Good afternoon,
Distinguished Guests,
Ladies and Gentlemen,

I am honoured to be invited to speak this afternoon in the presence of the distinguished author of the seminal work on moral capital, Dr. Alejo Jose G. Sison.

The subject of moral capital is an important one, particularly since markets are all about the trading of capital, in which trust and integrity is affirmed or not-affirmed in every transaction. From the day we are born, we are told that we need to have a moral compass in life, and through this, we accumulate moral capital, without which leadership cannot be exercised.

Reading Professor Sison’s book made me realize how difficult moral capital is to define as a concept, let alone put into practice. It is something that all of us instantly recognize as significant, but in trying to pin it down, we become like blind men describing an elephant by touching and feeling it. Our perspective depends on where we stand, and as a market regulator, I have been asked to give my personal perspective.

Consequently, I must make the usual caveat that all opinions and views expressed here are totally personal and not necessarily those of the SFC or IOSCO.

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1 I am grateful to my colleague Joe Kenny for research assistance in the preparation of this paper. All errors and opinion are mine alone.
First of all, we are all grateful for Professor Sison for taking the understanding of markets that daily trade capital or property rights one level higher. He has moved from the mundane level of laws and regulations that define property rights into the realm of philosophy that seeks to define morality or value. In the heady bull market days of the Roaring Nineties, many traders behaved like the cynics so memorably described by Oscar Wilde: people who know the price of everything but the value of nothing.

Professor Sison defines moral capital as “excellence of character, or the possession and practice of a host of virtues appropriate for a human being within a particular sociocultural context”\(^2\). He says that moral capital is what makes a person good as a human being.

Indeed, using an accountant’s or economist’s toolbox to analyse this definition, one would arrive at the concept that moral capital is a stock of values, which can be added to or subtracted from by the flow of actions. Positive action that enhances trust, integrity and goodwill would increase moral capital, whilst misconduct, cheating and doing harm to others (i.e. damaging the public interest) would reduce moral capital. Indeed, Sison says, “Moral capital builds up through one’s actions, habits, character and lifestyle.” There is an old Chinese saying that echoes this: 听其言，观其行。 (Listen not just to one’s words, but observe one’s actions)

I suppose that if we could assign an economic value to moral capital, then it would be fair to say that individuals, companies or even regulators accumulate moral capital through their adherence to high ethical standards and through their observable actions. Investors and revenue drift to those market participants (producers and intermediaries) whose moral capital is reflected in their high standards of corporate governance or reputation for professionalism and excellence. Similarly, the globalized financial market gravitates to domestic markets that are observed to be well regulated.

During the heady period of the bubble economy, some were willing to trade-off or negate their moral capital, their brand name of high repute, for short-term gains; even illegal or immoral gains. Because high profile corporate scandals have routinely involved a gross abuse of the public trust, the public demanded that regulators take action. As securities regulators, we are conduct regulators; ensuring that market participants obey the law and all the moral and ethical values that are embedded in the law. We are charged with investigating, prosecuting and disciplining market participants. Hence, our capacity and ability to exercise moral leadership to change the conduct of others depends on leading by example: we must practice what we preach.

As Professor Sison maintains, moral capital in the world of business, finance and economics is beyond the merely desirable; it is the very foundation of our legitimacy.

For me, our credibility depends upon on our transparency and accountability, which in turn depends upon the effectiveness by which we are able to deliver on the statutory objectives that the law imposes upon us.

The senior management of a for-profit company is principally accountable to its shareholders, for whom it must maximize value. As a corporate citizen, it must also serve the interests of its other stakeholders – including its consumers, creditors and those affected by its operations. Its charter is the memorandum and articles of association of the company.

On the other hand, a regulatory authority is typically tasked by the legislature with fulfilling a role in the public interest; its charter is in its governing legislation. In the case of the Securities and Futures Commission it is the Securities and Futures Ordinance, a law that was nearly ten years in the making. Our moral capital is founded on the integrity and expertise with which the Commission and its staff conduct our daily business in service of the public interest. We all know that because Hong Kong is an international financial centre, our moral capital affects not only Hong Kong, but also how it is regarded by the global community of investors.

Hence, ultimately, the securities regulator’s job is all about enforcement of the legal and conduct requirements imposed on market participants. The fairer, the more transparent and more effective the enforcement, the higher the moral capital. The Hong Kong Securities and Futures Commission is already subject to a comprehensive array of checks and balances designed to maintain the highest standards in the way the Commission enforces the law. These include an independent Securities and Futures Appeal Tribunal, an independent Process Review Panel, the Ombudsman, judicial review as well as ICAC review.

As an active member of the International Organization of Securities Commissions (IOSCO), the Commission recognizes that exercising its powers and discharging its functions demands its adherence to international standards. We are fortunate that we share common ideals and standards with our fellow regulators around the world, and I am honoured to be the current Chair of the Technical Committee.

Finding and maintaining the integrity and transparency of the regulatory decision-making process is a key challenge for all regulators. If a regulator is perceived to be biased in favour of one interest group or another, then the market will feel that there is no level playing field and have no incentive to play according to market rules. Hence, there is the
need for regulators to be impartial, to avoid conflicts of interest – both real and perceived - and to be fully accountable and responsible for their regulatory decisions. In a Common Law system, every regulatory decision is potentially a precedent-setter, and bad precedents sow bad seeds. Therefore, the transparency of the regulatory decision-making process, in which every person who is the subject of a decision is accorded due process in full measure and in which each decision may be subject to review or appeal, is fundamental to the building up and protection of our moral capital. The accountability that comes with such transparency also sustains our legitimacy and credibility.

Striking the right balance in making regulatory decisions or setting conduct requirements is complicated by their impact on the interests of market participants. Favouring the intermediary or the issuer could be to the detriment of the investor. Protecting the investor too much could impede market development and engender moral hazard. Taking no regulatory decision, or failing to take timely regulatory action, merely because the decision is too difficult or tough is itself a risk to the regulator's moral capital.

Hence, in the volatile and uncertain global markets of today, regulation has become a professional’s craft, which requires professional judgement based on international and domestic experience. I am not saying that an amateur cannot be a good regulator. All I am saying is that the amateur more often than not is likely to pay for his learning costs and these are costs that investors and market participants alike can ill afford to pay.

To illustrate what I mean, let me use the example of the Dutch coach of the South Korean football team in the last World Cup. The Korean leadership had the moral courage to pick a foreigner to run their team, against the strong nationalist sentiment. I believe it did so for two fundamental reasons. First and foremost, the Dutch coach was a globally acknowledged professional, at a level that the Koreans lacked. More importantly, the Dutch coach, being outside the system, did not have the conflicts of interests that a Korean coach would have had; he was free from the vested influences that might cloud his judgement in picking the best players for the Korean team.

To continue the footballing analogy, securities regulators are the referee in the serious game of market regulation. They are the gatekeepers of the industry who keep the ill-equipped players from entering the field and they run all over the pitch upholding the rules of the game. What regulators do, whether showing the red card to a player who commits a foul, or allowing extra time for injury, does not make them popular. But they have to be scrupulously objective in what they do, to ensure that the game is not only fair, but seen to be fair. And when it is fair, it is also fun to watch.
Hence, part of the moral capital of a regulator is the courage to take tough decisions and to have the moral strength to do what it passionately feels is right, without fear or favour. It is about the moral courage to say things that no one likes to hear when that is in the public interest and to listen carefully to both sides of the argument, whilst being transparent about what one does and why.

Because many regulatory cases have their unique elements, the regulator not infrequently finds itself in uncharted waters. Too often, it is in uncharted waters where decisions with the potential for the widest impact need to be made and made swiftly. That is one reason why you have heard me advocating that changes to the governance structure of the SFC should leave the ship with one captain. Another reason is that regulation is a team effort but the skipper’s reading of the moral compass must set the regulator’s course where his shipmates cannot agree on the direction in which the compass is pointing.

The question is: what, in such circumstances, is the regulators moral compass? How does the regulator strike the right balance between over-regulation and under-regulation; between over-prescription and under-prescription? How can one facilitate business and innovation without unduly imperilling the interests of investors? What is the regulator’s gyroscope that helps maintain its balance?

To my mind, the answer is more than acting within the parameters of our legal authority and beyond striving faithfully to fulfil our regulatory objectives; though it surely includes these. The answer also includes espousing the “Nolan Principles”\(^3\) of Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty and Leadership. Though about a decade old, I find that the Nolan Principles are today more relevant than ever as the core values for persons who choose to work in the public sector.

The regulator’s moral compass has to factor in an important practical consideration: “regulatory benefits versus costs”. The cost of regulation comprises not just the direct costs of regulation, but also the costs of compliance incurred by intermediaries and the cost of unintended consequences of regulation that retard innovation and competition.

In calculating the balance between benefits and costs, there are elements of risk and uncertainty that cannot be measured with precision. Now add to the equation the constraint of resources. No regulator has unlimited resources, which must be allocated to deal with multiple objectives. The result is that the moral compass must require the regulator to be both value-bound in terms of ethics and resource-bound in terms of practice.

\(^3\) The UK Nolan Committee’s First Report on Standards in Public Life, 1995.
This explains the risk-focused approach of modern regulators who, in the interest of the greater good, target their limited resources at areas that create the greatest risks to the attainment of their regulatory objectives.

But we must also recognize that we are all human. Ultimately, out of sheer necessity, regulatory decisions must often be taken on the strength of the judgment and expertise of qualified staff. Though we may not always get it right, I am sure that with all the transparent checks and balances that we are subject to, the test of our accountability will be judged by the market and by history.

Let me conclude by saying that I commend this effort by the East Asia Education Association to educate the community on the meaning of moral capital and leadership. The market, like all social institutions, is about the interaction between people, whether acting individually or through enterprises, intermediaries or institutions, in public or private. The common thread of social interaction is trust, without which there can only be conflict, strife and social instability.

Trust is a contractual relationship between people, family, followers and leaders and between market participants, not least between regulators and the market place. Business leaders would not be leaders if they did not invest in building their moral capital. Similarly, regulators, being human and part of the social fabric, could not function without the trust of the community from which they spring.

At the heart of human relationships must be the need for greater communication and action that reinforces trust and humanity. I want to thank Professor Sison for articulating a useful model for all of us to reflect on how to do our work better and to foster greater moral capital in the society that we live in.

Thank you.

Andrew Sheng
Hong Kong
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