The Conscience of Our Companies
Hong Kong Institute of Chartered Secretaries
Corporate Governance Conference 2014

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Madam President Edith Shih, distinguished guests, ladies and gentlemen, good morning.

Introduction

First of all, I would like to thank Ms Samantha Suen, Chief Executive of The Hong Kong Institute of Chartered Secretaries (HKICS), for this invitation. I have known Samantha for many years and I have a lot of respect for her drive and determination. So when she asked me to give the keynote speech at your annual conference, I knew she would not take No for an answer!

Let me also take this opportunity to congratulate Edith for being elected recently as the Vice President of your global body, the Institute of Chartered Secretaries and Administrators. It is good to see Hong Kong professionals taking up leadership positions in international bodies. This truly reflects Hong Kong's role as an international financial centre.

As you may know, the HKICS is dedicated to the promotion of its members' role in the formulation and effective implementation of good governance policies.

In 30 years as a practising accountant, followed by two more as chairman of the SFC, corporate governance has always been very close to my heart. I've seen great progress in local corporate governance practices and this is one of the key factors underpinning Hong Kong's success.

Clearly, your organisation has played, and will continue to play, a very important role here. Not least by setting the highest standards of integrity and independence. I greatly appreciate all your members have done to raise the standard of corporate governance in Hong Kong and to make sure your companies are run properly and managed professionally. Well done.

Today's theme

A main theme today is "change". Of course, the role of the company secretary has changed dramatically and in importance over the years. This is clear from the significant growth in the number of companies listed in Hong Kong and the changes in the regulation of these listed companies. The role of the corporate secretary has become ever more demanding and you play a critical role in ensuring the proper functioning of the board of each and every listed company.

I returned to Hong Kong from the UK in 1985 and not long after we had the "Black Monday" in 1987. Some of you may remember that day. As a result of the Ian Hay Davison report in 1988, the three-tier regulatory structure was introduced consisting of the Government, the

Securities and Futures Commission (SFC) and the Stock Exchange. The SFC was established in 1989. And yes, that means that the SFC celebrates our 25th anniversary this year.

In 1989, there were only 290 listed companies on our exchange and now there are over 1,400. Market capitalisation has increased from $600 billion then, to over $25 trillion now.

And we need look no further than this room to see evidence of the changes worked by the hands of time. I'm referring, of course, to many of my old friends who are here today, and by that I don't mean they are getting older with more white hair; rather, I mean the great contributions many of them have made to corporate governance in Hong Kong.

A look back

I would, if I may, take a look back at some of the key events in the recent history of corporate governance. Many of these developments came in response to market failures or corporate misbehaviour. Unfortunately the trend has been that we need a crisis to bring about change. And the market, investors and politicians all seem to have very short memories.

If you recall, the global financial crisis a few years ago triggered a near-collapse of financial systems and the damage is still felt today. One estimate of the lost output in the developed world is over US$3 trillion – that's about the size of the German economy.

And this was just one of many crises over the last two decades. I'm thinking of the Barings collapse, the 1997 Asian financial crisis, and the dotcom crash.

There were many attempts to explain these crises but I believe they all boil down to greed and short-termism. Bank managers focused on short-term returns to shareholders. Compensation structures were skewed all along the mortgage securitisation chain, from the people who originated mortgages to the people on Wall Street who packaged them into securities. Tying compensation to earnings created the temptation to manipulate the numbers.

In the DNA

What we learnt from these crises was the importance of greater accountability and transparency, more ethical business behaviour and stronger corporate governance. As regulators we do not want to wait for the next crisis to find out which corporations are not being properly and professionally managed. We need to stay ahead of the game and be proactive in making sure that corporate governance practices are meaningful and effective.

Back in January, the SFC hosted its first industry forum. We started by considering the impact of the 2008 financial crisis. From there, we looked at how to create more resilient financial markets and how to work together to prevent future crises. We also examined short-termism in the financial industry and how to restore trust in capital markets.

Recent events have shown that poor governance increases risk and undermines shareholder value. In particular, the failure to ensure appropriate and efficient corporate governance can result in poor allocation of resources, abuses and theft by management, asset stripping – not to mention reputational damage, and even bankruptcy. So far this year, billions of dollars of fines were imposed on investment banks for various corporate failures, including selling toxic investment products to their customers.

The evidence in favour of good corporate governance is just as convincing. Studies have shown a strong correlation between good governance and stock returns. It turns out that it matters a great deal whether good corporate governance principles are taken into account in the decision-making process.

For these reasons, then, it is clear that good corporate governance needs to be part of every company's DNA. The tone at the top is therefore very important. Indeed, it is a key factor in the long-term prospects of the business.

Hong Kong

As I have said before, good corporate governance cannot be achieved just by ticking the boxes. As a regulator, the SFC does not believe a box-ticking approach is of much value at all. Thankfully, over the years the standard of corporate governance among listed companies in Hong Kong has continued to improve. But we must not be complacent—we cannot afford to fall behind in global corporate governance standards and practices.

At the SFC, our mandates include maintaining orderly and transparent markets, protecting the investing public, minimising crime and misconduct in the markets and reducing systemic risks in the industry. These all have corporate governance dimensions.

Let me briefly highlight some of our ongoing work related to corporate governance:

1. We recently decided to take a more proactive role in overseeing corporate conduct as a means to ensure the proper governance of our listed companies. This complements the continuing disclosure regime for listed companies and the new IPO sponsors regime;
2. Second, we have set higher supervisory expectations for financial institutions through our newly integrated Intermediaries Division;
3. And on the enforcement front, we continue to send strong deterrent messages to the market. We also take action to remedy the effects of market misconduct and in this way we function as "public protector".

New challenges

Looking ahead, we will continue to develop and fine-tune our role as a statutory regulator in response to changing conditions in the market and in the global economy. However, I believe that good corporate conduct does not only rely on the regulatory and legal framework.

For example—and those of you here today who are involved in legal and compliance work will be glad to hear this — at the SFC Forum in January, regulators in the region came to a consensus that a thicker rule-book is NOT what we need going forward. It is just as important that all company directors and managers have self-discipline and perform their duties properly and professionally.

We realise, however, that there is no single model of good corporate governance, and the best way to achieve it will vary from company to company. But that should not discourage us from taking part in the debate about corporate governance practices.

Company secretaries have a vital role to play in this debate. Sitting at the centre of the board's operations, you are uniquely situated to observe—and hopefully to influence—the development of governance practices. For this reason the company secretary has been described as the “conscience of the company.”

But whether you are a company secretary, or a director, auditor, or regulator, recognising the changes in the corporate governance landscape is essential for understanding today’s rapidly evolving markets.

In wrapping up, I would stress that businesses need an ethical corporate culture, including the ability to look beyond short-term gains for the long-term interests of stakeholders. We need to see three things in companies – openness, integrity and accountability. These values will help to drive us forward. Good market conduct is driven by good behaviour, and in this everyone involved has a unique and important role to play.

Thank you for inviting me to share my thoughts with you today. I wish you all a successful conference!