OECD Second Asian Roundtable on Corporate Governance

Luncheon Address

Transparency, Accountability and Standards in Global Markets

By

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Mr Chairman,
Distinguished Guests,
Ladies and Gentlemen,

On behalf of the Securities and Futures Commission, let me welcome all our visitors to Hong Kong.

The theme of this Roundtable: "Disclosure in strengthening Corporate Governance and Accountability" is very close to the heart of securities regulators. This morning you had a discussion on accounting and audit, so what I will try to do is to give you an overview of how I see globalization impacts on transparency, accountability and standards.

We live, as the cliché says, in a time of change, with technology as the defining element. Technology is rewriting the national and global balance sheet. The Asian crisis was a crisis of globalization cracking open local markets through capital flows. We need to recognize that financial markets are like networks. The global network is a patchwork of local networks that have not been designed to operate on global capital flows. Today, a ILOVEYOU virus can spread from one centre across the world in hours. Luckily, regulators are more likely to open IHATEYOU mail rather than the former.

At the IOSCO Annual Meeting in Sydney last month, two quotes define the mood on how technology is changing our markets. Australian Treasurer Peter Costello said that we have the New Economy, but Old Values, and SEC Chairman Arthur Levitt said that we have complex markets, but should have clear simple rules of the game. These are fairness, transparency and freedom to compete.

Indeed, the combination of globalization, technology and innovation is changing the markets and organizational and institutional structures so fast that no one can claim any defining insights into the future. For what is worth, these are my personal tentative observations: -

1. Reliable, accurate and timely information is a market fundamental;
2. Globalization is forcing convergence of standards;
3. Technology operates in marketspace, not market place. This transcends legal and geographical boundaries, forcing regulatory convergence;
4. Technology is threatening traditional franchises and structures – this changes corporate and social governance;
5. Since change is so rapid and complex, we can only avoid social or system volatility through the ethics or knowledge foundations of the individual. We need to spend more time and resources on investor, consumer or mass education.
6. Corporate governance is a necessary but not sufficient condition for market reform.

Transparency, Accountability and Disclosure in the Market

So what have all these got to do with transparency, accountability and disclosure? Why do we need them?

To maintain integrity and to function fairly and efficiently, the market needs high quality information, timely disclosures and efficient access to such information. Investors need this information to make investment decisions and to trade. When relevant information is not properly disclosed in a timely fashion, when insiders abuse their positions and misuse information, or when misleading information is given, this will destroy market fairness and integrity and the level playing field.

In my work with the G-22 Working Group on Transparency and Accountability, I have come to appreciate that the lack of transparency and accountability exacerbated financial weaknesses at the firm and national levels. Transparency refers to a process by which information about existing conditions, decisions and actions is made accessible, visible and understandable. Accountability refers to the discipline and need to justify and accept responsibility for decisions taken. Generally, transparency and accountability work hand in hand to help improve economic performance.

Gaps in information

The Asian financial crisis has demonstrated that we have gaps in disclosure, gaps in incentives to use information, gaps in the law and regulatory net and gaps in capacity to use information.

But we must remember transparency is not an end in itself. Transparency entails a price. Transparency and disclosure have costs because it costs to produce high quality information. Why should anyone disclose proprietary information? There will always be a trade-off between the high cost of collecting information, analyzing information, and using information and the need to disclose the information for the public good.

My personal lesson from the Asian crisis is that a macro-crisis has micro origins. It can be summed up as follows:-

Bad accounts = bad statistics = bad policies = bad risk management = financial crisis.

I have also learnt that full transparency of bad accounts is still bad disclosure. Consequently, the Financial Stability Forum decided last September that a Task Force should be established to look at the Implementation of Standards relevant for sound financial systems.

It was not as if there are no international standards. The FSF has a compendium of over 60 standards, with a list that is growing by the day. But what was missing was the implementation and enforcement of these standards. In other words, it is insufficient to pay lip service to say that we have standards, but how well we implement them.

Indeed, its time to move from form to substance. You can have the most elegant financial architectural drawings, but how well the international financial system will withstand the next shocks will depend on how solid is the foundation, the plumbing and the actual construction or engineering. Implementation – or deeds rather than words, will determine the outcome. As the LTCM case testified, its no use to design your sophisticated model that can take a market volatility of 4 standard deviations when the market moved 15 standard deviations.

Thanks to the good progress and contributions made by the standard-setting bodies, the IMF, and World Bank, the OECD in promulgating and assessing observance of international standards, the Task Force identified three factors as being critical to fostering successful implementation of standards:

- The first is **ownership**. Implementation is a sovereign decision taken in the national interest of strengthening financial systems;

- The second key factor is **incentives**, both market and official. For market incentives to work, market participants must have access to information on economies' observance of standards. Disclosure alone is not sufficient. We need to do more to raise market participants' awareness of standards, and structure information in a way that can be used more effectively. The Task Force views official incentives as a complement to market incentives but there was varying degree of enthusiasm for their use;

- The third factor is **resources**. Implementation of standards is very resource-intensive. The Task Force recommends that standard-setting bodies be encouraged to forge closer partnerships with the Fund and the Bank to better leverage their resources in assessing observance of standards.

I will not elaborate on the strategies recommended by the Task Force, as I understand that Warren Gorlick will talk about that in greater detail later in this Roundtable.

The Quality of Accounts in Corporate Governance

As I indicated earlier, high quality information is a market fundamental. By definition, the quality of Corporate Governance is only as good as the quality of information available to make decisions and to improve accountability between a corporation's insiders and its stakeholders. Without information needed to make informed decisions, the right to make the decision is of little value.

And raw information is useless without high quality accounts (including non-financial information) prepared according to international accounting standards and verified or audited according to international or generally accepted auditing standards. In statistical terms, we need to have transparency also about the meta-data – how that data is produced and classified.

In this area, the accounting profession both those in private practice responsible for audits and those in industry responsible for preparing financial statements have very critical roles.

At its recent meeting in Edinburgh, the worldwide accounting profession was challenged to take steps to address investors concerns that audited financial statements from many countries do not meet basic expectations either in respect of the accounting treatments adopted or the standards of audit. With the creation of IFAD, the large international accounting firms are beginning to go beyond local accounting and auditing standards and rules to impose some minimum criteria.

IOSCO at its recent Annual Meeting in Sydney last month has now agreed on a set of International Accounting Standards that could be adopted for cross-border listing standard purposes. This would eliminate the excuse for any company that wishes to obtain cross-border capital funds to use only local standards. It is not true that local standards are by definition better or worse than international standards, but all the market (and increasingly international regulators) is saying that if you wish to raise international capital, you should apply IAS.

In other words, participation in the global economy imposes obligations as well as providing opportunities. To exploit fully the benefits of greater and cheaper sources of investment provided by international capital, corporations must accept the disciplines of better financial disclosure and high quality audits.

Because markets function on information and trust, we all incur reputational risk. The dilemma of Internet speed is that you can run, but you can't hide. Ultimately, the market will judge the quality of your information, your work, your reputation. It is therefore in everyone's self interest to move towards higher quality of information.

As key providers of information, the higher the quality maintained by the accounting and auditing profession, the stronger will be our markets. It is both in the accounting and the corporate community's interest and in society's interest to do so.

Let me sum up. Corporate Governance, like accounting or any other standards, is not about what you preach but what you practise. It is a process by which a corporation or any social unit improve its performance for what we all agree must be the greater social good. The very nature of human society must mean that there is no one road to good corporate governance, but there are minimum standards of transparency, fairness and trust that we must abide by.

I still think that Arthur Levitt sums it up best: “In this information – driven age, the director’s responsibilities have become more complex. But the director’s role rests on an old fashioned value: integrity. Integrity of character. Integrity of information. Integrity of auditing and compliance systems. And above all, integrity of mission.”

Thank you.

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