Public Enforcement and Corporate Governance in Asia

GUIDANCE AND GOOD PRACTICES

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Foreword

The first of its kind at a regional level*,* this Guide to *Public Enforcement and Corporate Governance in Asia* was endorsed by 14 Asian jurisdictions at the 15th meeting of the Asian-OECD-Asian Roundtable on Corporate Governance on 12-13 February 2014 in Mumbai, India. Established in 1999, the OECD-Asian Roundtable on Corporate Governance (Asian Roundtable) has served as a valuable regional platform for exchanging experiences and advancing the reform agenda on corporate governance while promoting awareness and use of the OECD Principles of Corporate Governance in Asia. It brings together policy makers, practitioners and experts on corporate governance from the Asian region, OECD countries and relevant international organisations. The Roundtables are co-organised by the OECD Directorate for Financial and Enterprise Affairs – Corporate Affairs Division and a host Asian country, in partnership with the Government of Japan.

The *Reform Priorities in Asia: Taking Corporate Governance to a Higher Level* issued in 2011 ('2011 Report'), a key product of the Asian Roundtable, recognised the need for an adequate regulatory framework and effective enforcement in Asian jurisdictions. The 2011 Report identified improving enforcement - in particular promoting better public supervision and enforcement - as one of the six priority areas in line with Chapter 1 of the *OECD Principles of Corporate Governance* concerning the development of an effective corporate governance framework.

The 2011 Report led to the establishment of an Asian Roundtable Task Force on Enforcement ('Task Force'), which commissioned a review of the legal framework and enforcement by capital market regulators in participating jurisdictions with the intention of issuing a good practices report on public enforcement. Based on the review, this Guide provides guidance and good practices to support policy makers and regulators in Asia in the area of public enforcement. The Guide will enhance the effectiveness of regulators and contribute to a culture of compliance by companies, in the interest of protecting investors and creating confidence in markets. It should serve as a basis for reform and self-assessment within national systems as well as a reference point for peer reviews at regional level and provide elements for consideration for the revision of the OECD Principles in 2014. Beyond the Asian Roundtable participating countries, the Guide could be an important benchmark for other APEC and ASEAN economies.

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Background and scope of the report

The Reform Priorities in Asia: Taking Corporate Governance to a Higher Level issued in 2011 ('2011 Report') recognized the need for an adequate regulatory framework and effective enforcement in Asian jurisdictions. The 2011 Report set out the priorities and recommendations that were agreed upon by participating jurisdictions in the OECD-Asian Roundtable on Corporate Governance and identified improving enforcement - in particular promoting better public supervision and enforcement - as one of the six priority areas in line with Chapter 1 of the *OECD Principles of Corporate Governance* concerning the development of an effective corporate governance framework.

The 2011 Report led to the establishment of a Task Force on Enforcement ('Task Force'), which agreed to commission a study of the legal framework and enforcement by capital market regulators in participating jurisdictions with the intention of issuing a good practices report on enforcement. Although public and private enforcement play complementary and interdependent roles, the Task Force agreed to focus on public supervision and enforcement; given the constituency of Asian Roundtable participants, there is more opportunity to influence reforms.

The study focused on the following areas:

- Comprehensive legal framework and adequacy of laws, with a focus on related-party transactions, disclosure of ownership and control, and fiduciary duties of directors,
- Structure of enforcement authorities,
- Authority to monitor, supervise, investigate, enforce and impose sanctions,
- Disclosure of enforcement actions and practices,
- Role of the courts and the judicial system, and
- Cross-border enforcement.

The study was conducted in 2013 through a questionnaire that was sent to respondents in Bangladesh; China; Chinese Taipei; Hong Kong, China; India; Indonesia; the Republic of Korea; Malaysia; Mongolia; Pakistan; the Philippines; Singapore; Thailand and Vietnam ('participating jurisdictions'). A report analyzing the responses on enforcement issues and an Issues Paper on Enforcement were presented to members of the Task Force in Kuala Lumpur on 4 June 2013. Taskforce members held a discussion to obtain more information about the challenges that regulators face. This was followed by interviews with participants in Hong Kong, China; India; Indonesia; Malaysia; Singapore; and Thailand to obtain more in-depth information about legal frameworks and enforcement by capital market regulators in their jurisdictions. The aim of the questionnaire, discussions and interviews was to identify key challenges and obstacles to effective enforcement, as well as the practices and policies in participating jurisdictions. The good practices and recommendations in this report have taken into account responses from the questionnaire, discussions and interviews. This report sets out guidance and good practices to aid policy makers and regulators in Asia in the area of public enforcement. It has been arranged according to the six areas identified above. Each area covers narratives of the landscape, challenges, good practices and recommendations.

Although the focus in this paper is on public enforcement, this is not the only approach that regulators use to develop an effective corporate governance framework. Reflecting evolving trends, regulators also use persuasive approaches such as engaging with listed companies by providing training and awareness activities. The report does not cover enforcement through civil action. Asian Roundtable and Task Force participants did express a desire to see future work address private enforcement as well as cross-border enforcement issues in more depth.

Legal framework and adequacy of laws

Recommendations

- There should be comprehensive requirements governing related-party transactions to prevent abuse and to penalize wrongdoers. These requirements should set clear thresholds for disclosure and obtaining approvals as well as include procedures for ensuring the reasonableness of transaction costs.
- Beneficial owners who have crossed a threshold of ownership should be required to disclose ultimate beneficial ownership arrangements, including acting in concert arrangements.
- Directors' fiduciary duties should be explicitly highlighted, and the board of directors should establish clear roles and responsibilities when complying with their fiduciary duties.

Good corporate governance requires an adequate regulatory framework and effective enforcement. Although Asian jurisdictions in recent years have substantially revamped their regulations and corporate governance codes and good practices, these differ among jurisdictions, particularly in the areas of related-party transactions, disclosure of beneficial ownership and fiduciary duties of directors.

The corporate governance legal framework in most jurisdictions is divided into three pillars comprising (a) company law, (b) securities regulations and (c) rules governing the issuance of and trading in equity and debts securities of listed companies, and corporate governance codes that adopt a 'comply or explain' approach to offer some flexibility. Regulators in participating jurisdictions may utilize their rule-making power to mandate certain corporate governance principles and guidelines to ensure compliance.

The three pillars of corporate governance are listed in Table 1.

Table 1. **The three pillars of the corporate governance framework**

Jurisdiction	First Pillar	Second Pillar	Third Pillar
Bangladesh	The Companies Act 1994	The Securities and Exchange Ordinance 1969; The Securities and Exchange Rules 1987	Corporate Governance Guidelines of 2012
China	Company Law (2005)	Securities Law (2005), Law on State-Owned Assets in Enterprises (2008)	Code of Corporate Governance for Listed Companies
Chinese Taipei	The Company Act	The Securities and Exchange Act; the rules and regulations promulgated by the Financial Supervisory Commission; the listing rules of the Taiwan Stock Exchange (TWSE) and the GreTai Securities Market (GTSM)	Corporate Governance Best-Practice Principles for TSE/GTSM Listed Companies (2010)
Hong Kong, China	The Companies Ordinance (CO)	The Securities and Futures Ordinance (SFO); The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited; Financial Reporting Council Ordinance	Hong Kong Code on Corporate Governance (2012)
India	The Companies Act 1956 and the Companies Act 2013	Regulations issued by the Securities and Exchange Board of India (SEBI)	Guiding Principles of Corporate Governance Voluntary Guidelines on Corporate Governance 2009
Indonesia	New Company Law (2007)	Undang-Undang Pasar Modal (Capital Market Law); Bapepam-LK Rules	Guidelines of Good Corporate Governance 2006
Malaysia	The Companies Act 1965 and amendments in 2007	Banking and Financial Institution Act 1989; Development Financial Institution Act 2002; The Financial Reporting Act of 1997; Capital Markets and Services Act 2007; Bursa Malaysia Listing Requirements; The Securities Commission Act 1993	Malaysian Code on Corporate Governance 2012
Mongolia	The Company Act (2011)	The Securities Act; Listing Rules; Banking Act	The Corporate Governance Code of Mongolia (2007)
Pakistan	Companies Ordinance 1984	Banking Companies Ordinance 1962; Prudential Regulations for Corporate/Commercial Banking	The Code for Corporate Governance 2002

Table 1. **The three pillars of the corporate governance framework** (cont.)

Jurisdiction	**First Pillar**	**Second Pillar**	**Third Pillar**
Philippines	The Corporation Code of the Philippines	Revised Securities Act; Securities and Exchange Commission Memoranda	The Revised Code of Corporate Governance (2009)
Singapore	Companies Act (CA)	The Securities and Futures Act (SFA); SGX Listing Rules	The Code of Corporate Governance (2012)
South Korea	Commercial ActFair Trade Act	Financial Investment Services and Capital Market Act	Code of Best Practices for Corporate Governance 2003
Thailand	The Public LimitedCompany Act 1992	The Securities and Exchange Act; The Stock Exchange of Thailand's Listing and Disclosure Rules; The Accounting Law 2000	The Principles of Good Corporate Governance for Listed Companies (2006)
Vietnam	Law on Enterprises (2001)	Securities Law (2006)	Ministry of Finance Circular 52/2012/TT-BTC on Corporate Governance

Source: Author's research

Related-party transactions

Asian business relationships are often informal and predominantly consist of family or state-run business groups. In such cases related-party transactions are perhaps inevitable. While most such transactions are not abusive and may play an important and legitimate role in business, under certain conditions, they may allow controlling shareholders to benefit at the expense of non-controlling shareholders. The perception is that related-party transactions in Asian capital markets pose a challenge to the integrity of these markets and must be monitored and curbed.[1]

Corporate governance frameworks have sufficient company and securities laws, as well as listing rules, to address related-party transactions. Directors are expected to declare the nature of their interests to the board and must declare any conflict of interest and provide details of the nature, character and extent of the conflict. Some jurisdictions clearly prohibit interested directors from participating in meetings when matters involving conflicts of interest are under discussion and also prohibit them from voting on contracts or proposed contracts. In most jurisdictions, company laws also specifically prohibit certain types of related-party transactions such as loans or guarantees to directors. Some jurisdictions may even require shareholders' approval for related-party transactions above certain thresholds.

The rules and regulations regarding related-party transactions are generally divided into three categories:

(a) Rules that require disclosure of related-party transactions

These require listed companies to make an immediate announcement of any related-party transaction of a value equal to or more than a certain percentage of the group's latest audited net tangible assets, or another relevant threshold. On an annual basis, a company is further required to disclose the aggregate value of related-party transactions entered into during the financial year under review in the annual report. The name of the interested person or related party under the corresponding aggregate value must also be disclosed.

(b) Rules that require the approval of shareholders (or board of directors)

Shareholders' approval is required when the transaction value is higher than a given percentage (usually 5%) of the company's latest audited net tangible assets or other relevant threshold. It is usually also required when the transaction is not in the company's ordinary course of business or not undertaken in market conditions. In general, company law provisions state that every director of a company must declare related-party transactions (the fact, nature, character and extent of the conflict) to the board of directors. Company laws also stipulate that transactions between a company and its directors are subject to the explicit approval by the board of directors. Moreover, company laws usually state that a director who is directly or indirectly interested in a contract entered into or proposed to be entered into by the company is not allowed to participate in any discussion on the matter at the board meeting. Such parties must also abstain from voting on the contract or proposed contract. If they do so, then action can be taken against the director concerned. In some jurisdictions, transactions obtained without shareholders' approval are deemed to be void. In Chinese Taipei, if the transaction amount reaches a threshold of 10% of the total assets, 20% of the paid-up capital or USD10 million, the company must obtain an appraisal report from a professional appraiser or a certified public accountant's opinion.

(c) Rules that prohibit certain related-party transactions

Company laws may contain provisions that prohibit specific related-party transactions, such as loans or credit by the company to a director of the company or of a related company. Companies are also prohibited from entering into any guarantee or providing any security in connection with a loan made to a director by any other person.

> **Good practices**
>
> Hong Kong, China; India; Malaysia; Singapore; and Thailand have comprehensive laws governing related-party transactions. It is sufficient for the company to make an announcement where the percentage ratio of the value of the transaction is small; for example, 0.25% compared to the value of the listed issuer. As the percentage ratio increases, the requirements become stricter and range from mandating a circular in the form of notice to shareholders, obtaining their approval, appointing an independent adviser to comment on whether the terms are fair and reasonable and on the impact of the transaction on minority shareholders, to appointing a main advisor. The audit committee has to give its opinion on the transaction. In Thailand, it is being proposed that if the audit committee's opinion differs from that of the independent advisor, each board member's opinion about the transaction has to be recorded to ensure accountability.
>
> In addition, the Malaysian Companies Act 1965, Thailand's Public Limited Company Act and the Korean Commercial Act prohibit companies from granting loans, giving credit or providing a guarantee or any form of security in connection to a loan made to a director.

Disclosure of ownership and control

The main control structures in Asian companies are simple majority ownership, commonly found in family or state-owned holding companies. These companies can own a significant portion of a listed company, or consist of complicated network ownership comprising a nexus of shareholder agreements or interlinked boards that grant control over a listed company to a family. Simple majority and complicated network ownership structures may result in subservient boards, as directors have been selected by controlling shareholders without robust debate.[2]

Definitions of ultimate beneficial ownership are part of the legal and regulatory framework (particularly securities laws and regulations) that governs the disclosure requirements for listed companies. The legal and regulatory framework ensures that timely and accurate disclosure is made of substantial beneficial ownership (and control structures) in listed companies. Certain jurisdictions have gone further and require companies to maintain a register of shareholders that is open to inspection by members and also a separate register of substantial shareholders. In addition, listed companies may require their members to disclose any voting shares that they hold as a beneficial owner or trustee.

Securities regulations in most participating jurisdictions govern the disclosure of interested directors, chief executive officers and substantial shareholders. It is the norm in these jurisdictions to require ultimate beneficial owners to disclose direct or indirect shareholdings of a class of securities in publicly listed companies, based on thresholds of a minimum of 5%. Shareholder agreements and acting-in-concert arrangements that result in parties holding 5% or more of accumulated voting rights in shares must be disclosed. In some participating jurisdictions (Chinese Taipei, Mongolia, Pakistan and Philippines), the threshold is 10%. Custodians and intermediaries holding shares as a nominee or an omnibus account holder are required to obtain (through special application forms), verify and retain records on beneficial ownership (including the identity of beneficial owners).

The Listing Requirements in Malaysia state that companies must make immediate announcements when they receive notice relating to substantial shareholding or any change of control or ownership. Listed companies are required to list in their annual report the names of significant shareholders and their direct and deemed interests, stating the number and percentage of shares in which they have an interest as shown in the register of significant shareholders; direct and deemed interests of each director including number and percentage of shareholdings; the number of holders of each class of equity securities and any convertible securities, and the voting rights attached to each class; distribution schedule of each class of equity securities and any convertible securities setting out the number of holders and their percentage stake in the company; names of the 30 securities account holders having the largest number of securities from each class of equity securities and convertible securities; and the number and[2] percentage held. Similarly, In India, Securities and Exchange Board of India (SEBI) regulations require public announcements relating to substantial changes in shareholding and changes of control or ownership.

Rules on disclosing beneficial ownership are sometimes difficult to enforce. In some cases, it is hard to detect non-disclosure. Opaque structures may be used that make it virtually impossible to detect beneficial owners, in particular where the interest is held by companies incorporated in off-shore tax-haven jurisdictions that do not require or facilitate disclosure.

Owing to statutory or practical limitations, supervisory and enforcement authorities may find it difficult to rely on the quality of disclosed information, especially where the companies or shareholders resist disclosure if they are not fully convinced of its benefits or conceal beneficial ownership by the use of nominee shareholders, foreign corporate vehicles or equity derivatives. In order to increase in the quality of information, enforcement norms should deal more effectively with non-compliance.

Good practices

The Securities and Exchange Board of India (SEBI) Regulations 2011 (Substantial Acquisition of Shares and Takeovers) require a person who is the beneficial owner of more than 5% of certain equity securities to disclose information relating to such ownership. The Regulations also make it mandatory for investors to disclose shareholder agreements and acting-in-concert arrangements if they, together with other shareholders, control 5% or more of the company's outstanding shares. It should be noted that the disclosure rules in most jurisdictions require substantial beneficial owners in the first, second or subsequent layers of shareholdings to disclose information. The disclosure requirement in India corresponds to the rules in China, Indonesia, Malaysia, Singapore and Thailand, where beneficial owners over the 5% threshold are required to disclose changes in the ultimate beneficial ownership arrangements (including acting-in-concert arrangements) to the company, the threshold in Chinese Taipei, Pakistan and the Philippines is 10%.

The Securities Industry (Central Depositories) Act 1991 in Malaysia provides that every securities account with the central depository should be opened in the name of the beneficial owner of the deposited securities or in the name of an authorized nominee. Where such accounts are opened in the name of the authorized nominee, the name of the beneficial owner and other relevant information relating to the beneficial owner must be disclosed by the authorized nominee, failing which securities account may be suspended.

Fiduciary duties of directors

The fiduciary duties of directors are open-ended standards of performance that can be separated into duty of care and loyalty, duty to disclose information, duty to abstain from self-dealing transactions and duty of good faith and fair dealing. In order to increase awareness and add certainty, boards should clearly stipulate the roles and responsibilities of directors in complying with their fiduciary duties.

Breaches of fiduciary duties on the part of directors may result in criminal action against them, especially if there is an element of fraud. In some cases action is taken by the Registrar of Companies or its equivalent, while in others it is taken by the statutory regulator (Securities and Exchange Commission or its equivalent).

Good practices

Pakistan's Code of Corporate Governance requires directors to confirm, at the time of their election, that they are aware of their duties under the law, company by-laws and listing rules. The Code also makes it mandatory for directors to attend accredited training programs.

The Corporate Governance Codes in Bangladesh and Malaysia explicitly state that the board should establish clear roles and responsibilities in complying with their fiduciary duties.

Enforcement

Enforcement is the most challenging aspect of the regulator's role because it often takes place in an environment where the damage is already done and the regulator's credibility is affected by perceptions that it was slow in detecting and preventing the breaches.

Capital markets operate within a framework of laws, but there must be adequate supervision to ensure compliance. Enforcement is an extension of supervision, with the purpose of penalizing non-compliance. These three elements – laws, supervision and enforcement - of a securities market are interdependent. Hence, capital markets with sound laws are ineffective if supervision and enforcement are inadequate. Laws must be sufficiently well-designed to permit supervision and enforcement to be conducted easily and effectively. Adequate supervision may prevent problems from erupting into breaches that require enforcement. As part of supervision, active surveillance by regulators through early monitoring, regular assessments and engagements with listed companies allow regulatory authorities to monitor companies for possible breaches, make informed decisions on governance aspects of companies and determine if there is need to introduce further regulatory measures. Supervision and enforcement are different aspects of the same spectrum: the purpose of supervision is early detection or prevention of breaches, while the aim of enforcement is to punish violations that have occurred, coupled with the aim deterring future offences by the offender and other parties.

This report focuses on public enforcement by analyzing the structure, authority and capacity of regulators, as well as the adequacy and disclosure of enforcement sanctions. It also assesses the role of the judiciary in enforcement and the practice of sharing information between domestic and foreign enforcement authorities.

In Asian jurisdictions, various institutions often share enforcement of corporate governance. Some of these institutions have the power to impose civil and criminal sanctions, while others have the power to only impose either type of sanction but not both. Stock exchanges as front-line regulators have, for the most part, been given power to impose civil sanctions ranging from caution letters, private or public reprimands, fines, suspension or de-listing among others, while the capital market statutory regulator, usually the Securities and Exchange Commission or its equivalent, may seek to impose criminal remedies through the judicial process.

The relationship between various enforcement authorities (the Securities and Exchange Commission or its equivalent, the Stock Exchange, Company Registrar, Central Bank and police) is an important element of effective enforcement of capital market laws. Overlapping jurisdiction between these authorities poses a challenge. Table 2 depicts the supervisory and enforcement authorities in participating jurisdictions.

Table 2. **Supervisory and enforcement authorities: Securities regulators and exchanges**

Country	**Enforcement authorities (discussed in the questionnaires)**
Bangladesh	Bangladesh Securities and Exchange Commission (BSEC) Other enforcement authorities for companies
China	China Securities Regulatory Committee (CSRC) State-owned Assets Supervision and Administrative Commission (SASAC) Stock Exchanges (Shanghai and Shenzhen) State-owned Assets Supervision and Administrative Commission (SASAC) Stock Exchanges (Shanghai and Shenzhen)
Chinese Taipei	Financial Supervisory Commission (FSC) Stock Exchange, Ministry of Economic Affairs (MEA)
Hong Kong, China	Securities and Futures Commission (SFC) Hong Kong Exchange and Clearing Limited (the Listing Department and the Listing Committee) The Companies Registry
India	Securities and Exchange Board of India (SEBI) Serious Fraud Investigations Office (SFIO) The Stock Exchanges Ministry of Corporate Affairs (MCA)
Indonesia	Otoritas Jasa Keuangan (OJK) (Bapepam LK until 31 December 2012)
Malaysia	Companies Commission of Malaysia (CCM) Securities Commission Malaysia(SC) Bursa Malaysia Central Bank of Malaysia
Mongolia	Financial Regulatory Commission (FRC) Mongolian Stock Exchange (MSE)

Table 2. **Supervisory and enforcement authorities: Securities regulators and exchanges** (cont.)

Country	Enforcement authorities (discussed in the questionnaires)
Pakistan	State Bank of Pakistan (SBP) The Securities and Exchange Commission of Pakistan (SECP) Karachi Stock Exchange (KSE) Lahore Stock Exchange (LSE) Islamabad Stock Exchange (ISE)
Philippines	Securities Exchange Commission (SEC) Philippines Stock Exchange (PSE)
Singapore	Accounting and Corporate Regulatory Authority (ACRA) Commercial Affairs Department (CAD) Monetary Authority of Singapore (MAS) Singapore Exchange(SGX)
South Korea	Ministry of Justice Fair Trade Commission Korean Stock Exchange
Thailand	Securities and Exchange Commission (SEC) Stock Exchange Thailand (SET)
Vietnam	State Securities Commission (SSC) Vietnam Stock Exchange

Source: Author's research

Structure and capacity of enforcement authorities

Jurisdiction and expertise of enforcement authorities

Recommendations

- Countries with multiple enforcement authorities should have a Memorandum of Understanding to formalize co-ordination and should have frequent meetings to discuss enforcement issues. These meetings should be coordinated by one agency with dedicated personnel to oversee and co-ordinate activities of all enforcement authorities and should, from time to time, involve senior management of all the enforcement agencies.
- Requests for information should be handled transparently and efficiently and should be attended to within a specified time. Sound reasons should be given when requests for information are rejected.
- There should be dedicated divisions within the police or public prosecutors to investigate and initiate criminal actions for breach of securities regulations. In addition, statutory regulators should be equipped with powers of prosecution.

The structure of enforcement authorities in participating jurisdictions may be either fragmented or concentrated within a single regulator. There are advantages and disadvantages in both systems. The structure alone is insufficient to determine the quality of enforcement, which also depends upon the level of experience, skills and training of the supervisory and enforcement staff. Where enforcement staff are experienced and are given adequate powers to carry out their role, enforcement may be more effective regardless of the enforcement-body structure.

Enforcement systems in participating jurisdictions are, for the most part, fragmented among multiple agencies at different levels. Most participating jurisdictions have a statutory regulator commonly known as the Securities (and Futures) Commission, Securities and Exchange

Commission or Securities and Exchange Board. Stock exchanges play the role of front-line regulators. The statutory regulator has broad statutory investigation and enforcement powers to uphold laws and regulations that govern the issuance of and trading in securities. It has the power to investigate and prosecute or start a legal action.

Front-line regulators in most participating jurisdictions are responsible for ensuring that the market is fair, orderly and informed. In undertaking this role, stock exchanges enforce their own listing rules through monitoring activities such as vetting announcements, circulars and financial reports; monitoring market activities and taking action when they detect a breach. Statutory regulators have wider authority but at times must consult other authorities such as the Commercial Crimes Division within the police force or the public prosecutor's office in order to obtain information or to prosecute offenders.

Thus the advantage of a fragmented enforcement structure is that it may foster specialization, as each enforcement authority deals with problems within its respective authority. Another advantage is that it provides better checks and balances, as power is not concentrated in the hands of one enforcement authority. Fragmented structures may, however, lead to overlapping areas of enforcement and even conflicting requirements imposed on companies. This usually does not pose a challenge if there is an agreement or arrangement as to the accountability of each regulator where there is overlapping jurisdiction and when this is made clear to the market. Overlapping jurisdiction involving the principal or front-line regulator with other bodies such as the Central Bank or the Companies Registrar may, nevertheless, pose challenges for co-ordinating enforcement. If this relationship is not properly structured, principal or front-line regulators may be perceived as inefficient. Some jurisdictions like India permit parallel enforcement action, which allows enforcement authorities of overlapping jurisdictions to take action simultaneously.

One of the biggest challenges that regulators face is co-ordinating investigations and sharing information. Although dialogues, inter-agency meetings and other methods of co-operation may reduce problems, different enforcement authorities may have different priorities or methods of achieving their aims. This may lead to failure or delays in detection and enforcement. For example, in some jurisdictions, cases involving fraud must be dealt with by the police within a range of numerous priorities that may hamper the investigations' effectiveness. Securities regulators in some jurisdictions are not granted powers to prosecute but rather must go through public prosecutors, who may lack in-depth knowledge about the intricacies of securities laws or have competing claims on their time.

While over-fragmentation is undesirable given the problems in respect of co-ordination, establishing a single 'super-regulator' might not be the solution. A single super-regulator could also face capacity problems to effectively supervise and enforce the wide range of possible infractions, from a breach of listing requirements to money laundering and corruption.

There is no one-size–fits-all enforcement structure; both fragmented and super-regulators have their advantages and disadvantages. Nevertheless it would be advisable to require regulators in a fragmented structure to address the problem of a lack of co-ordination. The preferred format would be to have a Memorandum of Understanding (MoU) to formalize co-ordination among regulators. There should be frequent meetings at which downstream organizations responsible for further investigations and prosecutions explain their reasons for failure to pursue a particular course of action. This would ensure accountability.

Frequent meetings among enforcement authorities from different organizations builds close networks, but there is a possibility that regulators may not respond adequately to personnel who are not part of this network. To avoid this, there should be clear timelines to respond to requests for information, followed by clear reasons as to why a certain request has not been acceded to. In other words, requests for information should be addressed in a transparent and efficient manner. The roles and responsibilities of the different regulators should also be clear so as to ensure smooth co-ordination.

Regardless of whether a jurisdiction has a single or multiple regulator(s), it is important that emphasis be not only on rule-making but also on adequate supervision and strong enforcement. The supervisory and enforcement divisions should be streamlined to ensure cohesiveness.

Good practices

In Singapore meetings are conducted every quarter among the enforcement authorities - the Singapore Exchange (SGX), Accounting and Corporate Regulatory Authority (ACRA), Monetary Authority of Singapore (MAS) and the Commercial Affairs Division (CAD) - to exchange information and obtain updates on enforcement actions. Similarly, the National Law Enforcement Coordinating Committee (NALECC) in the Philippines maintains close co-ordination and co-operation among member agencies on enforcement matters. Unlike other jurisdictions, the NALECC acts as a co-ordinator of the activities of enforcement agencies. The Financial Stability and Development Council (FSDC) in India plays a similar role. Pakistan has introduced a co-ordination committee which has been formed under an MoU between the Securities and Exchange Commission of Pakistan (SECP) and the State Bank of Pakistan. The SECP is introducing a Sector Monitoring Division (CSMD). CSMD will be responsible for regular off-site surveillance and monitoring of corporate and regulated entities, as well as for conducting on-site inspections and investigations to assess the overall financial health of companies and check compliance.

In Chinese Taipei, the Ministry of Justice has designated a prosecutor to sit at the FSC. In the event that the FSC discovers criminal activities such as insider trading, related-party-transaction or stock-price manipulation, the FSC consults the prosecutor, who will provide an opinion on whether there is enough evidence to prosecute. This improves timelines, mutual understanding between the regulator and prosecutor, and the quality of the prosecution.

The CAD, which is part of the Singapore police force, is in charge of investigating a wide spectrum of commercial and financial crimes. Securities regulators refer cases to the CAD for further investigations.

The Securities Commission of Malaysia has the authority to prosecute breaches of securities laws following consent from the public prosecutor.

The independence of enforcement authorities

Recommendations

- Regulators should be free from political interference and should be commercially independent, while being accountable and receiving full support by the government to enable them to carry out their duties effectively.
- Demutualised stock exchanges should ensure independence of their regulatory function through being subjected to oversight by a statutory regulator or equivalent independent body.

Independence is important to secure and maintain trust in the enforcement system. Four indicators ensure that regulators operate independently from political and commercial influence: the source of funding, checks and balances and transparency of the same, the right of legal recourse and appeal by the errant party, and the expertise and independence of the courts and judicial system.

The source of regulators' funding may lead to conflicts of interest. There are different funding sources for regulators consisting of funding by market participants, funding through government sponsorships, and third-party sponsorships. Most stock exchanges in participating jurisdictions are funded by market participants, while statutory regulators are either partly or fully funded through government sponsorships or completely market funded. The Securities Commission of Malaysia and Bursa Malaysia, the Hong Kong Stock Exchange, the Securities and Exchange Commission of Pakistan, the Taiwan Stock Exchange in Chinese Taipei and regulators in Singapore are funded by market participants. SEBI, Otoritas Jasa Kewangan (OJK) in Indonesia, the Financial Supervisory Service and Financial Supervisory Committee in Korea, the Financial Supervisory Commission in Chinese Taipei and the CAD in Singapore are publicly funded. The Securities and Futures Commission (SFC) in Hong Kong, China is also self-funded, although it may request the government to fund their activities. In Vietnam, the State Securities Commission is affiliated with and funded by the Ministry of Finance; in Mongolia, the Financial Regulatory Commission is also funded by the government.

Table 3 shows that most regulators and enforcement authorities have sources of self-funding (by market participants) at their disposal, indicating that they operate at least partially independently from government institutions.

Regulators should be free from political interference, financially independent and should receive full support by the government and the market in carrying out their duties. [2] Statutory regulators can maintain their independence by being self-funded and report directly to Parliament or its equivalent in their jurisdiction. Most regulators, regardless of how they are funded, have taken steps to ensure their independence.

Table 3. **Funding of enforcement authorities**

		Main funding resource		
		Self-funding	Public funding	Third party transaction
Bangladesh	BSEC	*	-	-
China	CSRC			
	SACAC			
	Stock Ex.			
Chinese Taipei	FSC	*	*	-
	TWSE	*	-	-
	GTSM	*	-	-
Hong Kong, China	SFC	*	*	-
	CR	*	-	-
	HKEx	*		
India	SEBI	*	*	-
	MCA	-	*	-
	Stock Ex.	*	-	-
Indonesia	OJK	*	*	-
Malaysia	CCM	*	*	-
	SC	*	-	-
	BURSA	*	-	-
Mongolia	FRC	-	*	-
Pakistan	SBP			
	SECP			
Philippines	SEC	*	*	-
Singapore	MAS	*	-	-
	ACRA	*	-	-
	CAD	-	*	-
	SGX	*	-	-
Korea	FTC			
	Korea Ex.			
Thailand	SEC	*	-	-
	SET	*		
Vietnam	SSC	-	*	-

Source: Author’s research

The regulators' method or source of funding is pertinent, as it may influence or give rise to conflicts of interest or a lack of independence and accountability. These are issues of concern with respect to the effectiveness of regulators in properly discharging their regulatory function. In addition, where the government is involved in business through state investment funds and companies, as is common in many Asian countries, the risk of political interference or distortion of competition is a real concern. There is a perception that enforcement authorities funded by the government might not be willing to take action against government-owned or government-linked companies.

There is also a risk that regulators will not receive full support from the government owing to a fear that strong enforcement in emerging markets could prompt the exit of some listed companies and discourage the entry of new ones.[3] On this basis, regulators are not given full autonomy to enforce their rules and instead must rely on other organizations within various ministries to help them carry out their duties, thus affecting the ability and, indirectly, the independence of enforcement.

Conflicts of interest may arise when regulators hold a dual role of developing and regulating the market. For example, demutualized exchanges carry out commercial activities while regulating the market. The danger is that commercial pressures may cause exchanges to compromise their regulatory role. The methods of funding, conflicts of interest, lack of independence and accountability are genuine concerns.[4]

The International Organization of Securities Commissions (IOSCO) highlighted the conflict of interest in demutualized exchanges as they may compromise their regulatory role to remain attractive and focus on year-on-year earnings growth and increasing profits. The conflict between commercial and regulatory objectives gives rise to the risk of the exchanges' reducing regulation (including challenging breaches of its rules) so as to reduce regulatory costs and thus enhance its attractiveness to issuers and intermediaries. This may also give rise to exchanges' reducing the resources spent on regulatory functions, which may in turn increase the risk of regulatory failure.

Demutualized stock exchanges should ensure that conflicts of interest are adequately disclosed and that there is no compromise in the discharge of their regulatory role. They can also preserve their independence by being subjected to the oversight of the statutory regulator, which should approve all rules made or amended by the exchange. Alternatively, they can organize their regulatory structure so as to permit their regulatory function to operate independently of the commercial or business activities of the exchange.[5]

Good Practices

Statutory regulators maintain their independence in several ways. SEBI in India and SEC in Thailand are autonomous bodies constituted under an act of parliament and enjoy operational and financial autonomy. In Pakistan the SECP commissioners are appointed under the SECP Act, and they cannot be removed from their position other than in circumstances outlined in the Act.

Bursa Malaysia is an example of a demutualized exchange subject to oversight by the Securities Commission Malaysia, and it has an internal framework for managing conflicts of interest. Bursa is required to submit an Annual Regulatory Report (ARR) to the Securities Commission with details on the extent and scope of its compliance with its statutory duties and obligations. The Securities Commission conducts a regulatory audit upon submission of the ARR.

Checks and balances in the enforcement system

Recommendations

- Independent bodies or committees should be put into place as checks and balances to ensure proper discharge of the functions of enforcement authorities, and these procedures should be publicized.
- There should be a right to appeal from or a review of the decisions of enforcement authorities, including in courts of law.

Statutory regulators have been granted wider powers than front-line regulators, but it remains necessary to have in place checks and balances to ensure that they exercise their power properly. Some statutory regulators in participating jurisdictions are subject to oversight by external authorities such as parliament or a relevant ministry, while others have instituted internal checks and balances such as ensuring that decisions to enforce cases are not vested in a single person or division but rather subject to a committee consisting of external independent members.

It is particularly pertinent for a front-line regulator that plays a dual role as a commercial entity to put into place appropriate and effective checks and balances. Most regulators are mindful of conflicts of interest and have taken measures to prevent them. While ensuring appropriate checks and balances is important, such arrangements must also be transparent and effective.

Some front-line regulators have regulatory committees or an independent body to oversee major enforcement actions. This could be a Listing Committee comprising independent members who preside over matters relating to alleged breaches by companies, their directors or senior management. It may also be an internal structure such as an Enforcement Committee that oversees the investigation and enforcement of decisions. There may be an internal panel to review internal procedures and operational guidelines on regulatory functions. Where stock exchanges are concerned, the committees may pursue actions for breaches of listing rules, but their actions are often subject to scrutiny by the statutory regulator.

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All participating jurisdictions have an appeal process for aggrieved parties, ranging from appeals to an Appeals Committee within the same regulator but with different committee members, appeals to a statutory regulator or appeals to the courts. Although it is not common in all participating jurisdictions, some – such as Singapore; Hong Kong, China; and Malaysia - have commercial courts that specialize in judicial review applications from capital market regulators. Usually, parties who challenge due process are expected to file an appeal. The aforementioned jurisdictions have devised key performance indicators in an effort to ensure that the courts dispose of cases quickly and efficiently. Efficiency and speed of appeals processes is an important issue that can render enforcement ineffective if too slow.

Good Practices

In Vietnam, the Inspections Department affiliated with the Ministry of Finance monitors and supervises the enforcement activities of the statutory regulator, which is the State Securities Commission in Vietnam. In Chinese Taipei sanctions against material violations of financial regulations are subject to a review process by the Financial Supervisory Commission Committee comprising Ministers of Finance, Economic Affairs, Energy, Justice and people in financial professions and with financial experience. In Mongolia, the review process is delegated to the supervisory board of the Financial Regulatory Commission (FRC).

The Securities and Futures Act in Singapore places a legal obligation on the Singapore Stock Exchange's board and management to establish effective governance arrangements, which include a Regulatory Conflicts Committee of the Board to ensure that conflicts are managed properly. The Philippines Securities and Exchange Commission requires its employees to adhere to a Code of Conduct under the Implementing Rules and Regulations of the Securities Regulation Code. A resident ombudsman has jurisdiction over the commission's activities. In Thailand, an Internal Enforcement Committee comprising non-investigating members has to review enforcement decisions before formal approval is granted to proceed with enforcement, and in Hong Kong, China the decision to commence disciplinary actions is made and approved at meetings of the Disciplinary Co-ordination Meeting.

The Hong Kong Stock Exchange has internal procedures in place for making decisions about the commencement of disciplinary actions. At the core of the decision-making process is a regular meeting chaired by the Head of Listing and attended by senior staff of the Listing Department, at which proposals for the disposal of disciplinary business are discussed and agreed to. The procedure is documented in the Operating Manual of Listing Enforcement.

The right of appeal is accorded in all the participating jurisdictions. In Hong Kong, China for example, regulated persons who are dissatisfied with the Securities and Futures Commission's disciplinary decisions may appeal to the Securities and Futures Appeal Tribunal, which is an independent Tribunal chaired by former and current High Court judges and assisted by panel members from the legal, accounting and financial industries. If the Listing Committee of the Hong Kong Stock Exchange imposes public sanctions, following a first review before the Listing Committee (constituted by members not involved in the earlier decision and not conflicted), a further review is available before the Listing Appeals Committee, which comprises the chair and two other directors of Hong Kong Exchanges and Clearing Limited, parent company of the Hong Kong Stock Exchange.

In India, any entity aggrieved with the enforcement action of SEBI may appeal to the Securities Appellate Tribunal, which is an independent Tribunal presided by a former judge of the Supreme Court or of the High Courts.

Bursa Malaysia has an Appeals Committee to hear and decide on appeals against decisions from the Listing Committee. The decisions of the Appeals Committee are final but are subject to judicial review by the courts of law.

Budget for enforcement authorities

Recommendations

- Regulators should have adequate resources to employ staff with the necessary skills, knowledge and experience.
- Regulators should invest adequately in technology to facilitate supervision and enforcement, such as tools to conduct real-time surveillance and to capture unstructured financial and non-financial information.

Most regulators in participating jurisdictions think that attracting and retaining talent is challenging. Budget constraints in the enforcement system lead to understaffing and a lack of sufficient training, affecting staff competency and effectiveness and thus giving rise to delays and perhaps even in an inability to enforce. There is evidence to suggest that budgets and staffing of regulators correlates significantly with capital market development, which is why training and budgetary constraints should be taken seriously. [6]

It is imperative that supervisory and enforcement units be staffed adequately with people who understand financial markets and have the necessary level of skill, integrity and experience. It is often difficult to recruit people with the necessary skills as the remuneration does not compare favourably with that of the private sector. Regulators' salary levels in some jurisdictions are equivalent to salary scales of government employees. Even when staff is paid adequately, their experience often makes them very marketable in the private sector.

Some participating jurisdictions attract high-quality employees by providing performance-based compensation through substantial additional allowances and bonuses. Not all enforcement authorities favour performance-based remuneration, however, on the grounds that it could create perverse incentives. It might be more effective for staff to be rewarded based on whether they effectively promote compliance in a positive manner by pre-empting breaches and obtaining the co-operation of companies in the capital market rather than by being reactive through a focus on the number of companies that are 'caught' breaching the rules. [7]

Another aspect of budget constraints is the amount spent on technology to help enforcers carry out the supervision and investigation of breaches of capital market laws. IOSCO has expressed concern over problems that regulators face in supervising and enforcing breaches owing to increased use of technology. Staff should be trained in the latest technology, and regulators should utilize latest technological hardware and software to conduct real-time market surveillance in order to remain one step ahead of those perpetrating fraud.[8] They should also focus on obtaining tools to capture unstructured financial and non-financial information to capture market trends and assess the quality of listed companies. Such tools should be able to detect financial ratios and anomalies. It may be worthwhile for regulators to co-operate with each other to develop and use technological tools such as computerized surveillance systems in order to reduce costs.

One reason for the lack of access to the latest technological tools is that the cost is high; it requires a lot of data input and constant updates to be effective. Yet it is imperative for regulators to have access to such tools as a high priority. Regulators should find cost-effective ways where possible to purchase such tools, which go a long way in assisting them.

Good Practices

In Hong Kong, China; India; Pakistan; Singapore; and Chinese Taipei, the enforcement authorities have implemented an effective recruitment and selection process that ensures employees come from multi-disciplinary backgrounds such as legal, accounting, IT and finance.

The Securities and Futures Commission in Hong Kong, China observes market trends and strives to keep staff compensation competitive. The SECP in Pakistan has implemented a performance-based annual appraisal system that has had a positive impact on the retention rate of employees.

Bursa Malaysia has implemented a new surveillance system that enhances surveillance capabilities, as it comes with ‘capacity-enhancing’ features better designed to detect market manipulation and abusive practices, provide faster access to historical information and make data highly available.

Authority to monitor, supervise, investigate, enforce and impose sanctions

Recommendations

- Statutory regulators should be given adequate powers to:
  - Prosecute criminal cases
  - Investigate all aspects of breaches falling within their jurisdiction
  - Compel unregulated persons to assist in investigations as long as there are reasonable grounds to believe that their assistance is necessary to the investigation
  - Enter the premises of regulated entities to conduct investigations
  - Request relevant documents or information that is relevant to investigation of the breach
  - Decide the type/mode of proceedings (i.e. administrative, civil or criminal) in effective enforcement of a breach
- Statutory regulators should be given adequate support by other authorities or regulators who have an obligation to grant assistance.
- Clear arrangements should be put into place, with accountability for reporting on cases referred from one regulator to another.

Enforcement is the most visible element in securities regulation and has a considerable impact on market perception of the regulator. When enforcement is weak or delayed, it fails in its role as a sufficient deterrent. It is imperative that enforcement authorities act swiftly to penalize breaches, using their powers to decide the mode of proceedings and the nature of the actions taken, whether criminal or administrative, and using a wide range of sanctions, from warnings or caution letters to imprisonment.

Statutory regulators have the power to investigate and access relevant information. These powers are usually exercised when there is reason to believe that regulated persons are involved in fraud; disclosure breaches, such as disclosure of false and misleading financial information; misappropriation or misuse of company funds in connection with the purchase of securities or fund raising by public companies. The statutory regulator may compel regulated persons to produce documents and records stipulated by the regulator; they may also be given power to enter the premises of regulated entities without prior notice or be given a search warrant to seize documents and records as long as they have reasonable grounds to believe that a securities offence has been committed or that evidence of the breach would be destroyed unless they went into the premises immediately. They may also compel the officers of regulated entities to assist in the investigation.

Some statutory regulators, however, do not have sufficient powers of investigation and must work with the police to conduct investigations. They must obtain a court order or have a police presence when entering the premises of regulated entities to obtain documents and other relevant evidence. They may also have to work with other regulators such as the Central Bank to obtain information about a company or its officers' or directors' bank accounts. While this is an important check on the authority of the regulator, it becomes an impediment if the judicial system is slow or if the police or public prosecutors are inadequately trained in commercial crimes or do not have enough resources to make such crimes a priority. Delayed investigations not only permit companies to dispose of evidence if they suspect they are about to be investigated, they also create a perception that the regulator is ineffective.

A challenging task for regulators is to gain access to information held by unregulated persons. For example, regulators may need to interview investors who have participated in transactions by listed companies that the regulators are investigating, or they may want to obtain information from Internet service providers, telecommunications companies or banks. Information provided by these parties is crucial, especially in cases involving insider trading. In some jurisdictions, statutory regulators are vested with powers to obtain information from unregulated natural and non-natural persons as long as it is related to dealings in securities and the regulator has reasonable cause to believe that the person has relevant information. The power may also be exercised to compel such persons to attend interviews and provide statements and, where the regulator has reasonable grounds to believe that evidence may be removed or destroyed, it may apply for a warrant from the courts to conduct a search of the unregulated person's premises. Nevertheless, such powers are not widespread. Many participating jurisdictions do not give statutory regulators powers to prosecute, so regulators must go through the public prosecutor's office to initiate legal action.

The power of stock exchanges in most participating jurisdictions is limited to enforcing breaches of listing rules. Stock exchanges may have the power to compel listed companies to surrender documents and information related to an investigation, but they do not have the power to enter the premises of these companies to ensure compliance or conduct investigations without prior notice. Where companies or their officers do not comply with directives from the stock exchange, there is little it can do to enforce compliance other than take disciplinary action and impose sanctions for non-compliance, or to refer the case to the statutory regulator or the courts of law to compel performance where relevant.

Most stock exchanges do not have power over unregulated persons and cannot compel them to give evidence, which may impede investigations into breaches of listing rules. In cases of related-party transactions, for example, there are significant challenges in monitoring compliance with disclosure of indirect shareholdings and nominee structures. It is difficult to link the parties involved, even when the regulator has strong suspicions of a related-party transaction.

As the stock exchanges are commercial entities, it may not be appropriate to grant them the wide powers that statutory regulators have. In cases where the stock exchange's powers are curtailed or there is a limitation to address or enforce the breach, it is beneficial to have a system in place for referral of cases to the statutory regulator. The system should also incorporate an arrangement where the stock exchange is kept informed of the outcome of the referral.

Good Practices

The Fair Trade Commission of South Korea, Securities and Futures Commission in Hong Kong, China and the Securities Commission in Malaysia have powers to institute criminal prosecution against regulated persons. They also have power over unregulated persons to compel them to assist in investigations. The Securities and Exchange Commission in Thailand has the power to order the freezing of the assets of companies in breach, subject to certain requirements.

SEBI in India has been empowered under the SEBI Act 1992 with the powers of a civil court to, inter alia; require inspection of books and the summoning and enforcing attendance of persons. Further, the recently promulgated Securities Laws (Amendment) Ordinance 2013 gives SEBI the powers to search and seize, as well as enhanced recovery powers including arresting a person, attaching bank accounts and selling properties, without having to approach the courts.

Sanctions

Recommendations

- The penalties imposed by regulators and the courts should be proportionate to the severity of the violation and sufficiently deterrent.
- Regulators should be given powers to take pre-emptive action.
- Regulators should publicize action taken on individual cases.
- Regulators should have the power to impose a wide range of sanctions.

The effectiveness of regulatory action depends on a mixture of enforcement powers and the ability to induce voluntary compliance. Even within formal enforcement procedures, leniency provisions for those who co-operate are useful.

Securities laws can be enforced by various authorities, either through administrative or civil proceedings or by the instituting of criminal charges against companies. Most jurisdictions devote significant resources to public enforcement, but the way that enforcement is carried out might not be effective. The effectiveness of enforcement is measured in terms of the nature of the actions taken (i.e. whether to initiate criminal, civil or administrative proceedings and, where appropriate, to agree to a settlement process to expedite proceedings against the alleged offender etc.); the type of sanction sought, whether a fine or imprisonment or even disqualification of directors; and its severity, whether the fine is high or the term of imprisonment is long enough to act as a deterrent. For example, India's Securities Laws (Amendment) Ordinance 2013 gives SEBI the power to issue direction to a person to disgorge an amount equal to the wrongful gain made or losses caused by that person's breach. In Mongolia, companies may be liable for fines equal to the minimum wage multiplied by 30 to 40 times, while officers of the company would be liable for the minimum wage multiplied by 10 to 15 times.

Sanctions vary from the banning of a person from acting as a director or senior management in company, administrative fines and other monetary penalties, restriction or suspension of voting rights or share transfers, warning or caution letters, injunctive relief or preliminary remedies, or imprisonment. Regulators may at times require wrongdoers to remedy the consequences of their breach. Statutory regulators usually obtain their powers to impose sanctions from statutes while stock exchanges incorporate it into their listing rules.

Regulators have the option of using a 'soft' approach, comprising information requests, norm enhancing reprimands and warning letters. The informality of these mechanisms makes it possible for supervisory authorities to save on the costs of administrative proceedings that may result from the imposition of more formal sanctions. This approach provides the opportunity to respond quickly and more effectively to non-compliance and to alert companies to deficiencies in their compliance systems before these escalate into significant violations of law. It also serves to stimulate dialogue with the business community, which adds to the experience of regulators and supervisory authorities. Furthermore, imposing informal enforcement sanctions offers the possibility of better detecting beneficial ownership and control structures that fall into the grey area of the applicable rules and regulations (such as contractually acquired ownership and control structures). The informal and co-operative approach offers a variety of mechanisms to manage specific problems, leading to a higher level of compliance with the spirit and intent of the disclosure requirements.

Some regulators may prefer to impose stringent sanctions even if it will increase the length and cost of the procedure, probably due to a common belief that compliance with corporate governance rules and regulations will improve if the sanctions are sufficiently severe. Delays in enforcement action arising from lengthy or slow processes dilute the effectiveness of enforcement. Regulators should bear in mind that the ability to reach an out-of-court settlement is also an effective enforcement method because it sends a message that the regulator is serious about enforcement and has saved the time and cost of going through the entire judicial process.

Regulators must be credible and have a track record of successful enforcement actions in order for out-of-court settlements to be an effective deterrent. The outcome of such settlements must also reflect the gravity of the offense, or the regulator will be perceived as settling the case because it does not have enough political will or the necessary evidence to prosecute.[9] It is also essential for the regulator to disclose the terms of the out-court-settlement, if possible, in order to gain investors' confidence.

The effectiveness of the regulators depends not only on sanctions but also on the regulator's ability to impose injunctive relief and take pre-emptive action expeditiously. The actions range from applications to the court to freeze the assets of the company allegedly in breach of securities laws owing to real concerns that it may transfer those assets out of the jurisdiction or dispose of it, to suspension in order to prevent further violation and damage that could have a significant impact on the capital market. It is important to develop an efficient method of measuring the seriousness of each violation quickly ('seriousness test'). Under certain circumstances, the supervisory or enforcement authority may issue a direct preliminary order, such as suspending trading in a listed issuer's securities, to protect investors or to maintain an orderly market. This is not always the first option, though, especially where the violation is not very serious. If the severity of the violation is low, the enforcement authorities may decide to increase the amount of the fine rather than impose heavy sanctions.

In some participating jurisdictions, the supervisory authority may initiate civil proceedings seeking injunctive or preliminary relief from the courts. Injunctive relief not only gives enforcement authorities the option of acting immediately to prevent further damage to investors or the market, it may also induce the companies concerned to seek out settlements that could otherwise end up in further expensive, unwanted litigation. Another example of remedial civil orders is a disqualification order preventing the company or its officers from dealing with the securities.

Statutory regulators in participating jurisdictions have varying levels of power to seize or prohibit the disposal of or dealing in any property in respect of which an offence is suspected to have been committed. The benefit of pre-emptive action is that it gives regulators the opportunity to take action before there is more damage either to investors or to the market as a whole. There are claims that broad investigation and enforcement powers may increase the risk of abuse, but this can be guarded against when enforcement actions are transparent. In other words, disclosure of enforcement actions is an important step in addressing any potential abuse of power.

Good Practices

The China Securities Regulatory Commission (CSRC) has the power to confiscate illegal income of individuals and companies where they have benefited from a breach.

In India, SEBI has been vested with pre-emptive powers to pass interim orders to immediately prevent damage to investors and the market. These orders range from barring entities from accessing the capital market, restraining companies from raising funds, and freezing transactions in specific securities held with the depositories. The Securities Commission in Malaysia has similar powers.

Disclosure of enforcement actions and practices

Recommendations

- Regulators should disclose their enforcement philosophy, objectives, internal structures, legal powers and procedures used to address cases.
- Regulators should annually provide details of enforcement actions and should disclose the outcome of court actions including out-of-court settlements as soon as they are able.
- Regulators should ensure adequacy of information in disclosure of enforcement actions, including the basis of such actions.

Regulators have developed the practice of disclosing, in the press and on their website, the details of their enforcement actions and decisions against regulated parties. The benefits of publicizing a breach is that it promotes proper behaviour within the capital market as other regulated parties will know what is unacceptable to the regulators and the repercussions of non-compliance, thus deterring them from committing similar acts. Publishing enforcement actions also promotes greater accountability on the regulators while providing access to foreign enforcement authorities with 'local' information, especially when it is published in English and available online. This procedure may also guide regulators in determining the finding of a breach and sanctions against parties for similar types of breaches.

Additional disclosure of the regulator's philosophy, objectives, structure and processes involved will go a long way in enhancing investor confidence. This may be accompanied by a flowchart describing the structure and procedures involved in enforcement. The checks and balances should include communication to the public of enforcement actions and of decisions and the basis for these, so as to create greater market awareness and understanding. At a minimum, there should be disclosure of the number of breaches prosecuted, the adjudication of cases and the outcomes. Disclosure of expenditures and resources allocated for different enforcement authorities should also be made transparently.

It is important for enforcement actions or practices taken by regulators to be transparent as this ensures accountability, provides checks and balances and helps to focus on and create a better understanding and awareness of the roles and actions of various enforcement authorities, which is especially useful in a fragmented enforcement structure. Regulators should also be open and professional in their disclosure of the internal structures, policies and procedures they have established when addressing cases and should include straightforward and clear information in a timely manner. Their communication with the public should be in simple and clear terms, written in an international language like English so that investors from other jurisdictions can understand.

Regulators have to look at their actions from the regulated parties' perspective as well as take into account shareholders' and investors' interests in making public the contents of the disclosure. They should build confidence in their fairness, level of competence, commitment to the rule of law, and professionalism and should ensure that there is no misconception about their enforcement actions. In addition, it should be made clear whether the enforcement actions disclosed would result in administrative or criminal sanctions, and great care and prudence should be exercised when disclosing the contents and wording of enforcement actions.[10] There should also be certainty in enforcement actions, which will have the benefit acting as a deterrent against future violations of laws and regulations.

Good Practices

The Securities and Exchange Board of India (SEBI) has placed its polices, procedure and processes of enforcement on its website, while the Securities and Futures Commission (SFC) in Hong Kong, China has outlined the disciplinary, investigation, appeal and settlement measures available to the Commission. The SFC publicizes all enforcement measures through press releases, which are subsequently displayed on its homepage. Malaysia, Philippines and Thailand have similar practices.

Specifically, the SFC has outlined on its website 'Disciplinary Proceedings at a Glance' and 'Disciplinary Fining Guideline'. It also posts the dates and places of upcoming hearings, with the names of parties and status of the hearings.

The Financial Services Authority of Japan publishes an annual plan and strategy to highlight the focus area of the supervision and enforcement practices.

The Taiwan Stock Exchange (TWSE) and Gre-Tai Securities Market (GTSM) have an Information Disclosure Ranking System that ranks every listed company's adequacy of disclosures and transparency. The ranking system ranges from A++ to C-. When a company receives a rank of C or below, the TWSE and GTSM intervene by offering assistance to enhance their compliance.

Courts and the judicial system

Recommendations

- Specialized business courts should be established and staffed with adequately remunerated judges and prosecutors trained specifically in capital market laws and procedures, to enable them to prosecute and dispose of complex cases efficiently. If there are no specialized courts, panels of judges with proper expertise should be set up within the ordinary court systems.
- The judiciary should be independent, with integrity and respect for the transparency of the judicial process. Decisions should be published.
- Ongoing training should be a permanent feature to build credibility and competence of the judicial process.

It is important to have a credible, independent and efficient judicial system to enforce corporate governance. A common problem, however, is the lack of judges' and prosecutors' expertise in corporate governance matters and financial market rules, plus a backlog attributable to the sheer volume of cases. While there may be a temptation to bypass the judicial system as much as possible, the complication is that the system is a foundation for public and private enforcement and is the ultimate legal authority in most jurisdictions.

There are several solutions to the problem of a lack of judicial expertise or long, drawn-out cases filed in court. The first would be to ensure that regulators have additional powers, such as full investigative power, administrative alternatives including injunctions to stop and reverse actions short of or before going to court, and power to initiate enforcement actions against board members. This would reduce the burden on the courts to be involved in each step and improve timeliness for disposal of cases.

The second solution would be to establish specialized business courts with the power to address civil and criminal breaches of securities laws. The advantage of specialized courts is that judicial officers' knowledge and experience are continually enhanced. Indonesia's experience with specialized courts dealing with corruption has contributed to the success of anti-corruption efforts by its Corruption Eradication Commission.

The High Court in Malaysia has three new commercial courts to deal with banking, finance, insurance, admiralty and sale of goods cases, which has reduced time and costs for litigants. Empirical evidence shows that specialized business courts play an important role in providing a high level of minority-investor protection.[11]

Another solution is to improve court procedures by encouraging judges to dispose of minor cases without unnecessary delays through setting key performance indicators for judges. It is important that judges' decisions be well-written and published, to ensure their quality and integrity. Other methods to enhance quality would be to raise judges' salaries, conduct performance management assessments established and monitored within the judiciary, and take steps to ensure their independence in order to insulate the judicial system from outside influence and interference. Regulators and ministries of justice should also work with judges and prosecutors to increase their knowledge of new laws and programs. Judges, prosecutors and the police should be given training to improve their understanding, which regulators can be facilitate through participation in international and domestic meetings, roundtable discussions, workshops and inter-agency task forces. Alternative dispute resolution (ADR) could also be explored. The Singapore International Arbitration Centre and the Hong Kong Market Misconduct Tribunal are examples of specialized entities that dispose of cases faster than conventional courts.

Good practices

Regulators in Thailand and Malaysia work closely with the Judges' Organisation and the Judicial and Legal Training Institute in their respective jurisdictions to enhance judges' knowledge on securities laws and related issues.

Hong Kong's Market Misconduct Tribunal is headed by a Chair who is a judge or former judge of the High Court. It determines whether market misconduct has occurred (insider dealing, false trading, price rigging, stock market manipulation, disclosure of information relating to prohibited transactions and disclosure of false or misleading information inducing transactions in securities and futures contracts).

Cross-border enforcement

Recommendations

- Cross-border co-operation should be improved through bilateral and multilateral arrangements.
- Inter-agency meetings and working committees should be established among regulators from different jurisdictions.
- Information sharing provisions in national laws should be reviewed to enhance cross-border co-operation.

Regulators are operating in a challenging environment owing to the internationalization of capital markets. A company might be listed in one jurisdiction while its board, management and operations operate from another jurisdiction, or they might use offshore corporate entities or international holding structures to conceal the identity of controlling beneficial owners. Offenders are able to move money across borders and to execute transactions simultaneously in several jurisdictions. Consequently, sanctioning these offenders may be a difficult task, which allows them to take advantage of the gaps in regulatory co-operation. The problem can be addressed only with effective cross-border collaboration. Enforcement cooperation necessarily requires that regulators have the legal authority to exchange non-public information and to protect the confidentiality of such information. It's important to note that laws and regulations in some jurisdictions require regulated entities to provide the relevant regulator with certain types of information or documents, regardless of where they are located, as a condition for being registered or licensed in their jurisdictions. However, due to laws relating to sovereignty and information access, regulators in some cases may not be fully aware or appreciate whether a regulated entity is complying with those requirements without the assistance of local regulatory counterparts. The enforcement cooperation mechanism typically does not provide for the exchange of information for prudential or supervisory purposes absent a specific violation(s) being suspected or alleged; in these cases, it may be necessary for regulators to enter into a separate agreement or MoU providing for cross-border supervisory cooperation.

In spite of this cross-border co-ordination between co-ordinators, there are challenges attributable to legal limits on information that can be shared, inadmissibility in court of information that has been obtained through informal channels, regulators with different priorities, and the difficulty of optimal co-ordination when there are strict time constraints and disincentives to share information, especially when regulators are self-funded. Some regulators in foreign jurisdictions for reasons that are not always clear take a 'protectionist' approach and will not co-operate even if they are co-signatories to the IOSCO Multilateral MoU (MMoU). The speed of response will depend on the relationship between countries and regulators in those countries. Some regulators remain unwilling to assist or are slow in giving assistance, as mentioned above. The IOSCO monitoring group can only apply pressure; there is no obligation on signatory jurisdictions to co-operate.

The enforcement authorities in some corresponding jurisdictions have developed several strategies for closer cross-border co-operation, comprising bilateral and MMoU, information-sharing provisions in national laws and membership in associations and organizations. Strategies to stimulate cross border co-operation are shown below.

Strategies to stimulate cross-border collaboration

Strategies

- Membership in association and organisations
- Bilateral memoranda of understanding
- Multilateral memoranda of understanding
- Information-sharing provisions in national laws

MoUs have been signed between member countries of the ASEAN Capital Markets Forum and IOSCO. The parties to these MoU are shown in Tables 4 and 5.

Table 4. **ASEAN Capital Markets Forum – members (responding countries)**

Country	Enforcement authorities (discussed in the questionnaire)
Indonesia	Otoritas Jasa Keuangan (OJK)
Malaysia	Securities Commission Malaysia (SC)
Philippines	Securities and Exchange Commission (SEC)
Singapore	Monetary Authority of Singapore (MAS)
Thailand	Securities and Exchange Commission (SEC)
Vietnam	State Securities Commission (SSC)

Source: Author's research

Table 5. **IOSCO MMoU – Signatories (responding countries)**

Country	Enforcement authorities (discussed in the questionnaire)
Bangladesh	Bangladesh Securities and Exchange Commission
China	China Securities Regulatory Commission (CSRC)
Chinese Taipei	Financial Supervisory Commission (FSC)
Hong Kong, China	Securities and Futures Commission (SFC)
India	Securities and Exchange Board of India (SEBI)
Indonesia	Organisation?
Malaysia	Securities Commission Malaysia (SC)
Pakistan	Securities and Exchange Commission of Pakistan (SECP)
Singapore	Monetary Authority of Singapore (MAS)
Thailand	Securities and Exchange Commission (SEC)
Vietnam	State Securities Commission (SSC)

Source: Author's research

Cross-border co-operation is encouraged through MoUs, as well as bilateral and multilateral arrangements. The benefit of MoUs is that they help facilitate cooperation and the exchange of non-public information in a manner consistent with national or domestic laws. Also, depending on their scope and how broadly they are written, MoUs typically allow sufficient flexibility for the regulators to address emerging regulatory issues that may have not been contemplated at the time they were executed. The inherent disadvantage of MoUs is they can take a great deal of time to negotiate, particularly when done on a bilateral basis. Being a signatory to IOSCO MMoUs is a good place for regulators to start although there are challenges, as mentioned earlier. While most jurisdictions do not prohibit information-sharing, in some countries personal data protection laws should be examined to determine if they prevent information-sharing among regulators. In addition, evidence obtained in one jurisdiction might not be admissible in the courts of another jurisdiction. Another impediment is a lack of authority to obtain or share banking information with regulators in other jurisdictions owing to banking secrecy laws and the requirement that regulators assist regulators in another jurisdiction only if the breach is an offense in their own jurisdiction.

Another method for improving collaboration is by having inter-agency meetings and working committees. There may be problems with travel costs and incidental expenses, but these can be alleviated through technology that permits virtual discussions, especially teleconferencing and videoconferencing.

Furthermore, information-sharing mechanisms are lacking in spite of MoUs that have been signed, as many jurisdictions do not have the technical capacity to provide assistance. At other times, although there are bilateral agreements in place to share information, the regulator has to make the request through another enforcement authority that then passes the request to its counterparts in the foreign jurisdiction (e.g. when regulators require information about bank accounts in a foreign jurisdiction), all of which extends the time frame to conduct investigations.

Although information- sharing problems can be dealt with if there is enough support and co-operation, the real problem lies with cross-border enforcement, as regulators might not be ready to take action even on the basis of concrete evidence provided by a foreign counterpart.

Cross-border or bilateral arrangements notwithstanding, many regulators still face legal barriers that prevent them from fully co-operating at the international level. Hence reforms should be geared towards improvement of intra-governmental collaboration, not only to share information but also to detect and deter market misconduct. The introduction of information-sharing provisions in national laws and regulations may also enhance cross-border co-operation.

Good Practices

The Securities and Futures Commission in Hong Kong, China is able to provide confidential information to IOSCO MMOU members and to securities regulators in other countries with which the SFC has an MOU. It is able to provide investigatory assistance such as obtaining trade or bank records, telephone records and beneficial owner information. It is also able to compel interviews and statements from regulators in Hong Kong. There are similar arrangements in Chinese Taipei and Pakistan.

The Securities Commission in Malaysia may, upon receiving a written request from a foreign supervisory authority for assistance to investigate into an alleged breach of a legal or regulatory requirement, offer assistance to the foreign supervisory authority by carrying out investigations of the alleged breach of the legal or regulatory requirement or provide such other assistance to the foreign supervisory authority as the Securities Commission Malaysia sees fit.

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