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Examining the rules of finance

SMU law professor Christopher Chen studies a wide range of regulatory issues in banks, insurers and capital markets

If you bought a structured product from a bank and regretted it after losing money, good luck trying to blame the bank.

In a study of over 300 lawsuits in Taiwan between 2000 and 2013 where retail investors accused banks of mis-selling structured notes, the banks won more than 80 per cent of the time, said Christopher Chen Chao-Hung, Assistant Professor of Law at the Singapore Management University (SMU).

"In the majority of cases, there was no straight fraud. The customers received a document warning them of risks, but they probably did not read it," he said.

"Unless investors are able to show that the bank did not do anything at all, and did not send them any information, they don't have a case."

Dr Chen, who is from Taiwan and has been based in Singapore since 2009, teaches financial regulation, company law and insurance law at SMU's School of Law.

His research on regulations and banks, insurers and capital markets spans a broad range of issues, and includes how the rules governing finance can be tweaked to improve the lives of ordinary people.

In a study of Taiwan lawsuits, for example, he used a big data approach to analyse whether an investor was more likely to win depending on factors like the type of argument used, product sold or level of education.

"I am interested in using technology to see if we can analyse legal risk more precisely. With more quantitative data, ordinary people and businesses can adjust their behaviour according to the legal risk involved," he said.

Given the low expected recovery rate of investors across the board, Dr Chen said banks need to have proper procedures and internal systems in place.

"For example, the person who tells me about the fund should not be the one conducting the suitability assessment. He or she should bring in somebody else to do the assessment," he said.

Dr Chen also feels that it is important for lawmakers to strike a fine balance between educating financial investors to make responsible decisions and overly protecting them. The latter may result in opportunistic investor behaviour, which is not healthy for the financial market.

Last year, banks in Taiwan were penalised by the authorities for selling Chinese yuan derivative products to clients.

"In Taiwan, there are complex structured products similar to accumulators in Singapore which bets the Taiwanese dollar against the renminbi. When the yuan is always on a rise, it's not a problem.

"One day, the People's Bank of China depreciated the yuan, and a lot of people lost money. Some Taiwanese investors claimed that they were not aware of the risks involved and demanded for compensation from the banks. The authorities eventually stepped in and many banks were forced to settle the disputes even though there may not have been any lapse in the first place," he said.

Comparing regulatory regimes

Another part of Dr Chen's research involves examining global standards, and how Asian regulations have evolved in response.

A study in 2012 identified potential legal and policy issues in the regulation of over-the-counter (OTC) derivatives in Singapore and Hong Kong.

For example, regulators who want to

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maintain control might want to force all OTC derivatives to be cleared with a local central clearing house. However, that might cause difficulties for local banks to transact with American banks, which want the trade to be cleared in the US.

A legal solution could involve allowing trades to be cleared abroad, provided the foreign country has a similar regulatory system.

The issues at stake can be extended to banking regulation, such as how to liquidate a problematic bank, Dr Chen said.

"We see different parts of the world progressing at a different pace. We can learn lessons from Asean countries," he said.

"In the long run, my research aims to help regulators and policymakers better understand what they need to do, and the implications of designing a regulatory system."

An issue Asian banks face is how much to invest in compliance systems to monitor suspicious activities, such as money laundering. These might be necessary in order to conduct business with US banks, which might require a certain standard.

From the regulatory point of view, placing the burden of compliance on banks is a good idea as regulators have limited resources, he said.

Corporate governance

Dr Chen's research also involves corporate governance issues, such as related party transactions and the network of company directors.

He is currently in the midst of a study with colleagues from the SMU School of Law and the University of Hong Kong Faculty of Law, which involves sampling several hundred companies in Singapore and Hong Kong.

"We want to see if there is a correlation between better corporate governance, say by having a higher proportion of independent directors, and the likelihood of scandals."

Another study to be published soon sheds light on squeeze-out transactions, where controlling shareholders forcibly buy over minority investors' stakes at unattractive prices.

Existing studies focus on the US and UK, which have dispersed public shareholdings. Dr Chen's new study focuses on Singapore and Hong Kong, which have more concentrated shareholdings.

The research concluded that Hong Kong provides more minority shareholder protection in this area.

Empirical evidence showed how differences in regulation between the two cities have led to a smaller number of squeeze-outs and higher premiums payable to minority shareholders in Hong Kong, as compared to Singapore, according to the study.

However, Hong Kong firms experience higher levels of related party transactions prior to the squeeze-outs, which could be a way for controlling shareholders to tunnel assets out, he said.

Ultimately, Dr Chen's interest in his research areas stems from their relevance to consumers, and the rapidly changing nature of global finance.

"It's a fast-moving and interesting area. Banks are huge. If a bank goes down, it affects millions of people. So it's worthwhile to spend more time on it, even though sometimes the topics can be rather technical," he said.

"But every few years, a new scandal surfaces. There is no shortage of topics for us to research on and learn from."

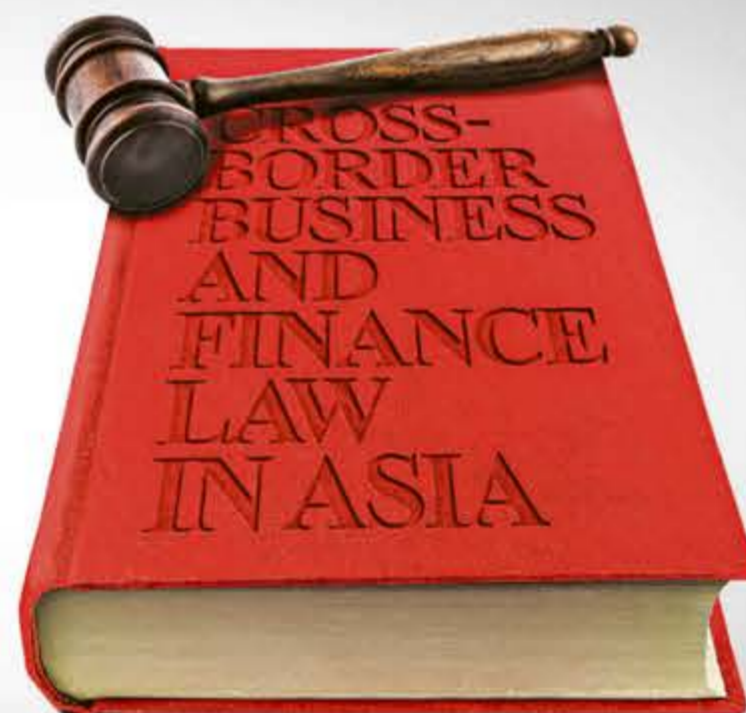
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