



“CORPORATE GOVERNANCE - SUBSTANCE NOT FORM”

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TO
THE SYMPOSIUM ON CORPORATE GOVERNANCE FOR DSM - LISTED
COMPANIES
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Introduction

First, may I say, on behalf of the Qatar Financial Centre Regulatory Authority, that we are very pleased to have been invited to participate in this conference, and I would like to express our thanks to the conference organisers Micro-Media and to the Doha Securities Market for this event and the invitation to participate in it. Although the DSM does not come under our jurisdiction, we look forward to ongoing dialogue with the Qatar Financial Markets Authority and the DSM in areas of interest to us all.

Corporate governance is very important topic for the QFC. High standards of corporate governance are a key element of the vision of the QFC, and Qatar, being a leading location for international finance and business and attracting and facilitating the investment of capital into Qatar and the wider region.

The QFCRA's own Regulatory Objectives include

- the promotion of efficiency, transparency and integrity, and the promotion and maintenance of confidence
- Operating with a view to establishing and maintaining the QFC as a leading financial and business centre in the Middle East.

In my remarks today (which I should note are personal and not necessarily the official views of the QFCRA), I will canvass

- the concept of corporate governance itself
- some of the roles and involvement of governments , regulators and market participants in this area
- some of the challenges faced by countries internationally in making changes.

I will conclude by giving some overall comments in the listed company perspective.

I should add that I had the opportunity to speak on this topic at a conference. also organised by Micro- Media. in Doha last year, and I am pleased to be able to speak again on these points, now to this audience.

Corporate governance - its role and relevance

Good corporate governance is a key part of any regime that has confidence, integrity and efficiency as its bedrock and which is looking to attract and retain capital on a sustained long-term basis.

Various studies have been done of the role of corporate governance in improving company value and performance, and endeavouring to quantify the resulting gains from improved corporate governance standards. I refer to some of the work done by McKinsey in this area. I cite as one example a September 2006 report¹ noting a survey that institutional investors in emerging market economies would be willing to pay a premium of as much as 30 percent for companies with good corporate governance, and that companies can expect a 10 to 12 percent increase in market valuation by going from worst to best.

In an article published just this month², McKinsey have also looked at what public companies can learn from private equity, and have expressed the view that public companies will need to raise their governance game if they are to

¹ See reference in The McKinsey Quarterly 12 September 2006

² "What public companies can learn from private equity" The McKinsey Quarterly , January 2007.

compete with private firms. The particular factors they raise, and indeed the pros and cons of private equity long term in the success of companies, could be the subject of some debate. That is not the point. What is of particular interest here are their comments on the “corporate governance arbitrage as a factor in looking at investment and growth opportunities.

In short, good corporate governance should be seen as good, indeed essential, for well performing businesses. Improvements in corporate governance can see major return benefits to companies by way of performance, returns, and growth in value to shareholders. That in turn can flow through to increased willingness by investors to invest on a sustained basis

It is also good for economies and markets generally. For example in:

- providing the degree of confidence that is necessary for proper functioning of a market economy
- lowering the cost of capital, thereby underpinning growth
- more specifically , underpinning financial markets and contributing to financial institution soundness and financial system stability
- providing a basis whereby economies and business with good corporate governance can compete over economies and businesses with inferior standards.

The concept of corporate governance and what it can involve

A vast amount has been written about corporate governance, what it is, and what good corporate governance should involve.

A very good starting point is of course the OECD Principles of Corporate Governance, discussed in detail in the earlier session of this conference. These are widely recognised benchmarks. In the financial sector context, they are one of the key sets of standards for sound financial systems as used by the Financial Stability Forum. They are used by the IMF and World Bank in their country assessments, and by other international bodies, such as IOSCO, in their standards setting.

The OECD Principles refer to corporate governance as involving a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through

which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

The OECD principles focus on:

- ensuring the basis for an effective corporate governance framework
- the rights of shareholders and key ownership functions
- the equitable treatment of shareholders
- the role of other stakeholders including employees, creditors and counterparties.

Regulators, self-regulatory organisations, professional bodies, stock exchanges and other interest groups have written many other statements of principles, guidelines and codes.

In this region, we also have the “Dubai Declaration on Corporate Governance” coming out of the OECD MENA Working Group on corporate governance /Hawkamah joint conference in November 2006.

It is also important the subject of corporate governance does not turn into fashionable business-speak or a concept devoid of meaningful application. Conversely, it is also very important that corporate governance, and improving corporate governance, is not seen as another term for legal compliance, and improving compliance procedures.

Compliance with laws and regulatory /listing requirements, and having systems in place so that Boards and management can monitor compliance with those requirements should be a given. While an essential part of good corporate governance is compliance, and monitoring compliance, with legal requirements it is only part of the corporate governance matrix, just as proper risk management is part of the same matrix.

The HIH Insurance Group collapse in Australia in 2001 was the largest corporate failure in Australia. The deficiency is still estimated as being between 3.6 and 5 billion Australian dollars. A Royal Commission was established to inquiry into the collapse. In his Report, the Royal Commissioner, Justice Owen said this:

‘I am becoming less and less comfortable with the phrase “corporate governance” - not because of its content but because it has been so widely used that it may become meaningless. There is a danger it will

be recited as a mantra, without regard to its real import. If that happens, the tendency will be for those who have to pay regard to it to develop a 'tick the box mentality'. The attitude might be, 'Yes, we have a state – of the art corporate governance model; yes it is committed to writing; and, yes, the company secretary has checked that each item is in place and has included a statement to that effect in the annual report. Therefore there could be no problem in the corporation.'

Corporate governance – as properly understood – describes the framework of rules, relationships, systems and processes within which and by which authority is exercised and controlled in corporations. Understood in this way, the expression 'corporate governance' embraces not only the models or systems themselves but also the practices by which that exercise and control of authority is in fact effected'.

What constitutes good corporate governance can also be defined by looking at examples of the opposite – and some of the catastrophic failures, such as Enron, Parmalat, Barings, and HIH, many of which happened very quickly, and involved companies that ostensibly appeared to be doing very well.

But we do not need to look only at the spectacular collapses -we also see examples of bad governance in the every day failure of firms, the everyday reluctance of particular investors to invest in particular markets, and in the regular cycle of market downturns where some participants survive, but others do not, or where confidence overall takes a severe battering.

Involvement of governments, regulators and market participants

A key feature of developments in corporate governance in recent years is the involvement of various players – it is not being left to one group alone, nor can it be.

Governments have a major role, including in

- providing the overall legal and regulatory regime with appropriate incentives and sanctions for good corporate governance; and robust and independent and regulatory and judicial structures, with appropriate enforcement mechanisms

- addressing the critical interface of corporate governance with company, securities, insolvency and criminal law; and
- having appropriate mechanisms to address market crises or failures.

International bodies and agencies are playing a key role. International bodies such as Basel, IAIS, IOSCO, OECD, ADB and the IMF/World Bank (including, in the case of the latter, for their FSAP processes) have a major interest in good corporate governance standards. In many cases those bodies are issuing standards themselves, or monitoring firms and regimes against particular corporate governance benchmarks.

Market regulators have a key role, including

- in relation to issuers of securities, and oversight of exchanges
 - disclosure requirements
 - listing rules requirements
 - monitoring and enforcement
- in viewing corporate governance as a criteria for authorisation
- in developing relevant and appropriate rules for market sectors (for example, in respect of banks or insurers supervised by those regulators).

Rating agencies have a key role, in that corporate governance is relevant to both their country and issuer assessments, which directly flow through to pricing of the paper of those sovereigns and those firms.

The market itself has a key role, for example in relation to listing requirements, professional associations and, very importantly, the approach that companies and other entities take to their own corporate governance.

In short, the topic of improving corporate governance can not be ignored – it is here to stay, and like any change the option is either for us to manage that change or else let the change manage us.

Challenges

I will comment briefly on some of the challenges which various countries have encountered in their efforts to improve corporate governance practices.

First, I mention the challenge of existing practices themselves. I have touched on these already. Specific failures have been extensively catalogued in insolvencies, inquiries, court cases and reviews. In a speech³ here in Doha last year, Mr Jaime Caruana, Chairman of the Basel Committee on Banking Supervision and Governor of the Bank of Spain succinctly summarised some of the common factors:

- failure by the boards of direction to understand the risks their firm is taking
- conflicts of interest and a lack of independent - and I would add particularly , independently minded - Board members and senior executives resulted in decisions that benefited a few at the expense of the many
- weak or non-existent internal controls , or controls which appeared to be adequate on paper, but which were not implemented in practice
- internal and external audit failure, either through negligence or incompetence, or through aiding and abetting fraudulent or inappropriate behaviour
- transactions, and organisational structures, designed to reduce transparency and prevent market participants and regulators from gaining a genuine picture of the firm's condition
- and perhaps most importantly, a corporate culture which fosters unethical behaviour and in particular discourages difficult questions from being asked.

Second, there are often attitudes which are impediments to change, for example:

- “short term” thinking - in particular by companies that might only be surviving for the moment because of a continuation of poor corporate

³ Speech by Mr Jaime Caruana at the 2nd Islamic Financial Services Board (ISFB) Summit 2005: The Rise and Effectiveness of Corporate Governance in the Islamic Financial Services Industry, Doha, 24 May 2005.

governance within that entity or the market in which that entity operates ; in other words where higher standards could put them out of business

- a culture that sees a company as proprietary to one or more directors or shareholders, with minorities, the public, other stakeholders, simply being ‘along for the ride’
- a feeling that the system “warts and all” is working, and that there is no real pressure to change
- a feeling that there is a lack of a sound legal, judicial and regulatory structure providing sufficient incentives and disciplines for good corporate governance even if there is a will within particular firms to change. Such lack also means that companies with, or aspiring to, good corporate governance may view them at a competitive disadvantage in the particular market.
- a lack of commitment and leadership driving change at political, regulatory, and Board and executive levels.

Implementation

In my view, all of these challenges can be overcome if there is a sufficient will to do so, and an appropriate approach and programme for implementation. The topic of implementation of a programme for improving corporate governance is a major one in itself. In my comments today I make three observations:

- it is very important to have an integrated approach to any corporate governance reforms. Laws themselves, for example, are insufficient without also a will and culture at senior government and business levels to have them work. Conversely statements of aspiration and good intent are insufficient without strong and robust legal, regulatory and enforcement structures
- it is also very important to recognise that a ‘one size fits all’ approach does not work. The US model for example is highly prescriptive and rules based; the UK/European model is more principles based; there are hybrids e.g. the ‘comply or explain why not’ approach
- in particular it is important to recognise the cultural, legal and structural issues existing in different countries. There needs to be a programme which will achieve the objective of improved corporate governance, but

by recognising and addressing those differences. For example, some countries have a high percentage of major companies with a dominant or family shareholding, other countries have a very wide spread of shareholders. Some countries have a history, and widespread practice, of using litigation to address disputes, in other countries litigation is not at all common, with disputes frequently being settled privately. Some jurisdictions have by now a well understood and accepted approach to public disclosure of information; in others it is the reverse. Some jurisdictions have a culture of free and vigorous debate between superiors and subordinates – others do not. To be effective, any corporate governance reforms must recognise the circumstances of the particular country and determine how best to address them.

Some overall comments

In relation to the opportunities to improve corporate governance here, I note Qatar is favoured by:

- a commitment at highest governmental levels to best international practice, already demonstrated, in the case of the financial and securities markets, by the Qatar Financial Centre, and in the case of the Doha Securities Market by announcements regarding the Qatar Financial Markets Authority and changes in the DSM
- a commitment to the continued development of robust regulatory structures and legal and regulatory regimes
- a strong sustainable economy with an ability therefore to make changes for long term gain
- a willingness to embrace change at governmental and business levels.

As in all jurisdictions, the effectiveness of a programme to improve corporate governance will depend on a number of things, including

- an appropriate high standard legal and regulatory regime which will be able to stand scrutiny in comparison with other high standard markets, avoid unnecessary compliance costs, and at the same time facilitate and encourage competition innovation and high performance

- an effective enforcement regime with independent ,properly resourced and empowered regulatory agencies
- in the case of trading markets, effective and well run and regulated exchanges in which investors can deal and trade in confidence
- very importantly, a commitment by companies themselves, their shareholders, and Boards, to buy in to the changes, and adopt them as part of a changed culture “in the spirit as well as the letter”.

The potential returns from good corporate governance include:

- an increased willingness of quality investors to invest in diverse sectors of the economy on a sustained basis
- improved company and market performance
- enhanced soundness of capital markets and the financial system generally
- long term benefits to the economy of Qatar , and its comparative advantage .

Michael Webb.