11-2019

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Citation

CHEN, Christopher C. H. and WAN, Wai Yee. Transnational corporate governance codes: Lessons from regulating related party transactions in Hong Kong and Singapore. (2019). *Chinese (Taiwan) Yearbook of International Law and Affairs*. 36, (2), 56-93. Research Collection School Of Law.
Available at: https://ink.library.smu.edu.sg/sol_research/2963

Transnational Corporate Governance Codes: Lessons from Regulating Related Party Transactions in Hong Kong and Singapore

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Abstract

Many jurisdictions around the world, including Asia, have corporate governance codes largely based on the transnational code drafted by the Organisation for Economic Cooperation and Development (OECD). The core ideas underpinning the OECD's principles of corporate governance are board independence and proper management of conflicts of interest. These ideas, drawn from the Anglo-American model of corporate governance, are designed to protect companies and their shareholders. However, the question remains as to whether a transnational corporate governance code is always appropriate and effective, particularly when the kinds of companies listed on the stock exchange significantly differ from the Anglo-American model. In this article, we examine Hong Kong and Singapore, two Asian financial centers with national corporate governance codes that are closely aligned with the OECD principles of corporate governance. The regulatory and institutional framework supplementing these principles has broadly followed the Anglo-American model. However, Hong Kong and Singapore have listed companies that differ from the Anglo-American model, particularly in two respects: the shareholdings in the two Asian jurisdictions are much more concentrated, and they have comparatively higher levels of foreign listings. Drawing from empirical data related to tunneling through related party transactions from 2002-2004 and 2009-2014, which has remained rampant among listed companies in the two jurisdictions, we argue that that a one-size-fits-all approach to the OECD principles may not be appropriate if we ignore local characteristics. Specifically, we examine the concentrated shareholding structures and the large number of foreign (notably Chinese) firms listed in Hong Kong and Singapore. Although this article does not fundamentally challenge the utility of the OECD principles of corporate governance, we suggest that national regulators should not unreservedly follow these principles without adapting to local circumstances and devising specific strategies to deal with local problems.

I. Introduction

Many jurisdictions around the world have corporate governance codes that are mostly drawn from, or based on, the transnational code of corporate governance drafted by the Organisation for Economic Cooperation and Development (OECD). The OECD code was first published in 1999,[1] with the latest version published by the G20/OECD in 2015.[2] Although transnational codes are intended for general application,[3] when they are implemented at the national level, they are often supplemented by a local regulatory framework of national legislation and listing rules. The OECD principles of corporate governance are largely drawn from the Anglo-American model of corporate governance. One of the earliest proponents of corporate governance code was the United Kingdom (U.K.), which published the *Cadbury Report* in 1992.[4] This report emphasized the importance of a strong independent element on corporate boards[5] and managing potential conflicts of interest.[6] Along with the U.K., the United States (U.S.) model of corporate governance, with independent directors and the accountability of the board at its core, became globally influential during the 1990s and early 2000s. This followed the collapse of the Japanese stock market, which demonstrated the weaknesses of insider/control oriented countries.[7] Subsequently, the Anglo-American corporate governance model became the paradigm of internationally recognized good practices in corporate governance.

In the aftermath of the Asian financial crisis of 1997, affecting much of East Asia and South-east Asia, the World Bank and International Monetary Fund (IMF) asserted that a principal reason for the crisis was the weak governance of companies in several Asian

* This research was supported by the Singapore Ministry of Education (MOE) Academic Research Fund Tier 2 grant with the MOE's official grant number MOE2015-T2-1-142.

[1] OECD, *OECD Principles of Corporate Governance* (1999), https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(99)6&docLanguage=En (last visited October 25, 2018).

[2] OECD, *G20/OECE Principles of Corporate Governance* (2015), http://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en (last visited October 25, 2018). (OECD principles)

[3] See generally, Andrew Keay, *An Analytical Study of Board Accountability in Transnational Codes of Corporate Governance* in JEAN J. DU PLESSIS & CHEE KEONG LOW (eds.), CORPORATE GOVERNANCE CODES FOR THE 21ST CENTURY: INTERNATIONAL PERSPECTIVES AND CRITICAL ANALYSES 117-143 (Cham, Switzerland: Springer, 2017) and the references therein; Peer Zumbansen, *'New Governance' in European Corporate Law Regulation as Transnational Legal Pluralism*, 15 EUROPEAN L. J. 246 (2009); Kevin T. Jackson, *Global Corporate Governance: Soft Law and Reputational Accountability*, 35 BROOKLYN J. OF INT'L L. 41 (2010).

[4] The Report of the Committee on the Financial Aspects of Corporate Governance (1992), available at http://www.ecgi.org/codes/documents/cadbury.pdf (last visited October 25, 2018). (Cadbury Report)

[5] Cadbury Report, *id.*, para 4.9.

[6] *Id.*, paras 3.2 and 4.6.

[7] Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 331 (2001).

jurisdictions.[8] Weak corporate governance was viewed as contributing to more expropriation by managers and greater falls in asset prices during the crisis.[9] Consequently, many Asian economies, either voluntarily or pushed by the World Bank or IMF, began a series of reforms to their corporate governance regulatory framework closely following OECD principles. Singapore published the first version of a Code of Corporate Governance in 2001.[10] South Korea imposed board independence requirements for the Securities Exchange in 2000.[11] Malaysia published its Code of Corporate Governance in 2000.[12] The Stock Exchange of Thailand published the Code of Best Practice for the Directors of Listed Companies (the earlier version of the current Thai Corporate Governance Code) in 1998.[13]

At the center of OECD principles is that corporate governance should promote fair and transparent markets,[14] and stock market regulations should support effective corporate governance.[15] "Shareholders should also be sufficiently informed about, and have the right to approve or participate in, decisions concerning fundamental change such as … extraordinary transactions…"[16] Further, all material matters should be timely and accurately disclosed.[17] OECD principles highlight the board of directors' duty to ensure the strategic guidance of companies and the effective monitoring of management.[18] For this reason the OECD emphasized that "the board should be able to exercise objective independent judgement on corporate affairs,"[19] and henceforth "a sufficient number of board members will need to be independent of

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[8] See Gilson, *id*.; see also generally ANDREW WALTERS, GOVERNING FINANCE: EAST ASIA'S ADOPTION OF INTERNATIONAL STANDARDS (Ithaca, Cornell University Press 2008).
[9] See generally Simon Johnson et al., *Corporate Governance in the Asian Financial Crisis*, 58 J. OF FIN. ECON. 141 (2000).
[10] Monetary Authority of Singapore, *Code of Corporate Governance*, http://www.mas.gov.sg/Regulations-and-Financial-Stability/Regulatory-and-Supervisory-Framework/Corporate-Governance/Corporate-Governance-of-Listed-Companies/Code-of-Corporate-Governance.aspx (last visited October 25, 2018).
[11] Kyung-Hoon Chun, *Korea's Mandatory Independent Directors: Expected and Unexpected Roles*, at 9, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2824303 (last visited October 25, 2018).
[12] Malaysian Code on Corporate Governance (March 2000), http://www.ecgi.org/codes/documents/mccg_mar2000.pdf (last visited October 25, 2018).
[13] Thailand Code of Best Practice for the Directors of Listed Companies, https://ecgi.global/content/codes (last visited October 25, 2018).
[14] OECD principles, *supra* note 2, at 13.
[15] *Id*., at 16.
[16] *Id*., at 21.
[17] *Id*., at 41 *et seq*.
[18] *Id*., at 51 *et seq*.
[19] *Id*., at 57.

management."[20] Beyond providing for a strong independent element on corporate boards, the OECD focused on managing conflicts of interest. Its principles specify that: "[r]elated party transactions should be approved and conducted in a manner that ensures proper management of conflict of interests and protects the interests of the company and the shareholders."[21]

The key question is whether transnational corporate governance, and specifically the corporate governance norms set out in the OECD principles, improve corporate governance. Regardless of why a country has adopted the transnational corporate governance code (e.g. improving global ranking such as the World Banks' Ease of Doing Business Ranking[22] or responding to corporate scandals to protect investors[23]), we have observed multiple layers when transnational corporate governance standards have been implemented nationally. The first layer is the way national laws adopt the standards, i.e. the law in the books. The second layer is how firms comply with corporate governance standards. This provides important insight into how firms in the market adopt international and/or national standards in practice. The third layer is the actual effect of corporate governance standards on a firm's behavior. In this article, we focus on the second and third layers, i.e. how transnational corporate governance standards infiltrate market practices at the firm level, given a jurisdiction's adoption of relevant standards. We examine whether there may be variations in compliance at the firm level even if a jurisdiction closely follows OECD principles in its written law.

In this article, we focus on the effects that implementing OECD principles has had on related party transactions (RPTs) in Hong Kong and Singapore. RPTs raise tunneling issues because although RPTs can be beneficial to a company, they can also become transactions in which the management or controlling owners put the company's resources into their own pockets at the expense of the minority shareholders. It is not always easy to tell whether these transactions fall within the former or latter category.[24] Tunneling "not only raises distributional

[20] *Id*.
[21] OECD, *supra* note 2, principle II(F).
[22] World Bank, *Ranking & Ease of Doing Business Score*, http://www.doingbusiness.org/en/rankings (last visited October 25, 2018). "Protecting Minority Investors" is an important benchmark in the ranking.
[23] See generally Michael C. Jensen & W.H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. OF FIN. ECON. 305 (1976).
[24] S. Johnson et al., *Tunneling*, 90 AMERICAN ECONOMIC REVIEW 22, 22 (2000); Atanasov et al. broaden the definition from tunneling by controlling shareholders to tunneling by managers who are not controllers. Vladimir Atanasov et al., *Law and Tunneling*, 37 J. OF CORP. L. 1, 5 (2011).

concerns … but has an intuitively negative impact on capital markets as a whole and on their dynamic efficiency."[25] The finance literature has broadly supported the view that tunneling has a negative effect on a company's performance and value.[26] Hence, although we acknowledge that RPTs do not necessarily involve tunneling,[27] and that there are other kinds of tunneling in addition to RPTs, there is no doubt that RPTs have been behind a number of significant corporate scandals.[28]

We chose Hong Kong and Singapore as the target markets for several reasons. Both markets are leading international financial centers in Asia. Both markets also share the same legal heritage and both have largely adopted International Financial Reporting Standards (IFRS). These factors make the two markets comparable to a certain extent, although there have also been differences in their market development that could raise some interesting questions. Both jurisdictions have closely followed the OECD principles in adopting their national corporate governance codes and both have enacted legislation and listing rules that support the corporate governance norms found in these principles. Hong Kong and Singapore also share the common trait of having a concentration of ownership in their publicly listed companies,[29] thereby raising concerns over tunneling by unscrupulous corporate insiders.[30] The World Bank in its *Doing*

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[25] Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)*, 16 E.B.O.R. 1, 8 (2015).
[26] E.g. Mark Kohlbeck & Brian W. Mayhew, *Valuation of Firms that Disclose Related Party Transactions*, 29 JOURNAL OF ACCOUNTING AND PUBLIC POLICY 115 (2010); Minjung Kang et al., *The Association Between Related-Party Transactions and Control-Ownership Wedge: Evidence from Korea*, 29 PACIFIC-BASIN FINANCE JOURNAL 272 (2014); Sung Wook Joh, *Corporate Governance and Firm Profitability: Evidence from Korea Before the Economic Crisis*, 68 J. OF FIN. ECON. 287 (2003); Yan-Leung Cheung et al., *Tunneling, Propping, and Expropriation: Evidence from Connected Party Transactions in Hong Kong*, 82 J. OF FIN. ECON. 343 (2006); Kee-Hong Bae et al., *Tunneling or value added? Evidence from Mergers by Korean Business Groups*, 57 J. OF FIN. 2695 (2002).
[27] Enriques, *supra* note 25, at 9.
[28] See, e.g. Grace Leong, *Ex-directors of Celestial Nutrifoods being sued*, Straits Times (March 16, 2016), http://www.straitstimes.com/business/companies-markets/ex-directors-of-celestial-nutrifoods-being-sued (last visited October 25, 2018) Elaine Henry, Elizabeth A. Gordon, Brad Reed and Timothy Louwers, *The Role of Related Party Transactions in Fraudulent Financial Reporting*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=993532 (last visited October 25, 2018).
[29] See generally Stijn Claessens et al., *The separation of Ownership and Control in East Asian Corporations*, 58 J. OF FIN. ECON. 81 (2000).
[30] See generally Michael L. Lemmon & Karl V. Lins, *Ownership Structure, Corporate Governance, and Firm Value: Evidence from the East Asian Financial Crisis*, 58 J. OF FIN. 1445 (2003). Jiang et al. found that a higher shareholding percentage by controlling shareholders is positively correlated with the use of non-operational fund occupancy for tunneling. See Guohua Jiang et al., *Tunneling Through Non-Operational Fund Occupancy: An Investigation Based on Officially Identified Activities*, 32 J. OF CORP. FIN. 295 (2015). However, there are also arguments that concentrated ownership may create value because having corporate control may allow a controller to

Business reports provided specific indicators for regulating conflicts of interest.[31] Thus, there are strong arguments supporting the design of an institutional framework that adequately protects minority shareholders from the expropriations of controlling shareholders.[32]

The challenge with regulating RPTs is that they are not unequivocally good or bad. Some jurisdictions have chosen to target what they regard as clearly non-beneficial RPTs.[33] However, some RPTs may also be fair and value-enhancing to a company.[34] For example, a controlling shareholder may be willing to lend funds to prop up the company. This kind of RPT may be beneficial to the firm as long as the terms of the loan agreement are reasonable and fair.[35] In other words, RPTs may sometimes be more efficient than transactions with outsiders.[36] If that is true, then prohibiting all RPTs could cause inefficient results. Nonetheless, it is very difficult to distinguish between beneficial and non-beneficial RPTs.[37] Thus, to reduce the chance of tunneling, policymakers have not prohibited RPTs outright but have regulated them using several regulatory toolkits.

As will be elaborated in Part II, the OECD principles provide important guiding principles to combat tunneling through RPTs. In general, they are divided into disclosure and transparency, independent review and approval and giving shareholders an effective means of redress. These guiding principles have been implemented in Hong Kong and Singapore through a variety of regulatory toolkits, such as corporate governance codes, listing rules and legislation.

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pursue his idiosyncratic vision for the firm. See generally Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560 (2016); Yan-Leung Cheung et al., *Buy High, Sell Low: How Listed Firms Price Asset Transfers in Related Party Transactions*, 33 J. OF BANKING AND FINANCE 914 (2009).

[31] World Bank Doing Business, *Protecting Minority Investors: Achieving Sound Corporate Governance*, http://www.doingbusiness.org/reports/case-studies/2016/pmi (last visited October 25, 2018).

[32] Michelle Pizzo, *Related Party Transactions under a Contingency Perspective*, 17 J. OF MANAGEMENT AND GOVERNANCE 309, 322 (2013).

[33] Enriques, *supra* note 25, at 14-15. See also 15 USC 78m(k) for U.S. law prohibiting a listed issuer from extending any credit in the form of a personal loan to or for a director or executive officer.

[34] See generally Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Shareholders*, 152 U. OF PENN. L. REV. 785 (2003); Atanasov et al., *supra* note 24; Elizabeth A. Gordon et al., *Related Party Transactions and Corporate Governance*, 9 ADVANCES IN FINANCIAL ECONOMICS 1, 4 (2004); Enriques, *supra* note 25, at 14.

[35] See generally Eric Friedman et al., *Propping and Tunneling*, 31 J. OF COMPARATIVE ECONOMICS 732 (2003). However, whether such a transaction is for propping up or tunneling may remain to be seen. See generally Winnie Qian Peng et al., *Tunneling or Propping: Evidence from Connected Transactions in China*, 17 J. OF CORPORATE FINANCE 306 (2011); Cheung et al., *supra* note 30. Professor Enriques suggests that tunneling, propping and RPTs are three partially overlapping circles. Enriques, *supra* note 25, at 6 note 24.

[36] Pizzo, *supra* note 32, at 317-318.

[37] Henk Berkman et al., *Expropriation Through Loan Guarantees to Related Parties: Evidence from China*, 33 J. OF BANKING & FINANCE 141, 141 (2009).

This article focuses on those regulatory toolkits that are *ex ante* regimes, that is, they regulate the RPTs before they are transacted.

The question arises as to whether the current *ex ante* and process-driven emphasis of the regulatory toolkits is appropriate in the context of actual transacted and reported RPTs in Hong Kong and Singapore. We contrast this with the *ex post* approach of giving shareholders an effective means of redress. To study this, we empirically examine RPT data collected from the annual reports and circulars of a sample of listed companies in Hong Kong and Singapore. Such data were reported pursuant to financial reporting standards based on the IFRS.[38] To clarify, this article does not attempt to determine whether any specific law reforms in either market have had the causal effect of reducing RPTs and tunneling. Instead, we present data to illustrate how RPTs are reported and traded in the two markets and reflect on the regulatory strategies (particularly corporate governance regimes) adopted in both markets.

Specifically, we identify four problems from our detailed review of the RPTs. First, there is the wide range of RPT types among the listed firms. Often the regulatory framework does not distinguish how different types of RPTs are regulated. This raises the question of whether a one-size fits all approach continues to be appropriate. Second, in Hong Kong, since 2000 there has been an increase in the core emphasis on regulating RPTs through the monitoring role of independent directors. Thus, we expected the reported RPTs to generally decrease. However, our results show a significant increase in reported RPTs from 2009 to 2015. When this is compared with the earlier period, 2002-2004, it raises the question of whether relying on the monitoring role of independent directors has been an adequate response. Third, the lack of detailed disclosures in reporting on RPTs, particularly recurrent RPTs, has not been optimal. Fourth, independent directors, who are important gatekeepers, have overwhelmingly relied on the opinion of independent financial advisers (IFAs). This is a concern because the IFAs have incentives that are not necessarily aligned with the minority shareholders. Therefore, although this article does not challenge the utility of improving corporate governance by following international standards, adopting transnational corporate governance norms may not be effective

[38] See *infra* Part III.A for a further explanation of the sampling and data collection process.

unless they are modified to account for the local characteristics of concentrated ownership and a predominance of foreign listings.

We make several contributions in this article. First, we contribute to the rich academic debate on comparative corporate governance and put forth the view that an unqualified adoption of the Anglo-American governance model does not always lead to the intended outcomes.[39] Second, this article contributes to the literature on how related party transactions are transacted by listed companies based on the information reported, and how firms comply with transnational corporate governance norms in practice. The results offer valuable insights into the effectiveness of relevant corporate governance norms and provide normative reflections for policymakers amid the competition to improve corporate governance standards globally.

The remainder of this article is organized as follows. Part II briefly introduces the three main regimes dealing with RPTs, how they connect to international standards and their respective issues. It argues that the approaches in Hong Kong and Singapore continue to be process-driven and shareholders do not have effective redress. Part III provides evidence of how companies in both markets trade RPTs, using empirical data on the number of RPTs transacted in a sample of listed companies in the Stock Exchange of Hong Kong (SEHK) and Singapore Exchange (SGX). Part IV examines some corporate governance and disclosure practices in both markets to identify the problems and offers policy reflections on the regulatory strategies and regimes governing RPTs. Part V concludes the article.

II. Regulating Related Party Transactions: An Overview

Because it is difficult to distinguish between beneficial and non-beneficial RPTs, the OECD principles seek to reduce the possibility of tunneling and enhance the fairness of RPTs by suggesting procedural requirements. This part introduces the three main regulatory procedural toolkits Hong Kong and Singapore use to control RPTs based on OECD principles: (1)

[39] See, e.g., Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006); Donald C. Clarke, *"Nothing but Wind?" The Past and Future of Comparative Corporate Governance*, 59 AM. J. COMP. L. 75 (2011); Ann-Marie Anderson & Parveen P. Gupta, *Corporate Governance: Does One Size Fit All?* 24 JOURNAL OF CORPORATE ACCOUNTING & FINANCE 51 (2013).

transparency and disclosure, (2) independent review and approval, and (3) a regulatory framework within which shareholders have effective redress. The overall aim is to ensure the quality of the approval and to disclose information as necessary to ensure that the board of directors or shareholders make informed decisions.[40] This part then briefly examines the potential issues with these regimes. Although there have been some incremental revisions over time, this regulatory framework has continued to govern RPTs in both markets since 2000.

A. Transparency and Disclosure

One important way to reduce tunneling is to improve transparency through mandatory disclosures.[41] This approach is supported by internal and external auditing and allows for shareholder redress when there is a misstatement of information.[42] The literature has shown that disclosure can reduce the risk of tunneling.[43] The disclosure of RPTs may come from at least two sources: accounting standards and listing rules.[44]

First, pursuant to accounting standards, listed firms are expected to disclose RPTs in their financial statements. Related party disclosures under the IFRS have gone through several rounds of reform since their introduction in 1984.[45] These rules have become harmonized due to the cross-border application of common accounting standards (such as the IFRS). The purpose of related party disclosures is to draw investors' attention to the possibility that a firm's financial position can be affected by the presence of related parties.[46] In general, an RPT under the IFRS is a transaction (which could be a transfer of resources, services, sale or purchase, etc.) with a related party. It involves a wide variety of persons, ranging from individuals who have control or significant influence over the company (including key management), to holding companies,

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[40] OECD principles, *supra* note 2, at 45.
[41] Enriques, *supra* note 25, at 21.
[42] Securities and Futures Act ss 200 and 254 (Singapore); Securities and Futures Ordinance ss 108, 277 and 391.
[43] See generally David Buchuk et al., *The Internal Capital Markets of Business Groups: Evidence from Intra-Group Loans*, 112 J. OF FIN. ECON. 190 (2014) (arguing that strict regulation and disclosure requirements have the effect of reducing the risk of expropriation through intra-group loans in Chile); Carlo Di Emiliano, *Related Party Transactions and Separation Between Control and Direction in Business Groups: The Italian Case*, 14 CORPORATE GOVERNANCE 58 (2014) (showing that transparency may provide a disincentive to establishing a pyramidal group for the purpose of expropriation).
[44] In addition, this article recognizes that there could be other regimes such as tax law or insolvency law on creditor protection that could affect RPTs. Atanasov et al., *supra* note 24, at 10.
[45] IAS, *IAS 24 – Related Party Disclosures*, https://www.iasplus.com/en/standards/ias/ias24 (last visited October 25, 2018)
[46] *Id*.

companies within the same group or associates or joint ventures of the company.[47] Accounting standards require companies to disclose the amount and outstanding balance of such transactions.[48] The most notable revision to related party disclosures under the IFRS was in 2005. At that time, the scope of related party disclosures was expanded to include the compensation of key management personnel and state-controlled entities. The definition of "related party" was also broadened to cover parties with joint control over the entity, joint ventures in which the entity is a venture and the post-employment benefit plans of both employees of the entity and close family members of an individual.[49]

Second, a listed firm may have to disclose certain RPTs pursuant to listing rules. For example, the listing rules of the SGX require a listed company (whether it is registered in Singapore or not) to disclose "interested person transactions" (IPT) in its annual report.[50] In the SEHK, a "connected transaction" (CT) must be disclosed.[51]

In short, an IPT is a transaction between a company and interested persons, including the directors, chief executive and controlling shareholders and their respective associates.[52] The transactions can include the provision or receipt of financial assistance or services, issuance of or subscription to securities or options, establishing a joint venture, or selling property units.[53] In general, a company must immediately announce an IPT if the value of such transaction is equal to at least 3% of the group's last audited net tangible assets.[54] The purpose is "to guard against the risk that interested persons could influence the [company] to enter into transactions with [IPTs] that may adversely affect the interests of the [company]."[55] The aggregate value of the IPTs should be disclosed in the company's annual report.[56]

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47 IAS 24.9 and 24.11.
48 Financial Reporting Standards 24: Related Party Disclosures (2010), at para. [3]. (FRS 24)
49 Financial Reporting Standards 24: Related Party Disclosures (2005), at p. 4.
50 SGX Mainboard Rules Chapter 9. (SGX MB Rule)
51 HKEX Mainboard Listing Rules Chapter 14A. (HK MB Rule)
52 SGX MB Rule 904(4) and (5).
53 SGX MB Rules 904(6) and 910.
54 SGX MB Rules 905 and 917.
55 SGX MB Rule 901.
56 SGX MB Rule 907.

Under the SEHK's rules, a CT includes specific types of transactions[57] between a company and a "connected person,"[58] which is widely defined to include the directors, chief executive and substantial shareholders of the company and its subsidiaries; an associate of those persons (including family members and a company in which 30% of the shares are held by the person);[59] and a connected subsidiary (i.e., a non-wholly-owned subsidiary in which the reporting company can exercise 10% or more of the voting power[60]).[61] A company should make an announcement of a connected transaction when the terms are agreed to.[62]

The scope of disclosure is not identical for accounting standards and listing rules. Between the SEHK and SGX listing rules, the definitions of "connected person" and "interested person" differ, although there is some common ground. For example, the definition of connected persons in Hong Kong is wider than interested persons in Singapore, because the former also covers some firms subordinated to the company in addition to key management and substantial shareholders. Further, under the SGX rules, an IPT is exempted from disclosure only if its value is below a certain threshold. There is no such exemption in the SEHK or under the IFRS. Thus, IPT disclosure in the SGX is more limited in scope than the SEHK or accounting standards.[63]

B. Independent Review and Approval

The second way to regulate RPTs is to require approval or review by an independent board and in some situations by the shareholders.[64] In other words, policymakers seek to regulate

[57] A connected transaction includes the following: acquisition and disposal of assets, financial leases, granting indemnity or financial assistance, joint ventures, issuing new securities, providing or receiving services, and acquiring or providing raw materials, intermediate products or finished goods. HK MB Rule 14A.24.
[58] HK MB Rule 14A.25.
[59] HK MB Rule 14A.12 to 15.
[60] HK MB Rule 14A.16.
[61] HK MB Rule 14A.07. There are also exceptions. See HK MB Rule 14A.09.
[62] HK MB Rule 14A.35.
[63] KPMG and NUS, *The Ties that Bind - Interested Person Transactions: Rules and Practices in Singapore* (2013), at 1, http://governanceforstakeholders.com/wp-content/uploads/2013/12/The-ties-that-bind-Publication_FINAL.pdf (last visited October 25, 2018). However, it should be noted that the Singapore Exchange has recently consulted on proposed amendments to remove the exemption for disclosure of transactions below S$100,000. Singapore Exchange, *Consultation Paper on Enhancements to Continuous Disclosures Consultation Paper on Enhancements to Continuous Disclosures* (2017), http://www.sgx.com/wps/wcm/connect/sgx_en/home/regulation_v2/consultations_and_publications/PC/Consultation+Paper+on+Enhancements+to+Continuous+Disclosures (last visited October 25, 2018). As of 28 March 2018, the SGX was still considering the feedback it received.
[64] E.g., Singapore Code of Corporate Governance 2012 Guidelines 12.1.

RPTs through enhanced independent board oversight.[65] This is based on the key idea of board independence and the audit committee improving the board's oversight function by underlining OECD principles.[66]

In a way, board independence has been treated as a popular "cure-all" for maladies ailing modern corporations.[67] We expect independent directors to exercise a supervisory function to ensure the fairness of RPT terms and reduce the chance of tunneling. Further, when RPTs (or at least the major ones) are reviewed by "gatekeepers" (such as the audit committee or sometimes professionals outside the firm), there may be a deterrence effect, because those who want to tunnel may be more reluctant to go through such a process. With an audit committee in charge of reviewing financial statements and supervising internal and external audits, the quality of disclosures should be ensured. Such gatekeepers should not only help to filter transactions *ex ante*, but also help to monitor RPTs on a continuous basis, *post* transaction.

For example, the SEHK requires connected transactions (or mandates for continuing connected transactions) to be approved by shareholders at their general meetings, with interested shareholders abstaining from voting.[68] Before a general meeting, companies should appoint an independent financial adviser to make recommendations,[69] and an independent board committee to advise shareholders on the terms and nature of the connected transactions.[70] These safeguards are intended to ensure that shareholders have an independent third party's fair assessment of the transactions. Continuing connected transactions are also subject to mandatory annual review by independent directors and auditors.[71]

In Singapore, the SGX requires an IPT to be approved by shareholders if the value of the transaction is at least 5% of the company's audited net tangible assets.[72] As in Hong Kong, the SGX allows listed firms to seek a general mandate from shareholders for recurrent IPTs of a revenue or trading nature or those necessary to day-to-day operations. Detailed information is

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[65] Atanasov et al., *supra* note 24, at 10.
[66] OECD principles, *supra* note 2, at 16.
[67] Adam C. Pritchard, *Monitoring of Corporate Groups by Independent Directors*, 9 J. OF KOREAN L. 1, 1 (2009).
[68] HK MB Rule 14A.36 and 37.
[69] HK MB Rule 14A.44.
[70] HK MB Rule 14A.40.
[71] HK MB Rule 14A.55.
[72] SGX MB Rule 906(1).

specified in a circular issued to the shareholders before a general meeting.[73] The objective appears to be the reduction of compliance costs so that firms can avoid having to seek approval for ordinary commercial dealings. Nonetheless, such a mandate could potentially open a backdoor for management or controlling owners to hide transactions under a shareholder mandate.[74]

C. Allowing Shareholders to Have Effective Redress

The most important form of effective redress is to allow shareholders to bring actions against wrongdoers for compensation. Such redress is an *ex post* regulatory toolkit that may also deter wrongdoing. If a director engages in tunneling, it is a breach of his or her duty unless the transaction has been properly approved. Both Hong Kong and Singapore follow the English common law tradition in which the directors owe a fiduciary duty to the company. If there is any conflict of interest, a director must disclose it to the company and seek approval from the board before proceeding with the transaction.[75] Otherwise, he or she could be in breach of the duty to disclose, with legal consequences that include a range of civil liabilities.[76] Some duties have also been codified into statutes.[77] These laws provide some constraints on a corporate insider's tunneling behavior. In the U.S., for example, a controlling shareholder may owe a fiduciary duty to the company or its minority shareholders.[78] However, it is worth noting that a controlling or substantial shareholder does not owe a fiduciary duty to the company or other shareholders under Singapore or Hong Kong law.[79] Moreover, expanding the shareholders' ability to obtain redress has not been effective. In our prior work, we have shown that public enforcement has often been more important, with private enforcement playing a secondary role in both Hong Kong and Singapore.[80]

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[73] SGX MB Rule 920(1).
[74] See *infra* Part IV.E.
[75] See *Bristol & West Building Society v. Mothew* [1998] Ch 1, 18-19 (per Millet J).
[76] See, e.g., Companies Act (Cap 50) s 157(3) (Singapore).
[77] E.g., see Companies Act (Cap 50) ss 156 and 157 (Singapore).
[78] E.g., *Jones v HF Ahmanson & Co* 460 P.2d 464 (Cal. 1969); *Kahn v. Lynch Communications Systems, Inc* 638 A.2d 1110 (Del. 1994); *Sinclair Oil Corp v. Levien* 280 A.2d 717 (Del. 1971).
[79] For a comparative analysis, see generally Ernest Lim, *Controlling Shareholders and Fiduciary Duties in Asia*, JOURNAL OF CORPORATE LAW STUDIES 113 (2017).
[80] See generally Wai Yee Wan et al., *Public and Private Enforcement of Corporate and Securities Laws: An Empirical Comparison of Hong Kong and Singapore* (forthcoming in E.B.O.R) at 19, 21 and 29, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3149367 (last visited October 25, 2018).

D. General Problems with the *Ex Ante* and Process-driven Approaches

Ideally, the three main regimes should be sufficient to reduce tunneling through RPTs. However, it is debatable whether individually or collectively they have been truly effective at deterring tunneling. Even in the U.S., some of the regimes mentioned above have been described as weak or moderate.[81] Without further detailed legal analysis, this section offers some general criticism of the *ex ante* and process-driven approaches to RPT.[82] Our criticism relates to the belief that better corporate governance (underlining the adoption of transnational corporate governance standards) can address agency problems in the Asian context.

First, disclosures may not be wholly accurate or reliable, raising concerns over the quality of RPT disclosures.[83] Whether a transaction is reported may sometimes depend on the company's discretionary assessment.[84] Further, how data is reported affects the way information is conveyed to the market participants. For example, within a group of companies, it may not be necessary to disclose information on an RPT in a consolidated financial statement.[85] Even in the U.S., large corporations may not effectively disclose self-dealing.[86] Therefore, the market may not be fully informed.

Second, knowing how to effectively audit RPTs may pose another problem,[87] because the nature of tunneling implies that wrongdoers are more likely to hide their dealings. This issue may further impact the quantity and quality of the information revealed not only to shareholders and prospective investors but also to independent directors and the audit committee reviewing RPTs. Annual reports often give blanket assurances that all RPTs have been conducted on fair terms,

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[81] Atanasov et al., *supra* note 24, at 49-50.
[82] For clarification, this article does not examine issues regarding enforcement and liability rules, which deserve another separate paper for full analysis.
[83] See generally Cynthia Utama & Sidharta Utama, *Determinants of Disclosure Level of Related Party Transactions in Indonesia*, 11 INT'L J. OF DISCLOSURE AND GOVERNANCE 74 (2014); Agnes W.Y. Lo et al., *Can Corporate Governance Deter Management from Manipulating Earnings? Evidence from Related-Party Sales Transactions in China*, 16 J. OF CORPORATE FINANCE 225 (2010); Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 COLUMBIA BUS. L. REV. 663 (2014).
[84] Enriques, *supra* note 25, at 21.
[85] Atanasov et al., *supra* note 24, at 15.
[86] Atanasov et al., *supra* note 24, at 41.
[87] Gordon et al. also suggested that more independent directors might improve the quality of RPT audits. Gordon et al., *supra* note 34, at 93-94.

often without further elaboration that would enable meaningful evaluation by investors and shareholders. Whether those statements are true may again depend on the management and the quality of auditing.

Third, the effectiveness of shareholder approval depends partly on whether minority shareholders have a real opportunity to vote for the interests of the company after a well-informed decision-making process.[88] Therefore, it is imperative that shareholders be given sufficient and appropriate information before a general meeting. In practice, however, shareholders may not always vote with the interests of the company in mind or they may not vote on an informed basis (e.g., inability to evaluate the information provided).[89] The assumption that shareholders are able to make good decisions on individual business transactions[90] may not always be correct.

Fourth, the effectiveness of board independence and audit committee review may also be compromised. One underlying assumption of the board independence regime is that independent directors are not only truly independent but are also competent to effectively perform their function. One or both assumptions could be false.[91] For example, in small jurisdictions like Hong Kong or Singapore, it is not uncommon for businessmen or professionals to be connected through family, business or social networks. This could undermine their independence if they serve as independent directors.[92] Because independent directors are still elected at general meetings (and the controlling shareholders may vote at these meetings) the controlling shareholders may have the ability to select candidates they prefer or remove undesirable directors if the law allows it.[93] The criteria for deciding whether a director is independent, and who is responsible for this decision, are critical to ensuring the integrity of the board

[88] Enriques, *supra* note 25, at 16.
[89] *Id*.
[90] Enriques, *supra* note 25, at 17.
[91] Enriques, *supra* note 25, at 18.
[92] See generally Zihan Niu & Christopher Chen, *Social Capital of Directors and Corporate Governance: A Social Network Analysis*, 11 BROOKLYN J. OF CORP. FIN. AND COMMERCIAL L. 343 (2017).
[93] Companies Act s 152 (Singapore); Companies Ordinance s 462 (Hong Kong).

independence regime.[94] In other words, a regime requiring approval by independent directors could create a "risk to shareholders if the board is co-opted or asleep."[95]

How independent directors are involved in the decision-making process could also make a difference. Their impact is much weaker when they only offer non-binding advice. However, the case is different when the rule requires RPTs to be approved not only by the board but also by a majority of the independent directors.[96] As with shareholder approval, the extent to which independent directors are well-informed plays an important role.[97]

In addition to the above, research on the role of independent financial advisers in takeover offers has shown that they may rely on non-standard methodologies for valuation. Because they are entitled to choose the methodology, they may be subject to bias that may not be easily detected.[98] This could apply to independent financial advisers evaluating IPTs or CTs in Singapore and Hong Kong respectively.[99]

Part III provides more insight on how listed firms trade RPTs and makes some general observations. Part IV further considers the different regulatory regimes and how compliance with them may reflect on the number of RPTs disclosed and transacted.

III. The Contour of Related Party Transactions

In this part, empirical evidence is offered on Hong Kong and Singapore's RPTs from 2002-2004 and 2009-2015. The inquiry is not about how RPTs are regulated in the books but how companies conduct RPTs in practice following a series of corporate governance reforms based on OECD principles. The data helps us examine the effectiveness of current regulatory regimes. This part first explains the source of the data and dataset design, then provides some general data on RPTs reported in financial statements in both markets.

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[94] Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J COMP. L. 1, 27 (2011).
[95] Atanasov et al., *supra* note 24 (2011), at p. 11.
[96] Enrique, *supra* note 25, at 19.
[97] Enrique, *supra* note 25, at 19.
[98] Wai Yee Wan, *Independent Financial Advisers' Opinions for Public Takeovers and Related Party Transactions in Singapore*, 30 COMPANY AND SECURITIES LAW JOURNAL 32, 42 (2012).
[99] *Id*.

A. Dataset Design

We constructed two databases for Hong Kong and Singapore. One dataset comprised a random sample of 25% of the firms listed in the Hong Kong and Singapore stock markets at the beginning of 2002 (and were still listed by the end of 2004). From this, data were retrieved on 157 firms listed in Hong Kong and 51 firms listed in Singapore, for a total of 208 firms and 624 firm-year observations. The other dataset randomly sampled 25% of the firms listed in Hong Kong and Singapore from 2009 to 2015.[100] It resulted in a sample of 103 firms from Singapore and 254 firms from Hong Kong for a total of 357 firms and 2,499 firm-year observations. We sampled only 25% because the coding exercise required us to handpick non-standardized information from financial statements. The reason for the difference in time spans (three years vs. seven years) was practicality, because many annual reports before 2002 were unavailable. To address the problem, we restricted the timeframe for the 2002-04 dataset to three years, even though we recognized that doing so would limit the power of any inference we might draw from the data.

In each dataset, we collected data on firm characteristics (e.g., place of registration, year listed), corporate governance benchmarks (e.g., board size or number of independent directors), and financial data for each fiscal year within the coverage period (including total assets, revenue, etc.) and finally, the RPTs extracted from the notes to financial statements for each company. We manually collected data on the number of RPTs from the annual reports because there was no publicly available centralized information on the level of RPTs in either Singapore or Hong Kong. In both markets, the companies did not disclose the number of their related party transactions. Thus, we only focused on the number of RPTs reported in the financial statements. Because both markets followed the IFRS, we believed that the data collected from them would generally be comparable. Conversely, because the content and methods of reporting differed significantly, data regarding connected transactions in Hong Kong and the equivalent of interested person transactions in Singapore were not quite comparable.

Why did we construct two separate datasets rather than a single dataset covering the span from 2002 to 2015? Our reasons are threefold. First, the IFRS revised the related party disclosure

[100] We sampled the companies that were listed at the beginning of 2009 and were still listed by 2015 based on the list of listed companies in the Stock Exchange of Hong Kong downloaded from Capital IQ.

rules, effective from 2005.[101] Second, we attempted to avoid the impact of the global financial crisis of 2007-08, which may have caused significant fluctuations in our sampled firms' performance. Third, constructing two datasets allowed us to observe one important phenomenon since 2006: an influx of Chinese initial public offerings and secondary listings in Hong Kong and Singapore. As a result, there were far fewer listed firms in 2002 than in 2009 in both markets. Further, a sample selected from the companies listed in 2002 might not be representative *post* 2008 global financial crisis. Thus, our trade-off was to construct two separate datasets with different compositions of firms. The authors are fully aware that the study design means drawing any statistical inferences between the two datasets would be difficult, considering the change in accounting standards and revisions to the corporate governance rules in each time frame.

B. Total Amount of Related Party Transactions

In general, we observed that the mean (average) of the total number of RPTs[102] reported in the financial statements (total RPTs) in both markets appeared to be higher in the period 2009-15 than they were in 2002-04, as shown in Figure 1 below. This illustrates the distribution and centrality of the total number of RPTs (denominated in U.S. dollars in millions).[103] In Hong Kong, the mean (average) of all observations of RPTs was US$18.48 million for 2002-04; however, the mean rose significantly to US$399.46 million for 2009-15. Likewise, in Singapore, the mean in 2009-15 (US$111.90 million) was much higher than in 2002-04 (US$ 63.31 million).

[101] See *supra* Part II.A.
[102] The total amount reported in this section does not include key management compensation or the balance of RPTs at the end of the fiscal year.
[103] The data in both periods are highly skewed, and therefore we present the RPT distribution in Figure 1 with logged figures.

Figure 1 Total Related Party Transactions

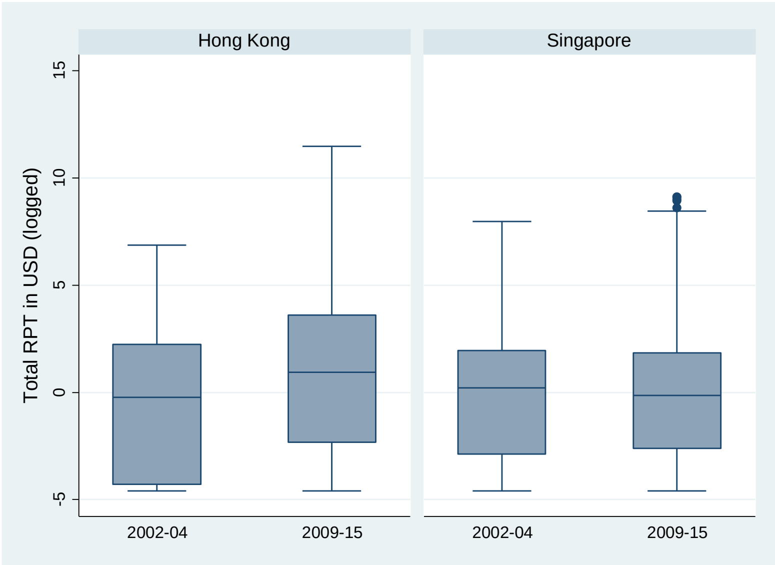


Figure 1 also shows that the box for 2009-15 is clearly in a higher position than it is in 2002-04 for Hong Kong, indicating a significant increase in the number of RPTs after the global financial crisis. This finding is supported by a comparison of data from each quantile.[104] In contrast, Singapore shows a different pattern. Although the mean for the total RPTs is still higher in 2009-15, the median value for the period 2009-15 is lower than the earlier period (US$0.86 million in 2009-15 vs. US$1.24 million in 2002-04).[105] Figure 1 also supports the observation that the boxes in both periods are largely in the same band. Thus, the higher mean in 2009-15 in Singapore could be the result of some extremely large observations.

The increase of the total number of RPTs in Hong Kong between the two periods may be explained by two factors: the change to accounting standards and the arrival of large Chinese initial public offerings. The change to the IFRS for related party disclosures in 2005 may explain the rise in the total number of RPTs, at least in Hong Kong. It is beyond the scope of this article to empirically examine the potential effect of the 2005 revision to the IFRS on related party

[104] In Hong Kong, we found that the 25% quantile was US$0.004 million for 2002-04 and US$0.084 for 2009-15. If we compare the median for the period, it is merely US$0.78 million for 2002-04 and US$2.50 million for 2009-15, much smaller than the mean. For the 75% quantile, it is US$9.30 million for 2002-04 and 37.06 million for 2009-15.

[105] If we compare the data for each quantile, the Singapore data for both periods are comparable up to the 75% quantile (US$6.31 million for 2009-15 as opposed to US$7.00 million for 2002-04).

disclosures of the number of RPTs reported. However, an international accounting firm in Hong Kong commented that the 2005 revision only had a moderate impact on Hong Kong.[106] Because related party disclosures were simpler in 2002-04, it hampered the ability to make direct comparisons between the two periods. Thus, how far the revision to the accounting rule accounts for the increase in Hong Kong RPTs is unclear.

The increase in the total number of RPTs in Hong Kong may also be partly explained by the arrival of many large Chinese listings. One sharp contrast before and after the global financial crisis was the rise in Chinese firms making initial public offerings in the Hong Kong market after 2006. Pursuant to the Hong Kong Exchange website, there were 226 H-share companies listed on the Mainboard of the SEHK at the end of 2017. Among these, 139 companies were listed on or after 1 January 2006.[107] Given that more large Chinese firms were listed in 2009-15, it could explain the increase in RPT levels in Hong Kong.

In contrast, the lack of a significant rise in Singapore's RPT level might offer a counter-argument that the increase in Hong Kong was due to the change in accounting standards, because both markets were affected by the same accounting rule change. However, because the random sampling of firms listed in Singapore did not include firms registered in China, we declined to draw much inference from our Singapore sample on the impact of overseas listings by Chinese firms in Singapore.

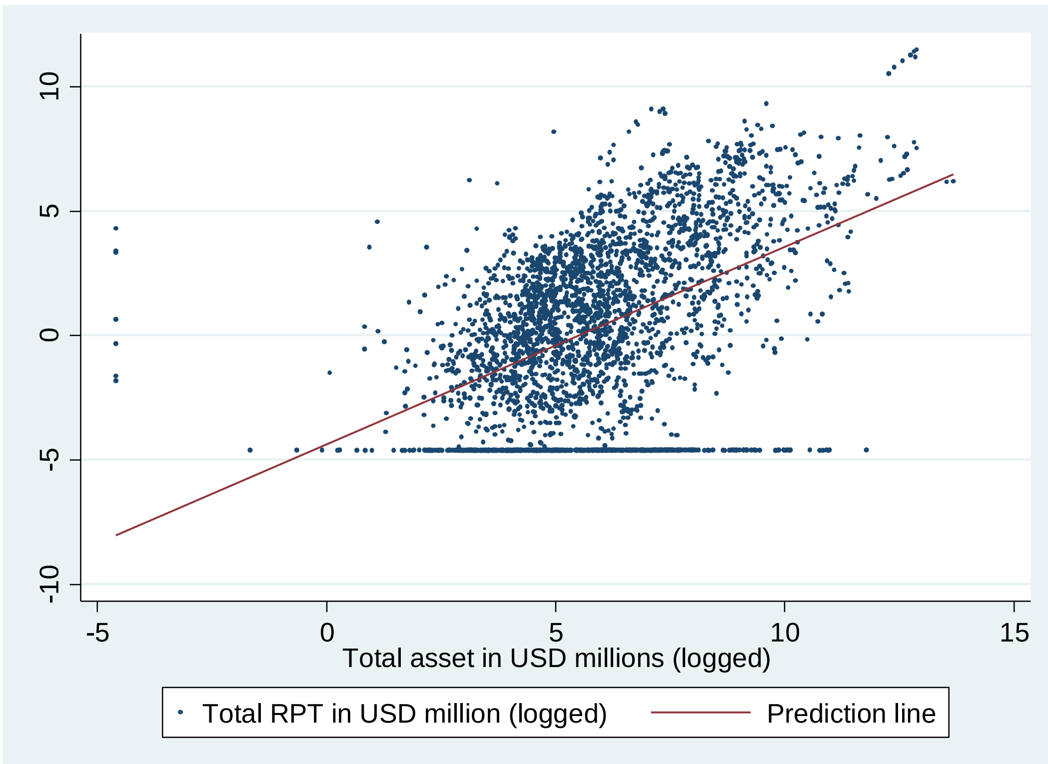
In addition, a considerable number of firms in both markets reported no RPTs in all or some years. In 2002-04, about 24% of the observations in either market reported no RPTs at all. In 2009-15, about 19% of the observations in either market reported no RPTs. This disparity might challenge policymakers attempting to maintain a balance between the regulatory regimes for RPTs and compliance costs, given that some firms have an extraordinarily large number of RPTs and many others have none.

Figure 2 below displays a pattern in which the larger the company was, the more the total number of RPTs (coefficient=0.915, p<0.001). We can also identify a positive correlation

[106] Deloitte, IMPLEMENTING HONG KONG FINANCIAL REPORTING STANDARDS: THE CHALLENGE FOR 2005, at 120 (2005), https://www.iasplus.com/en/binary/dttpubs/0508hongkong.pdf (last visited October 25, 2018).
[107] Hong Kong Exchange, *China Dimension*, http://www.hkex.com.hk/Market-Data/Statistics/Consolidated-Reports/China-Dimension?sc_lang=en&tabName=Main%20Board# (last visited October 25, 2018).

between a firm's annual revenue and total RPTs (coefficient=0.827, $p<0.001$). The trend is similar if we analyze each period separately or examine each market separately.

Figure 2 Total Assets and Total Amount of Related Party Transactions



To summarize, after a series of corporate governance reforms, a substantial number of RPTs were still entered into by listed companies in Hong Kong and Singapore. Arguably there were more RPTs in terms of total transaction amounts in Hong Kong after the global financial crisis of 2008, whereas in Singapore it appeared to be quite stable. The total amount of RPTs could be partially explained by the a company's size in terms of its total assets, because the proportion of total RPTs to total assets appeared to be relatively stable between the two periods in the two markets.

This finding prompted two questions. First, does it mean that RPTs are not as widespread as has been feared? Second, what could be the implications for RPT regulatory strategies if larger companies tend to have more RPTs? We reflect on those two questions in Part IV.

C. Types of Related Party Transactions

This article considers different types of transactions. However, the accounting standards do not provide a standardized method for defining types of transactions. Instead, they only offer a list of possible transactions as examples, such as purchases or sales of goods, rendering or receiving services, leases and transfers under finance arrangements or guarantees.[108] This approach avoids the issue of defining transactions when a single transaction can fall within multiple categories at the same time (e.g., sale and lease back). Because we have no means of examining the details of a deal other than those disclosed in the financial statements, we can only rely on the description provided by the reporting company.

This article found more non-financing RPTs than financing RPTs when RPTs were classified into two such broad categories. Financing RPTs include loans to or from a company, deposits and placing or receiving investments. These transactions directly involve cash inflow or outflow to or from the company (or subsidiaries) that is not in exchange for other goods or services. Non-financing transactions include sales and purchases and the offer or provision of services or leases that are not for financing purposes.

In Hong Kong, our data shows that the mean (average) of non-financing RPTs was US$442.46 million (median = 4.95 million) in 2009-15 and 16.23 million (median value = 0.78 million) in 2002-04. In contrast, the mean (average) was US$50.22 million (median = 0.38 million) for financing RPTs in 2009-15 and 5.96 million (median value = 0.10 million) for 2002-04. In Singapore, the mean (average) of non-financing RPTs for 2009-15 was US$120.20 million (median value = 1.17 million) and US$33.21 million (median = 2.69 million) for 2002-04. In contrast, the mean (average) was US$16.82 million (median value = 0.07 million) for financing RPT in 2009-15 with a mean of US$50.29 million (median value = 0.11 million) for 2002-04. If we convert this into percentage terms, financing RPTs amounted to an average of 10.8% of total RPTs (in terms of amount) in Hong Kong in 2002-04 and about 10.3% in 2009-15. In Singapore, financing RPTs amounted to about 2.3% in 2002-04 and 9.3% in 2009-15. Thus, in general we have seen more non-financing RPTs than financing RPTs in both markets. This is a sensible result given that most of the sampled firms were not banks or other financial institutions.

[108] FRS 24, *supra* note 48, at para. [21].

One point to note is that the proportion of different transactions could differ greatly among firms. For example, a bank might have more loans or deposits with related parties than non-financing RPTs, whereas a consumer product company would most likely have more sales with related parties. The dynamics of RPTs within a business group could also change depending on economic conditions. For example, a study of Chinese business groups showed that a firm could engage in more loan-based RPTs with a controller if the latter experienced a credit crunch and there were more non-loan-based RPTs when the listed firm's performance dipped.[109]

In our sample, among all the observations, regardless of the market or period, about 53% of the 3,123 firm-year observations involved RPTs providing or receiving services (other than finance). About 55% were sales or purchases of goods or properties, and about 45% involved leases or rentals. Financing RPTs can be broadly divided into two categories: those resulting in cash inflow into the company (i.e., borrowing or taking money from related parties) or those resulting in cash outflow (e.g., lending to related parties). Financing RPTs occurred far less often than non-financing RPTs. If all firm-year observations are counted, only about 22% of the observations had related borrowing and about 22% had related lending. Therefore, a variety of RPT combinations were traded by firms. A clear pattern was not identified.

It is challenging to judge whether a specific type of RPT is more prone to tunneling without other robust evidence. It all depends on the transaction terms and how the parties handle cash flow during the life of the transaction. This article does not rely on income or expense as a pure benchmark for tunneling. For example, a company may sell a property to a controlling shareholder. This transaction represents cash income for the company, but it could also be tunneling if the sales price is unjustifiably lower than the market rate. Therefore, although it is commendable that companies reveal the nature of their transactions (e.g., sale, lease, loan, etc.), it is unclear how much useful information is disclosed to the market through related party disclosures.

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[109] See generally Nan Jia et al., *Coinsurance within Business Groups: Evidence from Related Party Transactions in an Emerging Market*, 59 MANAGEMENT SCIENCE 2295 (2013).

D. Types of Related Parties

A further point to analyze is the amount of RPTs transacted with different related parties. Because we recorded data from consolidated financial statements, transactions with subsidiaries were consolidated and reported accordingly. Although some companies also reported RPTs at the company level, most reported only RPT data on a consolidated basis. Thus, this article cannot provide a systemic analysis of RPTs transacted with subsidiaries.

There are some challenges to analyzing related parties. Some (such as the management or controlling shareholders) may be disguised. For example, a controlling shareholder could enter into a sale of goods agreement with a company in his own name (or in the name of his spouse). He could also enter the same transaction through a shell company that he fully controls. It is often challenging to see through the veils of an ownership structure hidden behind a pyramid of holding companies that are occasionally clouded by cross-shareholdings. Without further details (which are often not fully disclosed), it may be fruitless to simply look at nominally related counterparties.[110]

One crude benchmark is to deduct RPTs with associates or joint ventures from the total number of RPTs. By definition, associate companies and joint ventures are entities in which the reporting company has some degree of ownership but not full control.[111] Thus, arguably RPTs with these affiliations would be less likely to involve tunneling and more likely to be normal business dealings if they are not otherwise owned by a controlling shareholder or key management.[112] In contrast, it is harder to evaluate whether an RPT amounts to tunneling if it involves a holding company or other group of companies with the same ultimate ownership.

Due to the dearth of information in many of the annual reports from 2002-04, this article can only present data from 2009-15. For 2009-15, our data shows that on average 74.83% of the

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[110] It is noted that in the recent consultation, SGX proposed that for IPTs the listing rules should be amended to require additional disclosure in the annual report of the relationship between the interested person and the company. Singapore Exchange, *supra* note 63.

[111] Under the IFRS, an associate is an entity in which an investor has significant influence (by holding 20% or more of the voting power) but no control or joint control. See IAS 28, https://www.iasplus.com/en/standards/ias/ias28 (last visited October 25, 2018). A joint venture is "a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control." See IAS 31, https://www.iasplus.com/en/standards/ias/ias31 (last visited October 25, 2018).

[112] In our sample and coding, we treated an associate or joint venture as a company linked to management, controlling shareholders or holding companies, etc. if they owned a significant stake in the associate or joint venture.

total RPTs in Hong Kong and 79.06% in Singapore were with related parties other than associates or joint ventures. In terms of the sheer amount, the mean was US$317.47 million in Hong Kong (although the median was merely US$0.62 million) and US$63.91 million in Singapore (with the median only US$0.32 million).

In addition, there were far fewer direct transactions with key management personnel or associated persons (including other related individuals or entities controlled by key management personnel), if they were not otherwise controlling shareholders. In 2009-15, the mean of the total RPTs with key management and associated persons was barely US$4.55 million in Hong Kong (median = US$0) and US$0.97 million in Singapore (median = US$0), representing only a tiny fraction of the total RPTs. We also note that the super-majority of firms in both markets did not have any RPTs with key management (and associated persons).

In sum, the result shows that a super-majority of RPTs were with holding companies (and their associated companies) rather than individual shareholders or key management personnel. This article explores the implications of regulatory strategies for RPTs in Part IV below.

E. Interested Person Transactions and Connected Transactions

In addition to the RPTs reported in the financial statements pursuant to accounting standards, another data source relied on is related to interested person transactions (IPTs) in Singapore and connected transactions (CTs) in Hong Kong reported in the listing rules. Due to the different ways of reporting and the difference in exchanges, we evaluated the IPTs and CTs in the two markets in different ways.

In Hong Kong, we had a total of 683 circulars (107 in 2002-04 and 576 in 2009-15) for the CTs obtained from filings on the SEHK. Among the 683 circulars, 252 (36.9%) related to continuing CTs. Thus, over one-third of the CT circulars related to continuing transactions in which shareholders could mandate authorization for the management to trade without separately seeking approval for each individual transaction. In 2002-04, only 12.15% (13 out of 107) of the circulars pertained to continuing CTs, whereas in 2009-15 it was 41.49% (230 out of 576). Thus, it seems there was a wider use of mandates for continuing CTs in Hong Kong *post* 2008 global financial crisis.

In Singapore, 553 firm-year observations (out of a total of 874, or about 63%) reported IPTs (including 119 for 2002-04 and 434 for 2009-15). In addition, 143 out of 553 observations (about 26%) reported IPTs under a shareholder mandate (similar to Hong Kong's mandate for continuing CTs). In terms of the amount, in 2002-04, the mean of the total IPTs transacted was US$40.44 million (median = 0.57 million), whereas the mean of the total IPTs in 2009-15 was US$70.04 million (median = 0.12 million). Although the mean was higher in 2009-15, the data shows that the level of total IPTs was lower in 2009-15 than in 2002-04 (p=0.003). This is consistent with the pattern of total RPTs reported in Figure 1 above. For continuing IPTs, if only those observations with IPTs are counted, the mean is US$41.16 million (median = 0) in 2002-04 and US$117.66 million (median = 0) in 2009-15. However, some companies had an extraordinarily large number of continuing IPTs in certain years (e.g., the largest observation was US$6,371.6 million), even though a significant number of firms had no continuing IPTs at all. This result, on the one hand, shows that continuing IPTs could pose problems for certain firms. On the other hand, no continuing IPTs occurred in several firms. Due to the wide variety of IPTs and CTs and the absolute values that were involved, it might not have been easy for the stock exchange to insist on firms following a consistent one size fits all rule relating to the disclosure of these transactions without imposing an excessive regulatory burden on the companies.

In sum, a significant portion of CTs and IPTs pertained to continuing transactions. The problem with this is that the shareholders had no ability to track and monitor once a mandate was passed except to receive aggregate information in the annual reports. By definition, this means that the transaction had already been completed. Continued monitoring conducted by the board of directors (specifically the audit committee) and auditors. There was also a lack of transparency because the companies did not report the details of continuing CTs or IPTs. This potentially created a backdoor for the management or controlling shareholders to exploit. In 2017, the SGX proposed that transparency in IPTs be improved by requiring firms to disclose the nature of their relationship with interested persons.[113] However, it can be debated whether such a proposal went far enough because the parties were still not required to disclose the exact

[113] Singapore Exchange, *supra* note 63, at 16.

relationship in more detail other than to provide a broad categorization (e.g., an associate of the issuer's controlling shareholder[114]).

F. Summary

The data presented above show that there were a significant number of RPTs (or IPTs or CTs) in Singapore and Hong Kong for the two periods of the study. In terms of the number of RPTs, in Hong Kong the volume was higher in 2009-15 than in 2004-04, after a flurry of large Chinese listings over the previous decade. We found a variety of RPT combinations in terms of the nature of the transactions, but there appeared to be no common pattern. Regarding the nature of the related parties, there was a lack of sufficient information for 2002-04. However, the 2009-15 data showed that a super-majority of RPTs were transacted with holding companies (or their subsidiaries or associates) or to a lesser extent key management (and associated persons) in both markets. For CTs and IPTs, we found that a significant proportion of those transactions were continuing transactions authorized by shareholder mandates. On this basis, Part IV reflects on adopting transnational corporate governance codes and regulatory strategies for RPTs in Hong Kong and Singapore.

IV. Reflections on the Implementation of Transnational Corporate Governance on Related Party Transactions

A. Board Independence and Tunneling

In theory, enhancing board independence should detect and deter wrongdoing carried out through RPTs. Considering that both Hong Kong and Singapore have progressively enhanced their corporate governance standards over the past two decades,[115] it is reasonable to expect that

[114] Singapore Exchange, *supra* note 63, at 16.
[115] For a brief history of amendments to the corporate governance codes in both markets, see Wai Yee Wan et al., *Managing the Risk of Corporate Fraud: The Evidence from Hong Kong and Singapore*, 48 HONG KONG L.J. 125, 140-146 (2018); Christopher Chen et al., *Board Independence as a Panacea to Tunneling? An Empirical Study of Related Party Transactions in Hong Kong and Singapore*, 15 JOURNAL OF EMPIRICAL LEGAL STUDIES 987, 990-992 (2018).

the corporate governance records from the 2009-15 sample would be better than the 2002-04 sample. A comparison is given in Table 1 below.

Table 1 Summary Statistics of Major Corporate Governance Benchmarks

Panel 1A Hong Kong

Mean (median) of	**2002-04**	**2009-15**
Total number of observations	471	1,778
Board size	8.33 (8)	8.97 (9)
Number of independent directors	2.68 (3)	3.53 (3)
Proportion of independent directors on the board	33.98% (33.33%)	41.00% (37.5%)
Size of audit committee	2.70 (3)	3.37 (3)
Percentage of observations with chairman-CEO duality	36.39%	26.46%
Shareholding interest of largest beneficial owner (%)	46.23% (45.89%)	45.98% (46.87%)

Panel 1B Singapore

Mean (median) of	**2002-04**	**2009-15**
Total number of observations	153	721
Board size	7.63 (7)	7.00 (7)
Number of independent directors	3.62 (3)	3.38 (3)
Proportion of independent directors on the board	47.09% (42.86%)	48.86% (50%)
Size of audit committee	3.24 (3)	3.25 (3)
Percentage of observations with chairman-CEO duality	37.88%	33.38%
Shareholding interest of largest beneficial owner (%)	41.19% (39.81%)	40.72% (39.62%)

There are several observations we can make regarding compliance with the directorial independence requirements in the corporate governance codes for both markets. First, there was high compliance. In 2009-15, all firms in our Singapore sample generally complied with the minimum 1/3 board independence threshold over the period. Even in 2002-04, only about 2% of the observations in Singapore failed to meet the minimum 1/3 threshold, notwithstanding that the Code of Corporate Governance 2001 only became effective in 2003. In Hong Kong, over 80% of the sampled firms were already in compliance with the minimum threshold by 2009. Thus, very few firms changed board composition in response to the minimum 1/3 threshold prescribed by the revision to the Code of Corporate Governance Practices in 2012. In 2002-04, all firms in the Hong Kong sample had a minimum of two independent directors on their boards, complying with the minimum requirement applicable at the time.[116] Therefore, it appears that the companies complied with the board independence requirements without undue difficulty. This offers *prima facie* evidence that the implementation of transnational corporate governance standards worked well without placing an undue burden on the market participants.

Second, most companies only complied with the minimum requirement related to directorial independence. In Hong Kong, about 24% of the observations in 2009-15 and 14% in 2002-04 had a majority independent board. Most firms managed to pitch the board independence level just enough to meet the minimum requirement. In Singapore, the proportion of observations with a majority independent board was higher, with about 43% in 2002-04 and 52% in 2009-15. Therefore, Singaporean firms appear to have been more willing to bring independent directors onto their boards, although about half the observations continued to show a pattern similar to Hong Kong. In sum, although most companies did not appear to have a problem complying with the board independence standard, the evidence suggests that most were not keen to comply beyond the minimum requirement.

Third, the chairman-CEO (chief executive officer) duality remained a problem. Despite the recommendation in both markets' corporate governance codes, that the roles of the chairman and CEO be separated, Table 1 shows that over one-third of the observations in Singapore had a chairman and CEO who were the same person. In Hong Kong, the situation improved after the global financial crisis. These findings are consistent with other surveys from Hong Kong and Singapore.[117] Therefore, the boards of most companies may still incur the risk of having insufficient checks on the executive chairman who, more often than not, would have been

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[116] The Hong Kong Stock Exchanged prescribed a minimum of two independent directors as early as 1993. The minimum number was later increased to three in 2004.

[117] A report in Hong Kong found that only 67.4% of the Mainboard listed companies had separate roles for the Chairman and CEO in 2012. See Lee Kha Loon and Kurt Schacht, *Board Governance- How Independent are Boards in Hong Kong Main Board Companies* (2012), at 1, https://www.cfainstitute.org/en/advocacy/policy-positions/board-governance-how-independent-are-boards-in-hong-kong-main-board-companies (last visited October 25, 2018). In Singapore, a survey showed that only 71.6% of listed firms separated the roles of the two offices. See Singapore Institute of Directors, *The Singapore Directorship Report 2016*, at 6, https://www.sid.org.sg/Web/Resources/Singapore_Directorship_Report_2016.aspx (last visited October 25, 2018).

appointed by the controlling shareholders. This could potentially affect the ability of the board to make objective decisions on RPTs. In turn, this issue could affect the overall effectiveness of the board independence regime for reducing tunneling.

Fourth, Table 1 shows no obvious change to the level of shareholding interests held by the largest beneficial owner between the two periods. In Hong Kong, the largest beneficial interests were on average over 45% in both periods, and in Singapore they were all over 40%. On the one hand, the data supports the general observation that listed firms in both markets had concentrated ownership. Although concentrated ownership can be present in well run firms, it does indicate that the risk of tunneling could still be very substantial. The question is whether under corporate governance reforms, if controlling shareholders find it more difficult to tunnel (and obtain benefits exceeding their economic interest), they will begin to reduce their shareholdings over time. As seen in Table 1, it appears that based on the OECD principles, the revisions to corporate governance codes in both markets before and after the financial crisis did not in general have an impact on the degree of concentrated ownership. Thus, although adopting the Anglo-American model of corporate governance standards might have changed the composition of boards of directors or their sub-committees, the evidence suggests that there was no fundamental change to the underlying control and ownership structure. The risk of tunneling could have remained significant because of the continuing high degree of concentrated ownership. This is worth policymakers pondering for future reforms.

Overall, the key question is whether better corporate governance can reduce tunneling. If so, this would justify the universal adoption of corporate governance standards illustrated by the OECD principles. It is beyond the scope of this article to present a full data analysis identifying whether better corporate governance (in terms of board independence) would have a negative effect on the amount of tunneling. Identifying causation is a complex question that requires comprehensive research and modelling to determine the potential causal effects of corporate governance reforms on tunneling. Another study by the authors based on the 2009-15 data showed that the 2012 reform in Hong Kong, in which a minimum one-third board independence threshold was imposed, did not appear to have a causal effect on the level of RPTs. This was based on a comparison between firms that changed board composition due to the rule change and firms that were already in compliance with the standard.[118] However, the lack of findings might have resulted from the SEHK being consulted on the rule change after 2010, so that the 2012 rule change was neither very strong nor a clean exogenous shock. In Singapore, the event took place in 2003, when the Code of Corporate Governance 2001 became effective. However, even in our sample of Singapore listed firms from 2002-04, we found only eight firms (out of a sample of 51) that changed board composition between 2002 and 2004, and three firms that had not complied with the requirement by the end of 2004. Other firms were already in compliance with the minimum requirement throughout the study period.

It is uncertain how far an enhancement of board independence would help to reduce tunneling. This requires further research to examine the practice of board independence and those who are hired as independent directors to better assess the effectiveness of the board independence regime. We observed an improvement to some corporate governance records in Hong Kong between the two periods of the study, whereas Singapore maintained the same standard in both periods. However, this article declines to draw an inference that RPTs were reduced due to corporate governance reforms. This is subject to further empirical studies.

B. Disclosure and Information for Gatekeepers

A deeper question is how to ensure that independent directors or other gatekeepers properly do their job by effectively reviewing the RPTs that amount to tunneling. The nature of tunneling means that those who want to tunnel often try to conceal their true intentions to prevent wrongdoing from being discovered. To help directors, shareholders or other gatekeepers make sound decisions, there must be sufficient information for them to form proper judgments. Thus, improving disclosure and information is an important aspect of OECD principles, especially information on the control structure and related party transactions.[119] There are two levels of information flow: access to information by independent directors and auditors, and the disclosure of information to the public.

First, it is unclear (or at least it might vary greatly between companies) whether independent directors have good access to information. There is a possibility for moral hazard if

[118] Chen et al., *supra* note 115, at 1011-1013.
[119] OECD principles, *supra* note 2, at 5-6 and 41 *et seq*.

corporate insiders exploit the lack of information flow inside a firm to disguise tunneling activities as beneficial RPTs. This situation may also exist when independent directors or auditors either do not do their job properly or simply do not have sufficient information before them when making decisions. The underlying and omnipresent challenge of distinguishing good RPTs from bad ones is also a factor. Therefore, there may be a grey zone, and corporate insiders may take advantage of the gatekeepers' lack of information or capacity to approve transactions, even if it is unfair to the firm.

Enhancing or strengthening the independent directors' access to information should be an important complementary tool to any board independence regime. In both Hong Kong and Singapore, corporate governance codes, based on OECD principle IV(A), specify that directors should make informed decisions. To do so, the codes prescribe that they be given the appropriate information in a timely manner[120] and have access to board papers and related materials.[121] It is the obligation of management to supply the board and committees with such adequate information.[122] It is the responsibility of the chairman to ensure that directors receive complete and reliable information.[123] The codes in both the Singapore and Hong Kong also stipulate that directors should have independent access to the company secretary to acquire information.[124] Therefore, in theory, as long as companies comply with the corporate governance codes, directors should be provided with sufficient information or have access to information if they make further enquiries. Having said that, how information flows inside a firm is not crystal clear to outsiders. Further, minority shareholders may have less access to internal information and thus be less likely to affect the management decisions.[125] Empirical studies are needed to fully understand the internal relationship between the board and other power structures within firms. This area may be one that policymakers should focus on in future reforms to improve corporate governance.

[120] Hong Kong Exchange, Code of Corporate Governance Practices, Principle A.6 (HK Code); Singapore Code of Corporate Governance, Principle 6 (SG Code).
[121] HK Code A.6.3; SG Code Guidelines 6.2.
[122] HK Code A.6.2; SG Code Guidelines 6.1.
[123] HK Code A.2.3; SG Code Guidelines 3.2.
[124] SG Code Guidelines 6.3; HK Code A.1.4. We take note that the Singapore Code uses the phrase "separate and independent access," whereas the Hong Kong Code only specifies that "[a]ll directors should have access to …"
[125] Pizzo, *supra* note 32, at 322.

Second, it is beyond the scope of this article to discuss the merits and problems of related party disclosure rules under accounting standards or listing rules, or to evaluate the quality of such disclosures. The coding exercise has shown that there is a wide range of procedures companies use to report RPTs in financial statements. For example, some companies duly report the names of related parties and relevant relationships; others simply label them as general categories (e.g., holding companies or associates), without providing further detail. Details may be sorely lacking with respect to transactions or even the identities of related parties.

It is no better for disclosures of IPTs in Singapore or CTs in Hong Kong. In Singapore, the disclosure of IPTs is rather imprecise, often revealing only the aggregate amount (or the amount for different interested persons). In most cases there are no details on the nature of the transactions or the related parties.[126] Conversely, in Hong Kong, there is often more information on CTs, including the time, place, nature, parties involved and amount of the transactions. Although it is good to have more information, it is provided in paragraphs that may not be easy for shareholders to go through if a company has pages of connected transactions.[127] In addition, the CT reports are included in the Directors' Report, which is in the middle of long annual reports. It is easy for shareholders to miss them unless they know where to look for the information. Therefore, there may be a need to standardize the ways and forms in which RPTs are disclosed in financial statements or annual reports. In addition, there may be a need to call for more complete disclosures of RPTs to reduce the chance of arbitrage between legal and accounting rules.[128] Better standardization would help shareholders and market participants gain more insight into RPTs and form market power.

With so many continuing IPTs or CTs in Singapore and Hong Kong, there has been a lack of detail over how they are transacted after a shareholders' mandate is approved by a general meeting. In Singapore, shareholders, at best, acquire some knowledge on the aggregate amount in the annual report without many details. In Hong Kong, there is also no further breakdown except for a paragraph repeating some basic information from the circulars and

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[126] See, e.g., Singapore Telecommunications Ltd. Annual Report 2016-17, at p. 228.
[127] See, e.g., CK Hutchison Holdings Ltd. Annual Report 2016, at p. 125-27.
[128] Atanasov et al., *supra* note 24, at 40-41.

providing at least the annual transaction amount or stating that the aggregate transaction amount is below the ceiling authorized by the shareholders.

Third, the presence of many foreign listings (with major operations and assets outside the market) may pose further challenges to the information problem. This issue is especially prominent in Hong Kong, where the stock market is dominated by firms registered outside of the special administrative region. In the 2002-04 sample, 78.34% of the Hong Kong observations were registered in foreign jurisdictions, as opposed to a mere 1.96% (i.e., just one firm) in the Singapore sample. The pattern continued in the 2009-15 dataset, in which 81.88% of the Hong Kong observations were foreign companies, compared to 14.56% in Singapore.

Where did those foreign-incorporated firms come from? In the 2002-04 time frame, the Hong Kong sample showed that most of the foreign firms (about 72% of all sampled firms) were registered in either Bermuda or the Cayman Islands, with 10 firms incorporated in mainland China (6.37% of all observations in Hong Kong). In contrast, all but three firms in the Singapore sample were local. The pattern continued in the 2009-15 dataset. Most foreign companies listed in Hong Kong were registered in either mainland China (11.37%) or the Caribbean Islands (about 71%), whereas the Singapore market was still predominantly occupied by domestically registered firms (about 85%). Thus, there was a sharp contrast between the companies listed in the two markets in terms of their national origins.

How do foreign companies trade RPTs? In Hong Kong, there was a contradictory pattern between the two periods. In 2002-04, the mean of the total number of RPTs was US$37.56 million for local companies, compared with US$13.25 million for foreign listings. In contrast, for 2009-15, the mean of the total RPTs for foreign companies was US$455.43 million (median = US$2.16 million), as opposed to US$149.20 million (median = US$4.89 million) for local companies. However, when a two-sample t-test was used to analyze logged RPT data, we found that local companies traded more RPTs than foreign companies both in 2002-04 ($p<0.001$) and 2009-15 ($p=0.003$). Thus, it may be wrong to target foreign companies.

In Singapore, considering the few observations of foreign listings at the time, it was meaningless to examine the difference between 2002-04, and 2009-15. We found that local firms traded more RPTs than foreign listings in the Singapore market ($p=0.01$) during both periods. There have indeed been Chinese listings in Singapore, because the so-called S-chips have had their fair share of governance problems in the Singapore market.[129] However, if we measure the size of companies by market capitalization in SGX, such as the component stocks in the lead Straits Times Index,[130] most are large local companies. The local firms are likely to be larger than the foreign companies we collected in our sample. Thus, the higher number of RPTs among local companies in 2009-15 can be explained.

The data were inconclusive on whether foreign listings were more likely to tunnel than local ones (or *vice versa*). Nonetheless, this result does not change the presence of so many foreign listings in the Hong Kong market. Further, it remains unclear how independent directors, auditors and shareholders can acquire sufficient information to review and verify RPTs, especially when the transactions take place on foreign soil with foreign related parties. With the rise in the cross-border flow of companies conducting business and floating in foreign capital markets, having international standards or guidance on corporate governance is justified to some extent. However, as mentioned earlier, how to adapt the standards to meet the peculiar problems of foreign listings may continue to be a problem in the future once we look beyond the common standards.

C. Effectiveness of Independent Review and Approval

This article casts some doubt on the effectiveness of independent review and/or approval. The previous two sections explored issues regarding corporate governance, independent directors and disclosure. This section focuses on the opinions of independent financial advisers (IFAs) and the recommendations of independent directors for CTs or IPTs in Hong Kong and Singapore. These opinions may help to improve the quality of the information received by boards of directors or shareholders to help them make decisions.

As mentioned in Part II above, both Hong Kong and Singapore require shareholder approval for certain CTs or IPTs (including mandates for continuing transactions). To help shareholders make fair assessments of proposed transactions, in the circular issued to

[129] One report showed that 10% of the S-Chips were suspended from trading due to governance or accounting issues by 2011. J Kwok, *"Are S-chips still a possible play?"* The Straits Times, December 25, 2011, http://eresources.nlb.gov.sg/newspapers/digitised/issue/straitstimes20111225-1.

[130] As of December 2017, the Straits Times Index comprised 30 stocks, with 21 locally incorporated companies or trusts. See Singapore Exchange, http://www.sgx.com/wps/portal/sgxweb/home/marketinfo/indices/sti_constituents (last visited October 25, 2018).

shareholders before their general meetings, companies must produce valuation opinions provided by an IFA in addition to the opinions of independent board members (comprised only of independent directors).

In this research, a total of 813 circulars were collected for our sampled companies during the study periods, including 130 in Singapore (7 in 2002-04 and 123 in 2009-15) and 683 in Hong Kong (107 in 2002-04 and 576 in 2009-15). Several IFAs were mentioned in these circulars, although some (e.g., First Shanghai Capital Ltd. and Guangdong Securities were each hired more than 20 times) appeared more often than others. Without further information, it was difficult to judge the relationship between an IFA and a firm.

Regardless of the period, in Hong Kong all observations showed that the IFA treated the company's valuation as fair and reasonable. In Singapore, for all observations in which we could identify information, the IFAs always considered IPTs based on normal commercial terms. In sum, we did not identify a single situation in which the IFA offered a negative opinion.

For independent board members' recommendations to shareholders, in all Hong Kong observations the independent directors recommend that shareholders vote in favor of a CT or a mandate. In Singapore, in all but one case independent directors recommend that shareholders vote in favor of an IPT or a mandate. In the sole exception, the independent directors only cautioned that the "[shareholders] should read and consider carefully this Circular in its entirety before giving your approval pertaining to the Pre-Mandate IPTs and IPT Mandate."[131] It is not that the directors never dissented.[132] However, it is quite unlikely that dissenting opinion would have been published. If so, it means that the independent directors have tended to agree with the management on the merits of IPTs or CTs.

In practice, IFAs almost always consider valuation to be fair or the transaction to be on normal commercial terms, and independent directors almost always recommend that shareholders vote in favor of a transaction or mandate. This raises the question of whether independent review and shareholder approval are effective.

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[131] See, e.g., Circulars to Shareholders by VGO Corporation Ltd. dated July 10, 2014, at p. 16; Siow Li Sen, *Rift Between Stanley Tan and Directors Far from Over*, Business Times Singapore (June 28, 2007); Michelle Quah, *Automated Touchstone Independent Directors Ousted*, Business Times Singapore (April 21, 2007).
[132] Chung Tai Printing Holdings Ltd Shareholders' Circular dated June 16, 2009, at p. 8.

On the bright side, the lack of variety in the dissenting opinions of public shareholder documents or announcements could indicate that independent review and approval work. Companies are probably less likely to proceed with a vote at a general meeting if either the IFA or independent directors offer negative opinions. We only saw cases in which the IFAs and independent directors concurred with the interests of the companies. If this is the case, such a regime was functioning as expected.

The counter-argument is that firms may choose friendly IFAs or board members to ensure that transactions go through. Although we do not have comprehensive data on this, stories have been occasionally reported in which independent directors have preferred to resign rather than dissent when they found something suspicious.[133] There are incentives to entice IFAs to approve transactions for the sake of maintaining their business connections with the controlling shareholders or their affiliates.[134] If this is the case, the lack of public disagreement in IFA opinions or dissenting opinions from independent directors does not suggest that all is well.

This article has no means of determining which view is true. Nonetheless, in the future regulators may want to consider this when designing laws to reform RPTs. Policymakers should not blindly accept that IFAs or independent directors fulfil their expected functions, because in practice they almost always approve board actions and there is no clear evidence showing that they filter non-beneficial transactions effectively.

D. More *Ex Post* Regulations?

To enhance the effectiveness of *ex ante* and process-driven approaches to RPTs, one possible solution is to increase shareholders access to redress against the controlling shareholders they suspect to be the primary source of tunneling. Alternatively, the duties of corporate management could be enhanced to deter them from tunneling.

Our data may lend partial support to this idea, because a significant number of RPTs between 2009 and 2015 were with holding companies or their associates or subsidiaries. There is

[133] E.g., it was reported that Mr. Alfred Au Yan stepped down from the board after objecting to a connected transaction with the company's controlling shareholder. See *Chung Tai Printing (0055): INED Alfred Au Yan to step down at AGM* (July 30, 2009), https://webb-site.com/dbpub/subject.asp?t=31 (last visited October 25, 2018). See also Circulars to Shareholders by Chung Tai Printing Holdings Ltd. dated June 16, 2009, at p. 7-8.
[134] See Wan, *supra* note 98.

an inherent danger of "expropriation of minority shareholders by the shareholders of high-up group firms through tunneling resources out of their firms."[135] Given that many non-SOE conglomerates in Hong Kong and Singapore are owned by wealthy families, there is also a risk that family-run groups may decay over time due to the dilution of their ownership and control across descendants (especially after the founder has passed away).[136] These factors could support the view that controlling shareholders should be held accountable for tunneling. However, it is beyond the scope of this article to examine whether Hong Kong or Singapore should impose fiduciary duties on controlling shareholders, and if so, how such duties could be imposed.[137]

Although a comprehensive discussion of independent directors' effectiveness is beyond the scope of this article, it is worth pointing out that there have been few cases of independent directors being charged with negligence for failing to uncover wrongdoing.[138] Arguably, the rules of liability are not sufficiently punitive to encourage independent directors to do their job. Imposing a duty or liability is clearly only one step toward effective deterrence.

Our data suggest that RPTs with holding companies (and related persons) should be the focus in the future, because they constitute a large portion of RPTs. Under this view, imposing more rules of liability may be an option if policymakers want to create a greater deterrence effect. However, doing so would require an overall assessment of all available enforcement authorities to determine the effectiveness of liability rules in preventing tunneling.[139] This consideration would in turn affect whether the law should impose more duties on directors or controlling shareholders. This would require a more comprehensive study that is beyond the scope of this article.[140] Thus, this article refrains from making a conclusive statement on the imposition of additional liability.

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[135] Marianne Bertrand et al., *Mixing family with Business: A Study of Thai Business Groups and the Families Behind Them*, 88 J. OF FIN. ECON. 466, 479 (2008), citing Marianne Bertrand et al., *Ferreting Out Tunneling: An Application to Indian Business Groups*, 117 THE QUARTERLY JOURNAL OF ECONOMICS 121 (2002) and Stijin Claessens et al., *The Separation of Ownership and Control in East Asian Corporations*, J. OF FIN. ECON. 81 (2000).
[136] See generally Bertrand et al., *id*. (2008).
[137] See generally Lim, *supra* note 79.
[138] Wan et al., *supra* note 80, at 19, 21 and 29.
[139] See generally Gordon Y. M. Chan, *Understanding the Enforcement Strategy for Regulating the Listing Market of Hong Kong*, 14 J. OF CORP. L. STUDIES 79 (2014).
[140] For some analyses of public and private enforcement actions in Hong Kong and Singapore, see Wan et al., *supra* note 80.

V. Conclusion

This article examined the effect of applying the transnational Anglo-American model of corporate governance standards in Hong Kong and Singapore from the national to the firm level. Following the U.K.'s Cadbury Report in 1992 and the OECD's Principles of Corporate Governance, reinforced by some global rankings, this article suggests that the core ideas underpinning corporate governance standards, such as board independence and transparency, are akin to transnational law. However, although improving corporate governance is generally a sound idea, it is unclear whether corporate governance codes that give effect to transnational corporate governance are complied with in practice. Further, there is the question of whether adopting these regimes can effectively achieve policy goals.

When we examined the impact of the markets' adoption of transnational corporate governance on the RPT data, we found certain concerns that regulators should reconsider. First, the incidence of RPTs (particularly with holding companies and associated companies), and the significant increase in RPTs in Hong Kong, highlights the importance of a sound corporate governance system. This is extremely relevant in the context of the highly concentrated ownership in Hong Kong and Singapore. There were incidents in which annual mandates allowed RPTs to take place without the close scrutiny that would ordinarily be required for individual RPTs. The data also revealed the inconclusiveness of the information disclosed. As such, it is important to revisit the elements of corporate governance as they relate to RPTs and to consider reform. Any such reform must consider the high concentration of shareholdings and the challenge of regulating foreign listings. Further empirical studies, which are likely to take the form of interviews, should investigate how directors and independent gatekeepers, (such as auditors and IFAs), scrutinize RPTs at board or audit committee meetings and the kinds of hard questions they ask.

In sum, over-reliance on independent review and approval may be misplaced if dissenting or countering opinions are lacking or not published for shareholders. Whether independent directors or audit committees would have the information needed to monitor RPTs and continuing IPTs and CTs remains a concern. There is a likelihood that independent directors or financial advisers may be used to rubber stamp and validate otherwise dubious transactions.

Although this article does not fundamentally challenge the idea of transnational corporate governance or the OECD principles, we suggest that national regulators should not blindly copy and paste international standards (even though widely adopted globally) without considering the dual local challenges of high ownership concentration and foreign listings.