

Conference on Corporate Governance in the Financial Sector
Gist of Questions-and-Answers by Expert Panel Speakers
8 December 2008 (Transcript)

After the presentation of all panel speakers, there was an Open Forum. Questions raised and answers given were transcribed below.

** See the list of panel convenor and speakers on page 51.*

Q1: In the Mainland, the regulators always invite senior management, company secretaries and compliance officers to attend director training and compliance programmes. Is there anything that should be done in Hong Kong and what is your opinion in the effectiveness of this kind of training?

Mr Paul CHOW Man-yiu:

- The Listing Division of the Exchange has conducted numerous training for H-share companies in Mainland China and they have been very well received. The attendance rate is very high. Normally, we present them with the topics of corporate governance, internal control, risk management, compliance and so forth. In Hong Kong, over the past few years, we have been working with HKIoD, HKSI, HKICS, HKICPA, in conducting courses and seminars for the market. Obviously, most of the attention seems to focus on the technical and operational aspects of the regulation, for example, how to comply with the Listing Rules and the Code of Corporate Governance. Perhaps we should do more on ethics training involving cultures, integrity and honesty. I think this is the area where obviously the ICAC can work with the professional bodies, the Exchange and the SFC. I believe that maybe starting from next year, we should put more focus on ethics training instead of the technical aspects.

The Honourable Laura M. CHA, SBS, JP:

- I agree with you that the training so far has been emphasising on the technical and compliance issues and when we talk about integrity, ethics and anti-corruption issues, I think that is more a matter of value, judgment and good practices. At the same time, I also feel that every time when there is a crisis, the market always queried where the independent directors were. Should they have smelled something? Should they have done something? I think we need to draw the line.
- Before imposing more responsibilities and liabilities on the directors, we have to be very clear on what the roles the INEDs play, as distinguished from the executive directors. Similar as the mini-bond incidents that happened in Hong Kong, Singapore and the sub-prime cases that brought down some of the financial institutions in the US, one would legitimately ask what the independent directors could have done. I don't think the approval of the sale of the products would have gone up to the board level. The board would have no idea and it should not be in the position to approve or disapprove certain products.
- I think the board's responsibility is really to ensure that there is enough checks and balances and internal control within the system. To place the ultimate responsibility of the failure of the products on the directors would only scare away people from serving as independent directors.

- There is certain training that has been done but also I think they cannot have excessive expectations on the independent directors as they could solve some of the problems. Of course, I know that in some cases, the directors really feel like being a director is no more than appearing in board meetings and that needs to be enhanced.

Q2: The number of corruption reports against the private sector is far more than those against the public sector in recent years. Are those working in the private sector more corrupt? Should the ICAC concentrate its work now on the private sector instead of the public sector?

Mr Daniel LI Ming-chak, IDS:

- I can't avoid by talking about history again. In the 70s', when the ICAC was first established, complaints against the Government, particularly the police, took up about 80% of the complaints we received in the old days. 35 years on is the reverse. Now that we could prove only one thing, public sector corruption has been largely, I won't use the word "eradicated", but controlled. I think when the ICAC was first established, people looked upon the ICAC to clean up the Government. Rarely were people concerned about corruption in the private sector. That was exactly what the ICAC had done in the early days – to clean up the Government. We had the worst time when police officers attacked the ICAC but that had alarmed the whole Hong Kong Government to reconsider the pay and package for civil servants. I must say that after 30 years, the pay, if not the conditions of services, have risen 30%. I can't help to say that under these circumstances, public sector corruption is well under control nowadays. But it is not 100% clean and will never be 100% clean.
- For the private sector, I think the former Judge who put in an in-depth report for the recommendation of setting up the ICAC did look at corruption with a very good insight. His argument was that if you have a corrupt society, including both the public as well as the private sectors, it is corrupted. You can't just clean only the public sector because corruption in the private sector will spill over and likewise vice versa. The recommendation at the time was to fight against corruption using a three-pronged attack on all fronts, whether it is corruption in the Government, government-funded public bodies and the private sector. Now it is a fact that we receive more complaints against the private sector. If you look at the government services, we are talking about 160,000 to 170,000 employees. If you look at the private sector, we are talking about two to three million employees, so it is only natural nowadays that more complaints, around 65% of all the reports we received, targeted at the private sector. In fact, if you look at the economy over the past 20 years, whether it was ups and downs, it gave rise to a lot of corruption opportunities. That is why nowadays we have more focused our resources, deployment of manpower on the private sector, but not forgetting the public sector problem. We would not allow serious corruption or syndicated corruption in the past to come back. If we look further, in the international arena, to the United Nation Convention Against Corruption, one of the recommendations in the Convention is to get all the governments signing the Convention to tackle private sector corruption as well. I think the Convention has adopted the ICAC model. I think overall it is a good thing to have global initiatives to fight against corruption.

Q3: Should the regulators interfere with the executive compensation? Would it be more appropriate for the regulators to focus on supervision and enforcement? On this, should the Listing Rules be given statutory backing in Hong Kong?

Mr Martin WHEATLEY, JP:

- In response to a crisis, there is invariably a political dimension which requires more regulations, more rules. As a regulator, we need clear rules, clear enforceable rules but not necessarily more rules. The focus on executive compensation is an easy target, partly because executive compensation has become so extreme particularly in the US. But I think the system for dealing with executive compensation properly rests with shareholders because they can vote on the compensation packages of the chief executive and directors of the company. It's not something that the regulator should try to enforce because, invariably it happens many many times over the years, if you try to create a structure to control compensation through tax or through enforcing rules, very clever companies simply find a way round it. Companies, if they want to pay their people well, will continue to do so. If they have the conversation with their shareholders properly, the regulation of compensation should be self-regulation.
- In terms of statutory backing, I think a couple of the examples I gave earlier in the remarks I made clearly indicate the area where the regulatory structure of the corporations in Hong Kong fall short of global standard. The Exchange has good Listing Rules, somebody says that it's too long and too complicated, but comprehensive and understood by the industry. The Exchange has a contractual relationship with companies but it doesn't have statutory investigative powers or penalties available for breach of rules. The regulator has certain statutory powers for certain breaches like false and misleading statements. But we don't have clear statutory powers for late statement or omissions. So if a company simply forgets to announce some price sensitive information under the structure we have today, you can just get away with that. I think statutory backing is necessary and we will urge the Government to bring forward a sensible work of structure which will benefit corporate regulation in Hong Kong for both the Exchange and the SFC.

Mr Paul CHOW Man-yiu:

- To supplement what Martin had said, the Exchange in a number of years ago has emphasized that we will support the SFC and the Government to turn some of the key provisions in the Listing Rules under statutory backing. They include price sensitive information and certain connected party transactions. On this front, we are very supportive of this initiative.
- On the compensation arrangement, we agree with Martin that it is possibly very difficult for regulators to regulate executive compensation because there are many routes for companies which do not want to follow regulations to bypass the regulations. Are you going to regulate the cash compensation, the bonus or other things? The companies can use different facilities to provide benefits to their employees and so forth. What about inviting friends and relatives to lavish parties, overseas trips and so forth? It is pretty difficult basically to regulate or legislate all these. However, what I can say is that the board of directors should be accountable to the shareholders and one of the principle duties of the board, including executive directors, non-executive directors and INEDs, is to search, identify and appoint a competent chief executive with the highest degree

of integrity and to ensure this chief executive will surround himself or herself with a team of competent senior executives who are not only conversant with the job, but also have the right qualities and right attitudes and the integrity to manage and run the business of the company. Until we move to this stage, there will always be lapses in how certain companies will manage their affairs.

Mr Y. K. CHOI, JP:

- I would also like to respond to this particular issue of compensation packages. I fully agree that this is a very difficult issue and that is the reason why so far regulators in different parts of world have not tried to interfere into compensation packages of financial institutions. But as highlighted from the current turmoil, one of the reasons is the incentive scheme of certain financial institutions that may encourage unsound and unsafe practices to be adopted. In other parts of the world, we have seen that some central banks had already become the major shareholder of individual banks. I think the first thing normally they will do is to look into the compensation packages of the senior executives. I believe that at some point, there will be international guidelines or best practices issued by some standard setting bodies. So we are following very closely the development of this area. I would consider whether such international practices are applicable to Hong Kong.

Q4: Does the Hong Kong Monetary Authority regulate the qualifications of the director of the banks? How do you assess the qualifications, including the background of company directors?

Mr Y. K. CHOI, JP:

- I think this is a difficult question. Actually, we do not have clear requirements on the director's qualifications such as whether he must be a university graduate or study specific subject in the university. I think it will be more important for an INED to have management experience rather than the experience in banking industry. It is because as an INED, his management experience may be beneficial for the bank's management. On the contrary, possessing adequate experience in the banking industry is essential for an executive director.
- On the assessment issue, it is the board of directors' duty to appoint a fit and proper person as a director and then base on his qualifications and experience to further decide whether the person should be appointed as an INED or executive director. In addition, we should also have a better understanding of the person's past working history and check if he has been criticised by the regulators or involved in some cases investigated by the law enforcement agencies. We will check with the law enforcement agencies and regulators.

The Honourable Laura M. CHA, SBS, JP:

- Because of time constraint, we cannot address further questions. I thank all panel members for your valuable views and insightful comments. 🙏