I am extremely honoured to be invited to deliver the third of the Vocational Training Council’s 20th Anniversary Distinguished Lecture Series. Following a distinguished scientist and new Chancellor of HKU, as well as the Chief Executive Officer of the Hong Kong Science and Technology Parks, is no easy feat.

I want to start this lecture with the usual caveat as a securities regulator. The views expressed in this lecture are totally personal. I have consulted some of my colleagues in the preparation of this lecture, but I want to stress that these views are not necessarily those of the Commission, including non-executive directors. I want to put these views out for airing, since I believe that we have reached an important crossroad in our objective of promoting investor protection in Hong Kong.

As you are all aware, post-Enron and WorldCom, corporate failure and the failure of corporate governance has become a household topic. In the last year, the total market cap loss for Enron and WorldCom was US$80 billion (HK$624 billion), roughly equivalent to the drop in the whole Hong Kong market capitalization during the same period.

I propose to divide this lecture into three parts:

- An overview of what went wrong and what the major markets are doing to fix it;
- The role of the SFC in tackling corporate misconduct.

Post-Enron change in regulations

The importance of good corporate governance came sharply into focus after the Asian crisis, and attention to this became universal after the tech bubble of 2000, when both US and European regulators realized that the bubble may have been partly fuelled by bad accounting and corporate misconduct. In other words, after the party (or when the tide goes out), the hangovers (or rocks) begin to appear.

The stories of Enron, WorldCom and others are still unwinding. Reasons for their failure are still being debated, but it would appear to be, as one senior US regulator told me, the “perfect storm” of corporate governance failure in the United States. Corporate governance has failed because the various checks and balances within the system have been weakened by the conflicts of interest that exist at different levels. Because the United States is the largest and deepest of securities markets, with the most sophisticated regulatory structure, it is worth spending some time to explain the differences between the US system and the Hong Kong system (which is broadly based on the UK and Australian common law framework).
Corporate governance is steeped in each jurisdiction’s financial, legal and market history. The US securities framework stems from the 1929 Wall Street crash, which led to the 1933 and 1934 securities legislation that founded the SEC. It is premised on statutory disclosure, with companies seeking public funding being required to file statutory information with the SEC, now under the famous EDGAR system. This rules-based system is based on “caveat emptor”, or buyer beware, with a set of rules that specify the disclosure that issuers must make to investors and the public, and which is presumptively material.

In the US, there are in fact four important lines of defence against corporate misconduct.

The first line of defence against corporate misconduct is clearly the management or Board of Directors itself, including the independent non-executive directors, who should represent the public interest. The US Senate report on the role of the Board of Directors in Enron’s Collapse clearly stated that there was fiduciary failure -

“The Enron Board of Directors failed to safeguard Enron shareholders and contributed to the collapse of the seventh largest public company in the United States, by allowing Enron to engage in high risk accounting, inappropriate conflict of interest transactions, extensive undisclosed off-the-books activities, and excessive executive compensation”.

The question whether underpaid non-executive directors can stop important corporate misconduct is still being debated in many jurisdictions.

The second line of defence lies with the corporate advisers, such as auditors, lawyers, professional valuers, sponsors, investment bankers, bankers and rating agencies who should provide independent and professional advice on corporate performance, including compliance with the relevant codes of conduct, rules and laws. As the recent cases show, when these professional advisers draw substantial fees from their clients, the question of independence of opinion has sometimes been called into question. This is where the regulatory oversight of such professionals comes in. For example, in the US and some parts of Europe, the auditing profession comes under public oversight, whereas in UK, other parts of Europe and Hong Kong, the profession is by and large still self-regulatory.

The third line of defence is the regulatory framework for listed companies. In the United States, the exchanges such as NYSE and Nasdaq assess eligibility according to their rules and quantitative criteria, but all the issuers must file statutory information with the SEC. The US has a huge range of sanctions, ranging from fines to jail sentences, on the provision of false or misleading information. Generally, willful violation of securities regulations is a criminal offence. In addition, the US exchanges closely monitor companies listed on their exchanges and frequently delist companies that do not perform. For example, Nasdaq delisted 770 companies last year, of which 390 were delisted for non-compliance with listing requirements, nearly 2.7 times more than the 145 companies that were newly listed. In addition, the US state and federal prosecutors’ offices can take severe action against corporate stealing, cheating or fraud.

Finally, the three lines of defence are buttressed by the class action-contingency fee system, whereby shareholders can jointly undertake direct legal action against management or majority shareholders where they feel that they have been disadvantaged. Such a powerful weapon in the hands of minority shareholders ensures that directors, controlling shareholders and their advisers are more careful to act without provoking costly class action suits.

I want to point out that such class action-contingency fee system is not available in the UK, Australian and Hong Kong legal systems, because of a different legal tradition and the view that it would encourage a litigious society.

Nevertheless, even under such powerful checks and balances the cases of Enron and WorldCom have slipped through. To be fair, the US authorities have quickly enacted the Sarbanes-Oxley Act on 30 July, 2002, which seeks to strengthen corporate governance and auditing oversight by:

- Creating an independent Public Company Accounting Oversight Board to enforce professional standards, ethics and competence for the accounting profession;
- Strengthening the independence of firms that audit public companies by having the SEC prohibit the provision of consulting services to audit clients, when these services create conflicts of interest;
- Requiring CEOs and CFOs to personally vouch for the veracity of their financial statements and providing much stiffer penalties for fraud;
- Strengthening disclosure requirements for public companies, notably in the areas of off-balance sheet transactions and insider trading;
- Protecting the independence and objectivity of securities analysts by directing the SEC to review rules ensuring their independence;
- Directing the SEC to undertake comprehensive reviews of corporate governance, the separation of audit and non-audit work, and the role of rating agencies; and
- Increasing the resources available to the SEC.

I have spent some time on the US system because market analysts who are familiar with the US system often wonder why we cannot adopt US-type legislation and rules into the Hong Kong system. This is founded on a popular misconception. As I hope to show later, each system is very different, and we need to understand how best to protect shareholder rights within our own legal and regulatory framework.

In Europe, the European Commission has issued a series of major reform directives aimed at harmonizing and strengthening the securities markets in Europe. These include the development of the Prospectus Directive, the Transparency Obligations Directive, the Investment Services Directive, the Market Abuse Directive and the amendment of the Admissions to Listing Directive.

The United Kingdom has also been upgrading its company law and securities regulatory framework:

- In May 2000, the function of the Competent Authority for Listing was transferred from the London Stock Exchange (which had held this role since 1984) to the Financial Services Authority (FSA). The Competent Authority for Listing is responsible for making the Listing Rules, which lay down the requirements that issuers of securities to the UK primary markets need to
meet, and for policing compliance with these Rules. It is also responsible for admitting securities to the UK's Official List;

- On 16 July 2002, following the final report of the Steering Group of the Company Law Review, the UK Government issued a White Paper indicating that the companies law would be simplified and modernized for all companies; and
- On 30 July 2002, the FSA issued a consultation paper on the review of the listing regime.

In Australia, the Corporate Law Economic Reform Program Act was passed in October 1999 and came into force on 13 March 2000. Amongst the major reforms were:

- The introduction of a statutory derivative action against corporate wrongdoing, which modified the common law action and circumstances under which shareholders can enforce their rights;
- The clarification of directors' duties of care and diligence; and
- The establishment of new institutional arrangements for the Australian accounting standard setting process.

In the Mainland, the China Securities Regulatory Commission has also made impressive strides in corporate governance measures for listed companies, such as:

- Rules requiring the appointment of independent non-executive directors;
- Quarterly reporting;
- Delisting of poorly performing companies; and
- Strengthening enforcement by closer cooperation with the police.

All these go to show that major markets, including the Mainland market, are actively reforming their corporate governance and their securities market regulatory structure.

**Corporate governance & protection of investor rights in Hong Kong**

Hong Kong has not been idle in pushing for reforms in corporate governance. As the Financial Secretary said in the 2001-02 Budget Speech, our primary objective is “to establish Hong Kong as a paragon of corporate governance, ensuring that those investing in Hong Kong are afforded the best protection and that our listed companies are managed with excellence”.

The major initiatives include the following:

- A major consultation paper by HKEx on changes to the Listing Rules relating to corporate governance, which covers protection of shareholders' rights, directors and board practices, and corporate reporting and disclosure of information. The consultation was completed in May, and the results of that consultation are awaited;
- A comprehensive review of corporate governance by the Standing Committee on Company Law Reform (SCCLR) began in 2000. A Consultation paper on specific proposals relating to directors' duties, shareholders rights and corporate reporting enhancements was issued in July 2001. The SCCLR has received widespread support from the community on many subjects, which are very close to measures being adopted in the major markets. The Administration is looking at how best to take forward these recommendations;

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SCCLR is now forging ahead with the second phase of the review to examine the role and functions of Audit Committees, developing financial reporting standards for different companies, and the efficiency of our present corporate reporting regime. This work is expected to be completed by the end of 2002;

The Securities and Futures Ordinance (SFO) was passed in March and is expected to be in force in early 2003. It will enhance the transparency of listed companies, establish a Market Misconduct Tribunal, and augment the SFC’s investigatory power, as well as providing investors with a private cause of action for false or misleading public communications;

The consultation paper on May 6, 2002 on subsidiary legislation to be made under amendments to the regulations under the SFO was issued to empower the SFC under the SFO to become the statutory regulator of listed company disclosure. This moves Hong Kong closer to the US SEC model, where the exchange (e.g. Nasdaq or NYSE) handles the listing, but the statutory regulator can enforce if listed companies disclose information that is false or misleading; and

On the international front, the SFC has co-chaired with the Italian securities regulator, CONSOB, a Task Force on Transparency and Disclosure to develop a set of International Ongoing Disclosure Standards. If these are adopted by IOSCO, we could readily apply them for Hong Kong.

While these initiatives are being pushed forward, Hong Kong has also begun to witness its fair share of corporate incidents. Recently, there has been a spate of minority shareholder activism, which called for regulators to intervene in corporate transactions. Minority shareholder activism in Hong Kong is a very healthy sign, and there is a very good reason why there are currently more investor complaints. Suspicious transactions are less obvious during a bull market, because all investors hope that asset prices would rise. However, during a bear market, minority investors are concerned that majority shareholders may enter into transactions that may dilute their interests or that are prejudicial to their rights.

There is a need to regulate listed companies because entities that raise funds from the public have a duty to the public to be honest and fair in their dealings. Hence, listed companies are normally regulated through entry requirements [under the Listing Rules], their conduct in transactions [under the Takeovers & Mergers Code and Listing Rules] and the enforcement of applicable legislation, such as the Companies Ordinance and the SFO.

As you can see from Figure 1, the rules covering corporate behaviour comprise both codes and rules, such as the non-statutory Listing Rules for listed companies, as well as legislation, such as the Companies Ordinance. There is, for example, a Code of Conduct governing the behaviour of corporate finance advisers. The main difference between codes and legislation is that sanctions for breach of the former do not have statutory backing, whereas the latter can include statutory sanctions, ranging from civil damages to jail sentences.

Under the current regulatory regime in Hong Kong, we have one regulator in charge of the entry requirements for listed companies [Stock Exchange], and many more with oversight over the conduct of their business [such as the Stock Exchange under
Listing Rules, the SFC under the Takeovers Code, and in insider dealing and market manipulation, ICAC in corruption and CCB in fraud and theft]. The Financial Secretary can appoint special inspectors under Section 143 of the Companies Ordinance. The exit of companies from the Exchange depends upon the Listing Rules and also on the liquidation process.

Since corporate misconduct cuts across many areas and the jurisdiction of several regulators, the core issue is whether there should be a single lead corporate regulator or co-ordinating body that ensures a consistent, coherent and firm response to corporate misconduct in Hong Kong.

Corporate misconduct can be divided into different levels of seriousness, ranging from incompetence, and unfair transactions to outright stealing. I would like to make three relevant points: -

• First, most listed companies in Hong Kong obey the law. Indeed, as the recent Standard & Poor's review of Hong Kong Corporate Governance says, “compared with other Asian countries, Hong Kong is a leader in the corporate governance domain.” We do have some of the best run companies in Asia;

• Second, the fundamental principle of full and fair disclosure is that the listed entity should provide all information that would be material or relevant to an investor’s investment decision as to its financial condition and future prospects. This is where enforcement against false and misleading information comes in;

• Third, the regulators’ involvement in transactions of companies after they are listed come in two areas - a “middle ground” of transactions where the regulators are often involved in ensuring that their own rules are complied with before the transaction happens. Then there are the “after-the-transaction” enforcement actions, which require investigation and prosecution of wrongdoing. These involve our Enforcement Division, the Police and sometimes the ICAC.

I shall concentrate in this section on the “middle ground” of corporate transactions, which are largely the preserve of the Exchange and the SFC. In the next section, I shall elaborate on our enforcement functions.

Under the 1991 Memorandum of Understanding between the SFC and Stock Exchange of Hong Kong, the Stock Exchange (now part of HKEx) is the frontline regulator of listed companies. This is because the Stock Exchange administers the Listing Rules, which governs the entry of listed companies, a large part of the conduct of listed companies and their exit or delisting.

The Stock Exchange basically operated a merit-based regulatory system in vetting the entry of listed companies for the Main Board. A disclosure-based regulatory system was adopted for the Growth Enterprise Market (GEM) when it was established in 1999. After demutualization and listing of the exchange in 2000, the perception of the nature of its regulatory role began to change.

• Firstly, a for-profit exchange could not be given statutory enforcement powers. Its relationship with other listed companies is contractual in nature.

• Secondly, the market perceives, rightly or wrongly, that a for-profit exchange has a commercial incentive to encourage listings, but

tackling corporate misconduct involves cost and risk, and often no commercial gain. Tough enforcement cases can lead to lawsuits that hurt corporate value.

- Third, there is a widely held view that a listed company should not regulate other listed companies.

As I explained earlier in describing the US regulatory system, the first and second lines of defence against corporate misgovernance lie in the integrity and conduct of the management of the company, the Board committees, and their auditors, legal advisers, sponsors and investment bankers. The bulk of these corporate governance attributes, therefore, fall to be regulated within the purview of the Listing Rules, which carry no statutory sanctions, unlike in the US or UK where the SEC or FSA can impose civil fines. Others are regulated by self-regulatory organisations.

Thus, in the middle ground of day-to-day corporate transactions, the third line of defence depends on the role of the regulators in overseeing such transactions. This middle ground is currently covered by two sets of codes, the Listing Rules, administered by the Exchange, and the Takeovers Code, administered by the SFC.

Listed companies in Hong Kong engage in thousands of commercial transactions every day. The bulk of these transactions do not involve regulators because, as I said, Hong Kong has overall a good corporate governance framework.

There are, however, transactions that can be disputed by shareholders, creditors and other corporate stakeholders that should fall under the purview of the courts, which is the fourth line of defence. Under our common law system, it is only the courts that are, quite properly, entrusted with deciding whether a transaction is legitimate. However, litigation is expensive in Hong Kong, and there is no class action/contingency fee system, so it is not surprising that shareholders call for the regulators to intervene in disputed transactions.

When these transactions fall under the Listing Rules or the Takeovers Code, the responsible regulator does the due diligence on compliance, which would involve considering whether the applicant or their advisers had done their work properly, whether there is full and fair disclosure, and in specific cases, requiring voting by independent shareholders. Such due diligence may include requirements for greater disclosure, requests for clarification and independent valuations.

At the controversial end of the spectrum of transactions are those that appear unfair but comply with the non-statutory rules. These should lead to rule changes, which would then go through the appropriate market consultation and due process.

The issue really boils down to whether corporate behaviour can be effectively regulated through non-statutory rules or codes, where private/public reprimands or censures are seen at best as slaps on the wrist. Codes of conduct can work where breaches can be disciplined as conditions of exit, such as the threat of withdrawal of licences, or where those who do not comply can effectively be excluded from the market, as in the Takeovers Code. But in the case of listed companies, delisting has so far not been used as a disciplinary tool.

The Commission has identified this gap in the enforcement of corporate disclosure, particularly with respect to the disclosure-based regulatory framework for the GEM. In order to strengthen the sanctions on disclosure, we consulted the market
in May on “dual filing”, which would make the Commission the statutory regulator of listed company disclosure.

We are pleased that the results of the consultation exercise supported the suggested rule changes, and the Government has approved this move. Consequently, under the SFO subsidiary legislation, which should be effective at the beginning of next year, all information to be filed with HKEx will be required to be dual filed with the SFC too.

For example, if disclosure is materially false or misleading, the SFC can exercise its Section 182-3 SFO investigatory powers to investigate. It also has a range of enforcement options, such as:

- Suspending trading in listed securities;
- Applying for court orders to remedy oppression, inadequate disclosure, unfair prejudice or crime or misconduct in a listed company;
- Injunctions to restrain breaches of the SFO;
- Recommending to the FS civil actions before the Market Misconduct Tribunal for disclosing false or misleading information about securities;
- Criminal prosecution for disclosing false or misleading information about securities;
- Winding up applications; and
- Disciplinary action (including fines up to $10 million, reprimands, revocation and suspension of licences) against a listed company’s SFC licensed corporate finance advisers.

The problem is that, despite reforms like these, we currently have a middle ground that has a front-line regulator looking after entry and exit, the corporate governance structure and transactions under the Listing Rules. The SFC is directly responsible for the Takeovers Code and is also tasked to monitor and supervise that front-line regulator.

This is where the current dual or split regulator roles lack clarity and add complexity and costs to the whole process. The need to coordinate regulatory roles leads to delays in regulatory response, because no one regulator has the total picture of what the perpetrator is up to.

Indeed, as some recent cases have shown, regulatory arbitrage can occur since if one transaction fails the regulatory test under one set of regulations, such as the Takeovers Code, the company may try a modified transaction with a similar motive under the Listing Rules, much to the frustration of minority shareholders.

In sum, the present Hong Kong model is very different from the “US model” of regulation and minority protection, where the US legal system enables aggrieved shareholders to sue on bad disclosure and other grounds through class action/contingency fee arrangements. There are also many other differences, in SEC powers and remit, institutional investor pressure, and quick delisting action by the Exchanges.

The UK is closer to Hong Kong so far as minority shareholder suits are concerned. Legal action is also costly to pursue there. But there the Listing Rules are administered by the FSA as statutory regulator and it has the ability to impose fines for breach of the rules. Stern administrative sanctions enforced by a strong independent agency covering the full range of core listed company regulation is a credible deterrent - it is quick, efficient, generates public confidence and is checked by administrative appeals and the possibility of judicial review.
It is vital in Hong Kong that this “middle ground” of regulation, currently administered by the Exchange and the Commission, is able to function at its full potential. It is the main bulwark against corporate misconduct when, in practice, legal remedies are hard to pursue. If the middle-ground regulators are weakened, there are no other compensating mechanisms and the result is that the whole area of investor protection cannot operate at its full potential.

In other words, two major policy issues need to be addressed. First, whether we should move to a statutory regime to improve corporate governance to protect shareholders' rights; and second, whether the present “middle ground” regulatory structure and processes should be simplified so as to avoid duplication and delays in regulatory response to corporate misconduct.

These are important questions that only wide public consultation and the government and legislature can answer. All I can do is to point out that there is ample international experience and debate on these issues that we can draw upon.

My colleagues and I do understand that there are complexities involved in making such policy choices, nor do we underestimate the resources and expertise that are needed to undertake this task. I personally, therefore, welcome the announcement by the Financial Secretary that the Government is considering appointing an expert group to look at these complex issues.

The Role of SFC in combating corporate misconduct

Finally, allow me now to describe how the SFC is combating corporate misconduct in the enforcement area. As explained earlier, there is no single corporate regulator in Hong Kong. The Stock Exchange is the front-line regulator of listed companies, and administers the Listing Rules. It is the gatekeeper in allowing companies to be listed. The SFC shares the regulation of conduct of the listed company sector in the policing of insider dealing, statutory disclosure of interests in securities (SDIO), and inspecting the books and records of listed companies if impropriety is suspected. The SFC also administers the Code on Takeovers and Mergers. In areas such as corruption, fraud and theft, and cases outside the jurisdiction of Hong Kong, the SFC cooperates with other regulators, such as the Stock Exchange, the CCB and ICAC, as well as overseas regulators to investigate and pursue enquiries.

As a statutory regulator safeguarding the rule of law in the securities field, the SFC must also act within its powers under the law. It is important to understand that we cannot normally intervene in commercial transactions. This is for the Board of Directors, the legal and financial advisers, accountants, and professional valuers and in specific cases, for voting by shareholders, to determine.

Three significant factors unique to the Hong Kong market govern our approach to combating corporate misconduct: -

- Nearly three quarters of the companies listed in Hong Kong are incorporated outside Hong Kong;
- Many of the listed companies in Hong Kong also have operations outside Hong Kong; and
- We therefore must cooperate closely with Hong Kong and overseas regulators to investigate companies listed in Hong Kong.

Some of you may wonder why we have stayed silent on a number of high profile cases. The reason is
that section 59 of the SFC Ordinance imposes an obligation of secrecy on SFC personnel in conducting investigations.

There are good reasons for this. First, any announcement of investigation can lead to a sharp drop in the share price of the company being investigated, causing potential losses to the shareholders. Second, any information leakage may tip off those under investigation, leading to the destruction of evidence or abscondment. Third, such leaks may prejudice subsequent criminal trials.

The same restrictions apply under section 378 of the new SFO. Whilst we cannot comment on live cases or investigations, I can say categorically that we are currently investigating a number of cases that have received high media profile in recent months.

Mr. Alan Linning, our Executive Director of Enforcement, has already in his press briefing on 24 June stated that the top priority in 2002-2003 will be corporate governance investigations. A few simple statistics should suffice: -

• We have already initiated 4 section 29A investigations and 3 section 33 investigations into listed companies since March this year alone;

• We have 19 active cases that we are discussing with the CCB, including 7 cases that involve listed companies;

• We have one of the best records in insider dealing prosecutions outside the United States. Last year, we had 3 major successes, disgorging $22.8 million in profits and $23.2 million in penalties (involving shares in Tysan Holdings, Indesen Industries and China Apollo). 4 more cases are under investigation and 8 are awaiting referral to the Insider Dealing Tribunal;

• In the area of market manipulation activities, we had 4 people convicted in 3 cases last year (Good Fellow Group, Perfectech International and The Hong Kong Parkview Group). The courts are getting tougher - 2 jailed, 1 given suspended a sentence and community service, 1 fined;

• In the first quarter of 2002, 4 persons were convicted in 2 cases (Grand Field Group and Gay Giano International Group), with full cooperation with the CCB. The CCB has charged 2 more persons in the Gay Giano case;

• In the disclosure of interests prosecutions, which require increased transparency regarding insiders' share dealings, 14 persons and 8 companies were successfully prosecuted and fined in the year to March 2002, with 72 warning letters issued. In the first quarter of this year, 4 persons and 2 companies have been prosecuted under SDIO, and 16 warning letters were issued; and

• In the last 12 months, we imposed 2 “cold shoulders” under the Takeovers Code, with 4 active investigations involving serious breaches of the Code, including 4 section 33 investigations.

In the matter of derivative actions, I wish to state that the Government has taken the advice of the SCCLR and asked the Commission to look into the possibility of developing a statutory derivative action. As the SCCLR Consultation document pointed out, the common law derivative actions for shareholders are complicated, but the Commission is actively studying the matter.

As you are all aware, the Commission successfully undertook the first legal suit under section 37A SFCO in the case of Mandarin Resources for unfair prejudice, in which we withdrew our section 45 SFCO winding up application only after the defendant
agreed to buy out the minorities at fair value. This investigation and case took 6 years, but we persevered to successful settlement. I would like to warn all those who engage in corporate misconduct that we will not hesitate to use our powers under the SFO to pursue them to court. My Enforcement colleagues are already actively looking.

The Commission is currently beefing up its enforcement and corporate finance resources to tackle these areas as a matter of priority. It will add 15 staff to this area by the end of the year.

In addition, the Commission has strengthened its cooperation with both the CCB and the CSRC in the investigation of corporate misconduct in Hong Kong and also the activities of Hong Kong listed companies in the Mainland. We will increase our vigilance and we will strive to complete our investigations as fast as we can work together with our regulatory counterparts.

In short, those who break the securities law are now warned. We will pursue them without fear or favour. They will be investigated and prosecuted in accordance with the law.

Ladies and Gentlemen,

The lessons of Enron and WorldCom are quite clear. Those who seek capital from the public have a fiduciary duty to the public - to be truthful, honest and fair. If Hong Kong is to maintain its role as an international financial centre and the leading overseas fund raising centre for Mainland and other regional companies, then we must press ahead with our reforms in the regulatory and infrastructure areas. The opportunities are huge, but so are the pains of adjustment.

In exercising regulatory functions, I am always reminded of the line that Dr Goh Keng Swee, former Deputy Prime Minister of Singapore used in paraphrasing an old Chinese saying, “regulation [governance] is like frying small fish - it must not be overdone.” If we over-regulate, we can stifle the entrepreneurship of the majority of listed companies that are law abiding and seek to raise funds from the public as efficiently and with as low costs as possible. Hong Kong has always prided itself as the freest of markets. On the other hand, if we under-regulate, a small minority that exploit loopholes or deliberately skirt the law can do huge damage to the integrity of our markets. Enron and WorldCom have already demonstrated what can happen in the largest and best regulated of markets.

The regulation of financial markets needs to walk that delicate tightrope between rewarding trust and efficiency, and punishing those who break the law. Each market must find its own right balance. There is no easy solution.

Under the new SFO, which has finally come into being after more than a decade in the making and which has strengthened our ability to do our job, the Commission is committed to defending the integrity of our markets. There are clearly structural issues in the Hong Kong regulatory framework that need to be addressed. Irrespective of these factors, the Commission will work closely with the Stock Exchange and all the other regulators in Hong Kong and abroad to tackle corporate misconduct as a matter of top priority. We all share the same objective to protect the integrity of our markets and the rights of shareholders.

I want to thank the Vocational Training Council once again for giving the opportunity to present these personal views.

Thank you very much.
### Figure 1 - Corporate Governance: Entry, Conduct & Exit

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<th>EXIT</th>
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<td>Takeovers &amp; Mergers Code - Regulation of acquisitions &amp; mergers</td>
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