

**Conference on
Corporate Governance in the Financial Sector**

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**FROM CORPORATE GREED TO CORPORATE DECEPTION
(ARE WE DOING SUFFICIENT ON GOVERNANCE?)**

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Madam Chair, Distinguished Guests, Ladies and Gentlemen,

Since I was a young undergraduate, and throughout my career with ICAC, I have witnessed four major international financial crises. The 1973 oil crisis caused the Hang Seng Index to drop by some 60%. The 1987 global stock market crash “Black Monday” that closed Hong Kong market for four days and caused the Hang Seng index to plunge 45%. The 1997 Asian financial turmoil, and today a new one, many call it a “financial tsunami”, ignited by the US sub-prime mortgage situation and the global credit crunch.

2. The coast to coast financial meltdown has been blamed on many things - the lack of corporate governance, insufficient laws on regulation, top executives’ avarice in prioritising the size of their bonuses, so on and so forth. Whatever it is, it begs the question - have we really learnt any lessons from the past? Or are we simply gripped by a greed mentality? Everyone agrees that financial regulation is essential. What everyone does not agree upon is how much.

3. The eighties and nineties of Hong Kong was a boom and bust era. It could be attributed to the uncertainty in the run up to 1997, coupled with a serious lack of statutory regulation in the financial markets. When boom was in full swing, corporate governance was hardly mentioned and largely ignored. Sir John Bremridge, then Financial Secretary, in his budget speech delivered in February 1984, said:-

“Not all is good in our economy. Things have taken place that are clearly disgraceful. Legislation may well be necessary. But greed cannot be cured by new laws, and self-regulation is preferable. Equally required is a proper sense of shame. I share in it.”

The shame factors were reflected and clearly recognised in the ICAC investigations and prosecutions of the Overseas Trust Bank case, the Carrian Group case, the Stock Exchange case, and others. Resulting from that was the introduction of changes and various statutory based regulatory schemes.

4. The pre 1997 boom and bust was, however, based on localised greed where the ethos was to get rich quick, and if necessary “do a runner” before Hong Kong re-united with China. Nowadays local corporate governance problems have more to do with cross border investments by both the Mainland and Hong Kong, and with nearby regions. The ICAC investigation of the

Shanghai Land case illustrates not only the far reaching consequences of concealing major transactions from shareholders, but also how the dishonesty and breakdown of integrity emerged at both corporate and professional consultancy levels, and spanned across jurisdictional boundaries. Similarly, the Gold Wo case illustrates how easy it would be, without proper regulation, to perpetrate a criminal conspiracy to defraud the Stock Exchange of Hong Kong for listing. Sarcastically the conspiracy extends to independent non-executive directors, professional accountants, and auditors who are engaged ostensibly to guard against fraud.

5. The ICAC experience is that investigation of listed companies invariably involved the corrupt and fraudulent actions of senior staff members, in particular, chairmen, directors, independent non-executive directors, consultants and professional advisers. The involvement of such senior company officials has lent weight to the call for tighter regulation, control of executive's bonus, and a more transparent approach to investment risk. The statistics show that greed plays an intrinsic part of any financial crisis.

6. A further example of late is the Minibond fiasco. Here Hong Kong was used as a dumping ground for high risk products. Lehman Brothers was an established investment bank with an international reputation, almost a household name representing stability and integrity. Recent events, however, show that they were party to seriously misleading the public over the Minibond saga, and other similar financial products. It should be noted that these products were not available for purchase by investors in USA. But in Hong Kong and in Singapore, these products were able to be purchased over the counter by ordinary citizens who lacked the understanding and sophistication needed to properly weigh the risk to reward ratio, and who had relied on the banks through which they were purchased. The result was that the hard earned money of those citizens/investors was indirectly transferred to Chief Executive Officers (CEOs) and other top executives of the banks and corporations, and perhaps their relatives and friends.

7. To know more about the situation, take a look at the lucrative year-end compensation rewards for the top management of financial institutions. They do not sit comfortably with the current financial turmoil. As stated in the Wall Street Journal on 21st November - "The credit bubble has burst; the economy is tanking; Investors in the US Stock Market have lost more than 9 trillion dollars in one year. But in industries at the centre of the crisis, many top officials managed

to emerge with substantial fortunes". The paper also quoted - "fifteen corporate chieftains of large home building and financial services firms each reaped more than US\$100 million in cash compensation and proceeds of stock sales over the past five years. Four of those executives, including the heads of Lehman Brothers Holdings Inc. and Bear Sterns Cos., ran companies that have filed for bankruptcy".

8. Who should bear responsibility for the current financial meltdown? Greedy speculators who failed to equip themselves with proper information but relied too heavily on the banks? CEOs of companies like Lehman Brothers who took advantage of that culture. Or regulators for not ensuring that these products could be purchased only through reputable dealers by experience investors. There are however no direct and distinct answers to these questions.

9. In the free market of Hong Kong, minimal government intervention, coupled with greed or naivety of the local investors, produced a marvellous opportunity for these financial institutions to side step the regulatory regimes of their own jurisdiction. They were able to offset that unacceptable exposure to risky lending through these products.

10. Overseas not too long ago, cases like Enron and Worldcom showed how corporate corruption and commercial fraud have exacted a huge price on these enterprises and investors. The issues had become a global concern, and more importantly, suggested a need for good corporate governance and a sound legal regulatory framework.

11. To understand the lessons, we have to remember that in the late 1990s through to 2003, corporate revenues skyrocketed and stock indexes set new records. Companies became grossly overvalued and internet companies flooded the market. Investigation into some of the most renowned corporate collapses found that executives were utilising fraudulent schemes in order to meet expectations of earnings. There were accounting frauds which appeared at the outset incapable of being addressed by the auditors and accountants, only to find out later that it was the complicity of the accountants and auditors that made these scams possible.

12. It would follow that corporate governance, whilst it must firmly include those at the top, is not limited to the executive directors. Independent non-executive directors have an important role to play. Corporate governance

must identify that the integrity of an organisation rests on its own internal monitoring systems. Those at the top might well implement such systems in principle but it should be the independent non-executive directors, the accountants, auditors and lawyers who equally have a duty to ensure that integrity is practiced as a fact and not just alluded to as a philosophy.

13. Here I would like to share with you a quote from the speech of former Premier ZHU Rongji, delivered at the 16th World Congress of Accountants in 2002:-

“Integrity is the fundamental element of market economy, it is also vital for the reputation of accounting firms and accountants....we must focus on the moral training of accounting professionals, enhancing regulations....ensuring that they make no false accounts”.

14. In echoing what the former Premier said, I would respectfully suggest that the stewardship of integrity encompasses all managerial and professional personnel who are concerned with an organisation. The stewardship of the independent non-executive director is of paramount importance, because such a person is well placed to either fully enforce corporate governance, or is best placed to usurp that governance and successfully hide the fact until it is too late.

15. Equally, auditors, accountants and lawyers are stewards of the corporate governance system to ensure that all breakdowns in integrity are exposed and properly dealt with. Likewise they are well positioned to arrange that such matters remain covered up and undetected. When such independent non-executive directors and professionals come together positively to uphold organisational values we find that not only will organisational integrity remain firmly intact but the opportunities, especially at CEO and executive director levels, to abuse systems for personal gain become much more difficult, and are exposed so much more easily. On the other hand a corrupt conspiratorial relationship between those important stewards of the organisation can cause massive abuse which could go largely undetected until it is all too late. It would usually take a financial crisis such as the one in Asia in the early 2000s, when the myth of the internet finally burst and the truth about hyper overvalued technology shares was finally brought home, or the financial meltdown that we are now experiencing for these scams to surface. They can be so easily hidden in boom times, unless self regulation is honest, holistic and taken seriously by all practitioners.

16. So what we can learn from the experience of USA. It is true that the introduction of public regulation has, to an extent, helped control corporate irregularities, like the Sarbanes-Oxley Act introduced in 2002 after the Enron scandal. Yet, the only way to stop irregular or undesirable, but not necessarily illegal, economic activities is to apply corporate governance that successfully brings a balance between profit making and social responsibility. The recent global financial crisis originates from the legal but totally undesirable business of sub-prime mortgage lending in US. The transactions in sub-prime mortgages and related credit derivatives grew rapidly, and before the bubble burst, they were seen as the boom of the property market. Yet, it defies all logic and reason that the experienced management of the financial institutions who financed the sub-prime lending could not have known that they were creating the very time bomb that has now exploded.

17. In the words of Sir Adrian Cadbury, a pioneer in promoting corporate governance:-

“In its broadest sense, corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals The aim is to align as nearly as possible the interest of individuals, of corporations and of society”.

18. Ladies and Gentlemen, the message from the ICAC is that we support a free and open economy. We are not here today to recommend over statutory regulation or regulation for the sake of it, but we do urge that integrity is not only a philosophy; it is a factual way of life. We believe that sufficient legislation that is strong enough to ensure easy detection of irregularities, especially criminal irregularities, should be in place, but we equally recognise that for Hong Kong to remain competitive that too much statutory control could become overbearing, stifling, bureaucratic and would impact upon Hong Kong's reputation as a place to do business. We urge that self governance and self regulation are not concepts that are just given lip service, and the approach to self regulation must not be minimalist. Rather it should be looked at holistically, and most importantly, should include each level of the organisation itself and those of the professionals that it employs or contracts with. It should embrace a regime whereby each organisation that it deals with, especially if that organisation is in a different jurisdiction, is proactively self regulated; and that the integrity systems of each organisation can dovetail together so as to ensure the maintenance of the

level playing field of business. Otherwise, history will repeat itself.

19. Thank you.