

Hong Kong Institute of Chartered Secretaries

“Corporate Governance at the Crossroads”

8 January 2008

by

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Good afternoon ladies and gentlemen.

It is a pleasure to be invited to address you today on the subject of “Corporate Governance at the Crossroads”.

I am going to address you briefly - in order for this to be

public companies. This legislation was prompted by the US corporate scandals which I have already mentioned.

The legislation is wide-ranging and establishes new or enhanced standards for all US company boards, management, and public accounting firms. The Act contains 11 sections ranging from additional corporate board responsibilities to criminal penalties. Supporters of the reforms believe the legislation was necessary and useful, whilst critics believe that it does more economic damage than it prevents.

Among its numerous provisions, SOX provides standards for issues ranging from the creation of a public company accounting oversight board, auditor independence, corporate responsibility, and enhanced financial disclosure.

The notorious section 404, requires that publicly traded companies establish, document and maintain internal controls and procedures for financial reporting. It also requires companies to check the effectiveness of internal controls and procedures for financial reporting. When this requirement was proposed it was thought to be reasonable. It was not at that time understood by the legislators that its implementation which requires the creation of extensive policies and controls within public companies to secure, document, process and verify material information dealing with financial results, would be very costly. It is this which has made the requirement controversial. Indeed, some have asserted that the onerous requirements of and the cost of implementing SOX has helped displace business from New York to London, where the FSA allegedly regulates the financial sector with a lighter touch.

Principles based regulation in the UK

In April 2007, the FSA released a report entitled “Principles Based Regulation – Focussing on the Outcomes that Matter”. The report heralded the FSA’s intention to move towards a more principles-based model of regulation, supplementing their risk-based and evidence-based approach. As explained in the paper, the initiative envisaged a move away from regulator dictated detailed prescriptive rules and supervisory actions on how firms should operate their business. Instead, the intention behind principles based regulation is to give firms the responsibility to decide how best to operate their businesses within the regulatory outcomes which are specified by the FSA. The proposal is to shift the balance of the FSA’s activity towards setting out desirable regulatory outcomes in principles and outcome focussed rules. Notwithstanding, the FSA have acknowledged that they will never entirely get away from detailed rules and that they have an important continuing role in the regime to ensure adequate consumer protection and sufficient consistency between regulated entities. In addition, the FSA is bound to implement the constant flow of EU rules.

It has been argued that the principles versus rules dichotomy is overblown and that both jurisdictions employ both rules and principles, but that the SEC rely more on rules than principles whilst the FSA perhaps rely more on principles than rules. The reason for this is the differences between the markets. The US has the largest retail markets in the world, whilst the UK is more dominated by institutional and controlling shareholders. Large institutions are better able to cope with more general principles than less sophisticated individual investors.

It is certainly true that a regulatory system has to be designed and tailor made to fit the particular needs of the environmen

Similarly, Asia companies seem to face greater difficulties than companies in the west in finding INEDs. It can be hard to find truly independent or appropriately qualified people to take on these roles.

Notwithstanding these differences in business culture, it is the role of the SFC, and the Exchange, given the shared regulatory role in Hong Kong, to maintain a regulatory framework with international standards and integrity. Although as regulators in Asia we tend to look to Western jurisdictions (UK, US) and experience in applying corporate governance practices, it is not always the case that what is good for, or works in the West is appropriate here. We need to take into account the local market conditions and culture.

We believe that in order to achieve this and to protect investors whilst at the same time attracting market players and innovation in terms of new products, there must be a balanced regime. That is a balance between principle based regulation in which the firms have the freedom to work out their own way of complying with the requirements, and a set of rules to ensure uniformity and conformity. In that sense we are taking the middle road.

Corporate Governance is not just a matter of compliance with a set of rules, it is also a philosophy which we hope and anticipate that market participants will want to adhere to, recognising that good corporate governance means good returns for investors. We believe that investors want the reassurance that they are investing in a company which has integrity and is compliant.

Since the corporate scandals of the 1980's investors now are much more aware of the importance of corporate governance. In relation to the companies involved in the corporate scandals, the principles of responsibility to shareholders as a whole were clearly ignored.

There has been some academic writing about the correlation between good governance and good returns. Let me share a story from Korea. The Korean ~~share~~ a story 481 Tc0.1326conditions and c6 0 Te911s o15.cently5 TD75 12.nh mporta

up-holding and supporting universal human rights
ensuring good supply chain labour standards
countering bribery

To reflect the growing importance of climate change eligibility for inclusion in the FTSE4Good Series is to be expanded to include climate change.

The FTSE4Good Series has rarely been out of the headlines in the UK. Many listed companies include the green globe logo in their annual reports and other corporate documents.

However, one commentator reported that a six-month study of Hong Kong companies had found only a basic level of awareness of corporate social responsibility, with most firms only interested in the concept if it would help their commercial interests. This was explained on the basis that the shareholders firstly want returns, secondly want the safety of their nest egg and that social responsibility comes a distant third. True up to a point – but CSR is central to commercial interests.

Talent

Another issue that Hong Kong corporates need to be alert to is that students today are more aware of clean & green issues and social responsibility. They are taught about it in their schools and moral and social issues are high on their agendas. When looking for an employer, these students are looking for companies with a good track record in corporate responsibility, and if the track record includes clean & green issues, they are more likely to consider them. This is a trend that corporates need to be aware of and respond to. The FTSE4Good Series is a good example of a framework that can help companies to improve their CSR performance and attract talent.

Hong Kong but it is for all of us, in whatever role we play in relation to Hong Kong corporates, to help direct them into a socially responsible way of conducting their business, recognising that a clean & green approach means not only a healthy living environment for us all to enjoy but also better returns all round at the end of the day.

We feel that Hong Kong is going in the right direction, but we have to constantly keep that under review and ensure that we are on the right path.

Crossroads – would you start from here – seems reasonable but the road is still a long one.