	1	1	2
					67

+We exclude 6 cases which remain pending as at 31 May 2017.

Panel B: Singapore

Type of regulatory action	Number of cases				
	Time taken to resolution 2 years or less	Time taken to resolution 3 to 4 years	Time taken to resolution 5 to 6 years[123]	Time taken to resolution more than 6 years	Total
Prosecution only	5	2	1	0	8
MAS only	1	0	0	0	1
SGX only	10	2	0	0	12
SGX and MAS	2	0	0	0	2
Other	0	0	0	1	1
					24

+We exclude 8 cases which remain pending as at 31 May 2017.

4 Other functional substitutes for private enforcement: shareholder engagement and requisitions

Our findings prompt the question as to whether there are other methods in which dissatisfied shareholders or investors can enforce their rights where they are displeased with governance failures. Armour et al found that shareholder governance rights serve as substitutes for civil enforcement in the UK.[124] A recent study shows that institutional shareholders are active sponsors of shareholder proposals in the UK.[125] Do the same results hold in Hong Kong and Singapore, which are characterised by concentrated shareholdings? We focus in particular on the requirement that shareholders owning at least 10% (Singapore companies), 5% (Hong Kong companies) or their equivalents for foreign companies can call for the directors to convene a shareholders' meeting.[126]

[123] Under s 234 of the SFA, the time-bar to bring the claim for statutory compensation is 6 years from the date of completion of the dealing or trading in which the loss occurred.

[124] Armour J et al. (2009).

[125] Buchanan B et al. (2012).

[126] Companies Act, s 176 (Singapore); Companies Ordinance, ss 566-568 (Hong Kong). Further in Singapore, shareholders holding at least 10% of the shares can call the meeting themselves: Companies Act, s 177. For foreign listed companies listed on SEHK, the SEHK requires that the articles of association of these companies should provide for similar requirements for the shareholders to requisition the meetings: see Hong Kong Exchanges and Clearing Limited (2016) Guide on General Meetings. The court will not intervene to prevent the shareholders from exercising such rights: see e.g. *China Investment Fund Company v Guang Sheng Investment* (CFI, HCA 411/2016). The constitution or articles of association of the company cannot limit the ability of shareholders to call for the meetings: Companies Act, s 176.

We have assembled our database of shareholder requisitions that are filed in connection with publicly listed companies during the 2008-2015 period. Our dataset is assembled on the basis of availability of filings on the websites of the SEHK, SGX and major financial press. On the websites of SEHK and SGX, we specifically searched for "requisition", and "shareholder resolution". We have the data for 2008-2015 for Hong Kong from SEHK's website. For SGX-listed companies, the SGX's website only retains the data from 2012 (five years). To assemble the data between 2008 and 2011, we obtained an index of filings from SGX and searched for the same key words, and then manually assembled the database on the contents from the major financial press.

Our dataset yields 84 shareholder requisitions filed during the relevant period. We exclude 26 from our analysis on the basis of incomplete information and a special case which was instigated by SFC.[127] We then identify which are linked to governance failures, that is, where the shareholders have complained that the directors have been in breach of their duties or involved fraud investigations. We collect information on the shareholdings of the requisitioning shareholders and whether they are the largest shareholders in the company based on the information in the requisition notices and annual reports.

Table 6: number of shareholder requisitions and the number which are related to governance failures:

	Hong Kong		Singapore	
	Number of requisitions	Of which, governance related	Number of requisitions	Of which, governance related
2008	1	0	3	3
2009	0	0	6	1
2010	2	0	2	0
2011	2	1	4	2
2012	3	2	2	0
2013	4	2	3	1
2014	5	0	1	0
2015	16	4	4	2
	33	9	25	9

Here, we find some evidence that in Hong Kong and Singapore, minority shareholders who are unhappy with the directors over governance failures do file requisitions to seek to remove directors and/or seek other relief (such as appointment of independent advisers). This occurred in Hong Kong (9 out of the 33 cases) and Singapore (9 of the 25 cases). Their shareholdings range from 12% to 42% (Hong Kong) and 11.1% to 25% (Singapore), and in 5 of these cases, these

[127] This related to GOME, where as part of the settlement of the SFC proceedings, the wrongdoing directors cum shareholders would seek to requisition a shareholders' meeting.

requisitioning shareholders are not the largest shareholders (which suggest that they will fail anyway). Thus, although our sample size is small, the evidence suggests that there are shareholders concerned about corporate governance and are willing to seek governance changes.[128]

Considering that minority shareholders still file requisitions even though they are not likely to succeed, we suggest that the reasons such filings could be due to their extra-legal forces, particularly from the perspective of exerting reputational pressure. Directors and/or controlling shareholders who are criticized for their corporate governance failings in breaches of directorial duties or not treating minority shareholders fairly could face a negative impact on their reputation, undermining their standing in the business community.[129] Our survey of the governance-linked requisitions show that they do criticize the decision making of directors or highlight their less than exemplary behaviour. Our findings contrast with the assertions of the lack of an activist culture among shareholders in Hong Kong and Singapore.[130]

5 Lessons and Normative implications

5.1 Deterrence: the case for securities regulator to enforce directorial duties in Singapore

Our findings reveal a gap between the law in action and law in the books for breaches of directorial duties in Singapore. Shareholder derivative action and unfair prejudice actions are rare in Singapore and while shareholders do exert their governance rights by filing requisitions to remove directors linked to governance failures, there are important limitations, as demonstrated in Section 4. First, they can only do so if they (or if they assemble fellow shareholders) hold the requisite percentage of shareholding (at least 10% in Singapore, and 5% in Hong Kong). Second, the requisitioning shareholders' bargaining power is somewhat limited vis a vis the controlling shareholders, though not negligible, as the requisitioning shareholders rely on exerting pressure through reputational concerns. However, reputational concerns are unlikely to be sufficient in themselves to incentivize shareholders to make such filings.

Table 1 shows that many breaches of directorial duties (as evidenced by stock exchange reprimands) are often not enforced by private enforcement. Where there is no new board of directors or if the company is in liquidation but the liquidators are unwilling to bring the action possibly due to lack of funds or where the directors are not able to fulfil any judgment made against them, there is little prospect of shareholders bringing private enforcement actions. As outlined in Section 2, shareholders are deterred by the general procedural hurdles relating to the lack of class actions, the unavailability of contingency fees, the presence of the rule that the loser pays the winner costs and an unfavourable discovery regime.[131] Further, we find that discovery disputes are

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128 Our study does not include the shareholders who have engaged in behind-the-scenes negotiations. There is evidence that such negotiations do take place and only engage in open confrontation when these negotiations break down: see Wong FMK (2017) (for Hong Kong).

129 See Coffee JC (2011) (arguing that social norms do matter and constrain controlling shareholders).

130 See Lan LL and Varottil U (2015); cf Wong FMK (2017).

131 Loke A (2009).

common and even the new boards or liquidators face uphill tasks, particularly if the wrongdoing directors have destroyed or otherwise do not make available the documents.[132] When the defendant directors are located outside Singapore, the litigation costs in bringing these actions become even larger and substantial delay is likely to result.

In contrast, in Hong Kong, while the general procedural hurdles to private enforcement are also similar to Singapore, the problem is ameliorated by the fact that the SFC has exercised its powers under section 213 and/or 214 of the SFO to obtain compensation for the investors in connection with breaches of directorial duties. The availability of the broad freezing orders taken out by the securities regulator also means that the likelihood of obtaining an early settlement is much higher. For example, successful settlement in GOME (Hong Kong), Greencool (Hong Kong) and China Sky (Singapore),[133] all involve cooperation from the mainland authorities, and which had involved regulators taken out freezing orders.

We argue that in Singapore there is a need for a securities regulator to enforce directorial duties in the case of public listed companies, with the ability to bring about civil penalties for the following reasons.[134] First, using only exclusively criminal sanctions are blunt tools for enforcement. As we have seen, the public prosecutor in Singapore can and does bring criminal actions in connection with breach of directorial duties, even in cases where the directors have been only reckless or negligent (as opposed to outright fraud). These actions focus on the deterrent effect of the enforcement actions as the sanction includes imprisonment, fine and/or disqualification. However, the powers to bring criminal actions against independent directors are only rarely exercised.

Second, as explained in Section 2.2 above, a civil penalty order will allow the court to calibrate the appropriate sanction in respect of the contravention, particularly since the breach of directorial duties cover a very wide range, involving classic fraud or conflict of duties, but also negligence. We have seen that the regulator uses the tools of criminal prosecutions and civil penalty orders to calibrate the punishment in connection with corporate disclosure violations and there is no reason why the full range of tools cannot be used in directorial disqualification cases.

Third, we are of the view that it may be unnecessary for the statutory regime to include an express power for the securities regulator to seek compensation for the listed company, and it is sufficient to include a civil penalty provision. Having an express power to seek compensation for the listed company may result in the investing public's expectation that such powers will often be exercised. A shareholder would also not know whether or not the regulator would exercise the power. Also breaches of directorial duties cover a wide range and it is best left to the listed company to make an assessment whether to pursue the action. The civil penalty provision will incentivize the wrongdoing directors to negotiate with the securities regulator to pay compensation to the company (particularly when there is a freezing order in place under section 324 of the SFA). The experience with China Sky in connection with corporate disclosure violations has shown that such incentives do exist.[135] Thus, the securities regulator, by having the jurisdiction to bring civil

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132 E.g. discussion in n 89 above.

133 See discussion in Section 3.2.1.

134 See discussion in Liau T (2014).

135 See n 102 and accompanying text.

penalty orders against the wrongdoing director, can indirectly obtain compensation for the listed company.

5.2 Individual and corporate claims and liability for corporate disclosure violations and the circularity problem

In Section 3, we demonstrate that the securities regulator does exercise its powers to benefit the investors for corporate disclosure violations. However, two questions remain. First, should the listed company or individual investors be able to recover for corporate disclosure violations? Second, these actions be brought against the listed companies or individual directors? In Singapore and Hong Kong, given that it is the regulatory authorities (rather than the plaintiff investors) who are significant in bringing actions that can lead to compensation, they can influence or determine whether it is the listed company or the investors that should be compensated in the course of exercising their regulatory powers. The choice of the appropriate plaintiffs and defendants bring to forefront the circularity problem in securities litigation, as outlined above.

In Singapore, notwithstanding the law in the books, public enforcement favours individual liability rather than corporate liability; the exception is stock exchange reprimands which currently do not carry pecuniary losses. Insofar as investor compensation is concerned, it is possible for the individual wrongdoers to offer to pay compensation to the *listed company* in order to reduce their potential liabilities for the civil pecuniary orders (as in the case of China Sky). The Singapore approach suggests that the key driver for private enforcement of corporate disclosure violation is deterrence, and investor compensation is only secondary for the following reasons:[136] it is inconsistent with investor compensation rationale to benefit the listed company. The circularity problem falls away because it is the wrongdoing individual directors who end up being liable. Such an approach can be justified: for misstatements or failure to disclose material information in the secondary market, the listed company (and its existing shareholders) usually would not have benefitted at the expense of the plaintiff investors.[137]

In Hong Kong, listed companies and individuals are targeted with civil penalties for disclosure cases. Insofar as compensation is concerned, the SFC have brought these actions against both the listed companies and individuals as the defendants in the course of seeking substantial compensation orders in favour of the investors who have invested in the securities when the false or misleading statements were in force (or during the period when the disclosure of material information should be but was not made) (in the case of CITIC). Thus, the key driver for enforcing corporate disclosure violation is investor compensation.

Our analysis shows that there are variations even in how the securities regulator can obtain compensation for investors, whether directly or indirectly, even in two markets which are similar in many respects. On balance, we argue that the principal driver for public enforcement should be deterrence and furtherance of corporate governance and in this respect, the Singapore approach in making only the wrongdoing individuals as defendants in enforcement proceedings

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136 In a different context, Tjio H has argued that the purpose of enforcing corporate disclosure is to further corporate governance, rather than investor protection: Tjio H (2009).

137 See Wan WY (2009).

and paying substantial compensation has its merits. While it could be argued that Directors Officers (D&O) insurance may step in, rendering much of the deterrence nugatory, D&O insurance will not cover fraud cases. [138]Directors and senior managers are also deterred from wrongdoing when the risk of paying substantial damages fall on them.

In Singapore, however, having the listed company as the beneficiary is over-inclusive and under-inclusive at the same time; benefiting the existing shareholders of the company means that shareholders who have been shareholders of the company as at the time of the misleading statement was made will benefit, even though they have not made any trading decisions in reliance of such statement. On the other hand, investors who have bought into the company during the currency of the false and misleading statement but subsequently sold the shares when the statement is corrected will not be compensated since they cease to be shareholders of the company.

In Hong Kong, while the investors directly receive the benefits of compensation, a position that is close to that in the UK (as seen in the Tesco litigation), [139] the securities regulator has sought to hold both the listed company and the wrongdoing directors liable. Holding the listed company liable will ensure that recovery to investors is more assured. However, it penalises the shareholders who have not participated in the wrongdoing. It could be argued that the listed company can subsequently recover the damages from the wrongdoing directors for breach of duties, we have seen that private enforcement by the listed company is rare unless there is a new board of directors or the company is in liquidation. Relying on investor compensation as part of public enforcement also has the drawback; regulators necessarily have to be selective in the cases that they choose to enforce due to budgetary constraints.

The lack of private enforcement demands a relook at the procedural rules on how private enforcement is conducted. For example, procedural rules on discovery can be facilitated. In Hong Kong, in a recent case, the SFC did not object to the new board of a company demanding discovery of documents that are no longer in the possession of the new board.[140] Looking at the number of stock exchange reprimands in both countries, it can be seen that the majority of corporate disclosure violations are not the subject of subsequent enforcement actions by the MAS or SFC which carries pecuniary sanctions or investor compensation.

We turn to criminal and civil penalty sanctions, where the circularity problem does not apply and the sole question is whether liability should fall on the listed company and/or the wrongdoer directors. Does corporate criminal liability or civil penalty sanctions offer any valuable tool? We argue that the primary purpose in this case is deterrence and deterrence is fulfilled in the two respects. First, it is used as a deterrence, which is the principal goal in imposing criminal liability and civil sanctions. In the case of civil sanctions, it is possible to calibrate the deterrence level but not setting too high a pecuniary penalty. Second, while stock exchange reprimands on listed companies have required firms to reform their internal controls and compliance programmes, corporate liability for civil penalties will provide further incentives to set up proper programmes. In sum, in Singapore, greater consideration should be given to enforcing civil sanctions against the listed companies as well, and not merely on the directors.

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138 Ibid.

139 See n 39.

140 See discussion in n 94 above.

5.3 Legal Transplantation

Finally, we discuss the broader implications of our research on legal transplantation of the optimal enforcement framework. Empirical research on US data demonstrates the existence of significant private enforcement of corporate and securities laws.[141] One would expect that the transplantation of the US-driven paradigm of private enforcement of securities litigation in other jurisdictions would achieve similar results where victims (particularly minority investors) are able to obtain to obtain some kind of redress, particularly in countries where the institutions (including regulator and court system) in the recipient countries are fairly robust. However, drawing from the evidence in both Hong Kong and Singapore which have considerably strengthened the institutional framework to allow for investors and shareholders to file compensation claims or derivative actions brought against wrongdoing directors and the listed companies, these mechanisms are hardly used in the two jurisdictions. In this paper, we add to the existing evidence that legal transplants are complex and when the other aspects of the institutional framework are not imported in the same manner or to the same degree, such as the civil procedure rules and contingency fee systems, the results may not be what are intended in the country of origin.[142] Thus, in the absence of a robust private enforcement framework, public enforcement remains important in the two jurisdictions in not only imposing sanctions but also in influencing the kind of investor compensation or redress.

The lessons on legal transplantation have relevance to the emerging countries in Asia and the rest of the world. The evidence from Hong Kong and Singapore show that the lack of actual private enforcement in practice does not inhibit the ability of financial markets to function well, judging from the sizes of their public capital markets.[143] The Hong Kong and Singapore models also shows that public enforcement can be used to obtain investor compensation in selected cases, without having to make far-reaching reforms to the private enforcement framework (such as introducing contingency fees) which has broad implications for all civil cases (and not merely corporate and securities litigation cases). However, we do recognise that for public enforcement to work effectively, there needs to be an effective government regulator and an effective court system, with appropriate public funding, and in some emerging jurisdictions, one or both of these elements may not be present. The approaches in Hong Kong and Singapore may not always invariably be the best, any more than the approach in the US. But reformers should recognise that the US paradigm of private enforcement is not the only way.

6 Conclusion

Despite the law in books in enhancing investor access to compensation through the availability of statutory derivative actions, public enforcement of corporate and securities laws in Hong Kong is much more central than private enforcement. The same picture can be seen in Singapore. In spite

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141 See e.g. Armour J et al. (2009).

142 See Pistor K et al. (2000).

143 See n 60 and accompanying text above.

of the availability of statutory derivative action and easier access to the statutory compensation scheme, almost all of the enforcement actions take place through public enforcement; private enforcement is rare, save in the case of directorial duties where there are new boards of directors or liquidators. However, in both jurisdictions, investor compensation is not completely ignored, as can be seen by the actions taken by securities regulator for the benefit of the investors. We have also seen functional substitutes in the form of shareholder requisitions filed by minority shareholders holding significant stakes. The Hong Kong and Singapore examples show that increasing the accessibility of remedies will not mean that shareholders will necessarily exercise these powers.

Our results show that in spite of the existence of robust public enforcement, there are gaps between law in books and law in action. In Singapore, while the substantive law for breaches of directorial duties is strong, there is a noticeable gap in the enforcement of breaches of directorial duties (as evidenced from the facts surrounding the stock exchange reprimands in Singapore) and obtaining compensation for the listed company. The reason for the gap lies in the regulator not having the important option of bringing civil penalty proceedings on directorial duties and is restricted only to criminal proceedings.

Our results also show that there are differences in the securities regulator in both countries in seeking to obtain investor compensation for corporate disclosure violation, both in respect of the beneficiaries of compensation and the defendants. We argue that when the securities regulator exercises its powers to obtain compensation, the proper beneficiary should be the investors, and the proper defendants should be the wrongdoing directors. Even if the wrongdoing directors are insiders and are controlling shareholders, their payment of compensation would exceed any benefits that they obtain by reason of their shareholdings. Finally, we argue that deterrence should be the main driver in imposing criminal or civil sanctions.

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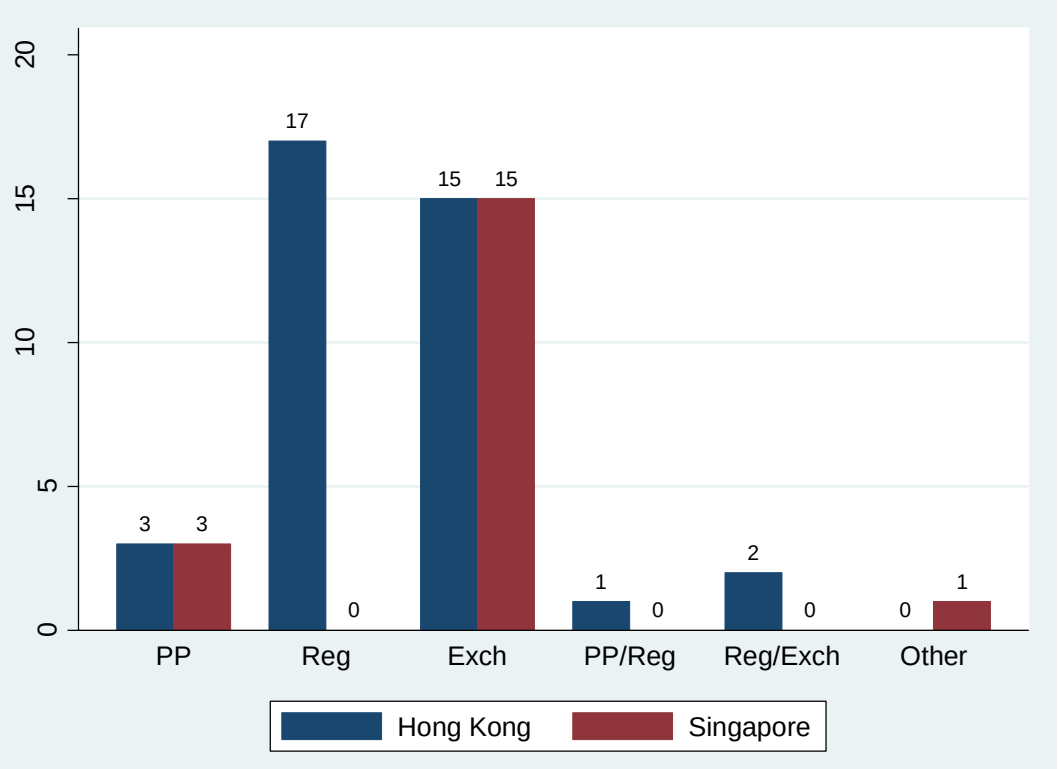
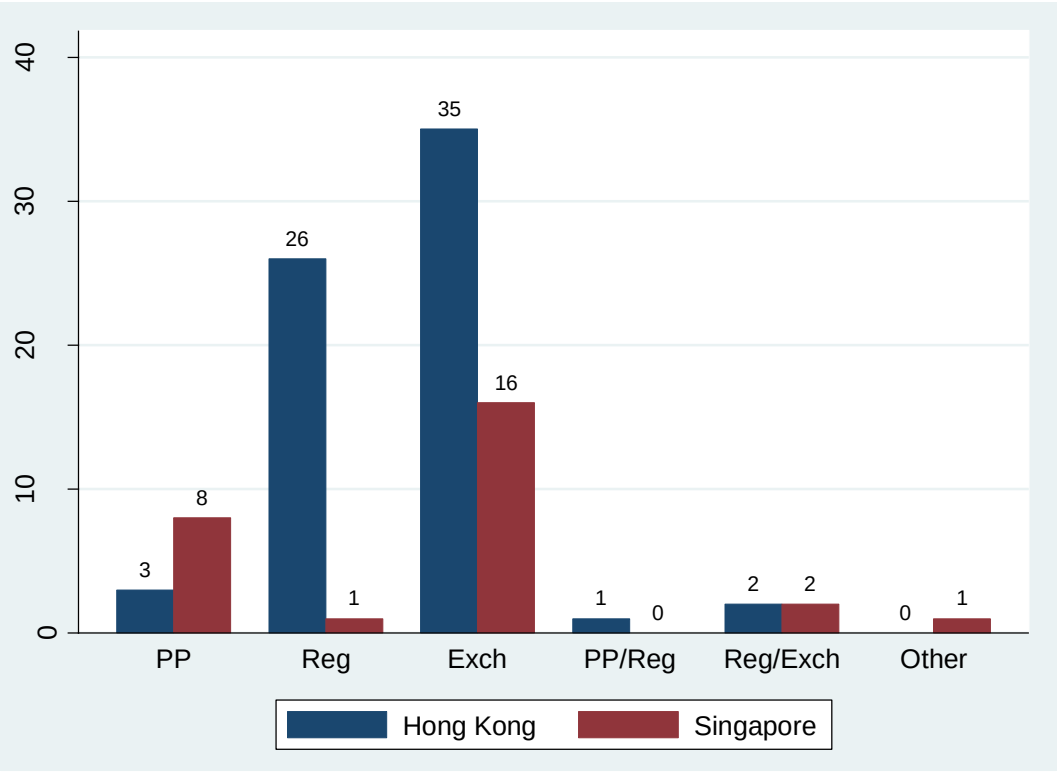
Figure 1 – Enforcement Agency for Breach of Directorial duties in Hong Kong and Singapore



PP	Public prosecutor
Reg	Securities regulator (SFC for Hong Kong and MAS for Singapore)
Exch	Stock exchange (SEHK for Hong Kong and SGX for Singapore)
PP/Reg	Public prosecutor and Regulator
Reg/Exch	Regulatory and stock exchange

Figure 2 – Enforcement Agency by Breach of Disclosure Obligations in Hong Kong and Singapore



PP	Public prosecutor
Reg	Securities regulator (SFC for Hong Kong and MAS for Singapore)
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PP/Reg	Public prosecutor and Regulator
Reg/Exch	Regulatory and stock exchange

Appendices

Appendix 1

Civil and Criminal Consequences Upon Breach of Directors' Duties*

	Civil action	Civil remedies	Unfair prejudice	Legislative provision making it a criminal offence	Criminal sanction	Civil penalty orders	Disqualification of director	Statutory compensation
Singapore+	Section 157 of Companies Act (act honestly and use reasonable diligence in discharge of duties) and at common law	Compensation, account of profits for breach of directors' duties taken by company (whether by company or by shareholders derivative action)	Section 216 of the Companies Act	Section 157 of Companies Act (act honestly and use reasonable diligence in discharge of duties)	Fine up to S$5,000 or imprisonment up to 12 months	NA	Yes	NA
Singapore	NA	NA	NA	Penal Code (misappropriation, theft, criminal breach of trust)	Various sanctions prescribed under the Penal Code	NA	NA	NA
Hong Kong	Section 465 of Companies Ordinance (exercise reasonable care, skill and diligence) and common law	Compensation, account of profits for breach of directors' duties (whether by company or by shareholders in derivative	Sections 724 and/or 725 Companies Ordinance 2012; previously section 168A of the Companies Ordinance[&]	NA	NA	NA	Yes, as orders made under section 214 of the SFO	Yes, orders under sections 213 and/or 214 of SFO

		action); section 466 of Companies Ordinance						

[*] The table does not include provisions relating to the breaches of directors' duties when the company is insolvent.

[+] The application of the Companies Act provisions in this table (that is, section 157 and 216) only applies to Singapore-incorporated companies.

[&] Sections 724 and 725 apply to both Hong Kong companies and non-Hong Kong companies (defined as companies incorporated outside Hong Kong but establish a place of business in Hong Kong).

Appendix 2

Civil and Criminal Consequences Upon the Making of False and Misleading Statements to the Securities Market

	Civil action	Civil remedies	Contravention section	Criminal sanction	Civil penalty orders	Disqualification of director	Statutory compensation (upon breach)
Singapore	Misrepresentation at common law; tort of deceit; negligent misstatement	Remedies for misrepresentation at common law	Section 199 of SFA (making false or misleading statements)	Section 204 of SFA: Fine up to S$250,000 and/or imprisonment up to 7 years	Section 232 of SFA: $2 million or 3 times the benefit gained	Yes, if conviction is after 1 July 2015	Sections 234 and 236 of SFA (for breach of section 199)
			Section 200 of SFA (fraudulently inducing persons to deal in securities)	Section 204 of SFA: Fine up to S$250,000 and/or imprisonment up to 7 years	Section 232 of SFA: $2 million or 3 times the benefit gained	Yes, if conviction is after 1 July 2015	Sections 234 and 236 of SFA (for breach of section 200)
	For prospectuses, in addition to the common law, there are specific statutory civil claims that may be brought against various defendants,	Remedies for misleading or non-disclosure in the prospectus	Section 254 of the SFA	Section 253 of the SFA: Fine up to S$150,000 and/or imprisonment up to 2 years; and up to S$15,000 per day for continuing offence	NA	NA	Section 254 of SFA

	including the company and its directors.						
Hong Kong	Misrepresentation; tort of deceit; negligent misstatement	• Remedies for deceit/ misrepresentation	• Section 108 of SFO (civil liability for inducing persons to invest in securities) • Section 277 of SFO (disclose false or misleading statement likely to induce transaction) • Section 391 (false or misleading public communication concerning securities) • Section 298 of SFO (disclose false or misleading statement inducing transaction) • Section 384 of SFO (provision of false or misleading statement under a	• Section 107 of SFO (criminal liability of inducing persons to invest in securities) • Section 303 of SFO : Fine up to HK$10 million and/or imprisonment up to 10 years • Section 384 of SFO: Fine up to HK$500,000 and/or imprisonment up to 6 months	NA	Yes, orders under section 213 and/or 214 of SFO	• Section 108 (civil liability) • Section 281 (for breach of section 277) • Section 391 (civil liability) • Section 305 of SFO (breach of section 298)

			requirement imposed in SFO to SFC and/or SEHK)				
	For prospectuses, in addition to common law and sections 108, 277, 281 and 391 of SFO) there are specific statutory civil claims that may be brought against the issuer and its directors	Remedies for false or misleading provisions in prospectus or non-compliance with prospectus requirements by persons who acquire shares in primary market	Sections 40(1) and 342E of Companies (Winding up and Miscellaneous Provisions) Ordinance (CWUMPO), Cap 32 (for false and misleading disclosure);	• Sections 40A and 342F of CWUMPO (for misleading disclosure): Imprisonment and fine • Sections 38 and 342 of CWUMPO) (for non-compliance with prospectus requirements)	None	NA	Sections 40(1) and 342E of CWMPO
			Various provisions under the Theft Ordinance for deceit	Various sanctions prescribed under the Theft Ordinance	NA	NA	NA

Criminal and Civil Consequences Upon Violation of the Continuous Disclosure Obligations

	Civil action	Civil remedies	Legislation imposing obligation on listed company on continuous disclosure	Criminal sanction	Civil penalty orders	Disqualification (of director)	Statutory compensation
Singapore	Limited	Limited	Section 203 of SFA (criminal sanction only applies if the breach is intentional or reckless, otherwise, negligent breach only attracts civil liability)	Section 204 of SFA: Fine up to S$250,000 and/or imprisonment up to 7 years	Section 232 of SFA: S$2 million or 3 times the benefit gained	Yes, if conviction is after 1 July 2015	Sections 234 and 236 of SFA (for breach of section 203)
Hong Kong	Limited	Limited	Section 307B of SFO	NA	Section 307N of the SFO: Fine not exceeding HK$8 million	Yes, section 307N: not exceeding 5 years	Section 307Z (for breach of disclosure requirement) Section 213 and/or section 214 of SFO