RECENT DEVELOPMENTS - DEREGULATION OR REREGULATION

DO THE GODS OF THE COPYBOOK HEADINGS REALLY EXIST?

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When considering what to say this afternoon about regulation and deregulation some lines of Kipling bubbled to the top of my mind and struck a resonance with our present situation, both here in Australia and Hong Kong. They sum up, I will suggest to you fairly well, the present position of those contemplating reform of bank regulation and company law generally and I will take them as my theme today. They go as follows:

> "Then the Gods of the Market tumbled and their smooth-tongued wizards withdrew,
> And the hearts of the meanest were humbled and began to believe it was true,
> That all is not Gold that Glitters, and Two and Two make Four -
> And the Gods of the Copybook Headings limped up to explain it once more."[1]

Implicit in those words is, of course, the notion that somewhere, somehow, there exists a universal body of rules and a system of operating known to the Gods of the Copybook Headings. If we could but find them, they would resolve all our problems present and future. But does such a paradigm exist? And if so, what is its content? Would it not be more appropriate to address the problems as revealed by recent debacles at base and improve the ethics of those in control of lenders and borrowers.

To take a good example from recent events, is there any way in which we can **legislate** against moral risk or, to borrow from Mr John Hyde, prevent the introduction of "political rent" into our system of doing business so that who, rather than what, you know becomes the determinant of success or failure?

Any such examination is bound to be controversial if it is not to be merely platitudinous. Just recently we have had a dispute of sorts between those who would try to bring everything within the confines of "black letter" rules, and those who argue for a much more broadly defined and less positivist approach to prevent malefactors from slipping through the legislative net. I will return to this topic in a moment.

THE ECONOMIC COST OF REGULATION

We are all aware that increasing regulation brings with it very large compliance costs for all those honest companies and borrowers and lenders doing business, a cost which inevitably reduces business competitiveness and makes Australia a less attractive place in which to do business. There is a need to avoid being carried away by the public demand for results which might see a large and expensive body of regulation foisted upon businesses which are well and honestly conducted.[2] The same fear has been expressed in relation to increased regulation of the Hong Kong banking industry where it

has been suggested that "over-regulation will damage confidence by causing widespread mistrust in local banks and raising costs (for example by raising the capital adequacy ratio) above those of regional competitors."[3]

THE GODS OF THE COPYBOOK HEADINGS: THE AUSTRALIAN PERSPECTIVE

With your indulgence I propose briefly and by way of overview to examine each of the separate headings mentioned by Kipling in an Australian context before turning to Hong Kong. You will appreciate that I speak as one who has not resided in Australia since 1986 so my review will be necessarily impressionistic and anecdotal. I will leave it to the expert commentators to focus on issues I will only briefly address.

The respective jurisdictions provide a most useful parallel. In one, Australia, in banking and commercial fields, we have gone from a system of reasonably strict regulation to one which is more flexible, while in Hong Kong the position is the reverse.

For many years in Hong Kong the system has been almost entirely deregulated and it is only now that the government is endeavouring to wring some of the excesses that that has engendered out of the system. As a result, in the past, there have been bank collapses galore, large-scale corporate fraud, and a worrying lack of stock-market regulation. Perhaps because of the wide remit of the Independent Commission Against Corruption there has been little suggestion of any "political rent" in a direct sense having any impact on the banking and financial markets.

That **both** jurisdictions, Australia and Hong Kong, have suffered grievous corporate failure, with consequent strain upon the banking system, should provide a caution against believing that massive de or re-regulation will, of itself, resolve all difficulties.

AN OVERVIEW

"THE GODS OF THE MARKET PLACE TUMBLED"

It is, perhaps, some small solace to those now cheek by jowl with the consequences of corporate and banking failure in Australia that such difficulties are nothing new. A little over 100 years ago, in 1891 (and by sad coincidence, once again in Victoria), under a much less regulated regime than that which applies today, 54 of 64 of the banks operating in Victoria closed, 34 of them forever.[4] In words which are completely apposite to today's situation, there was a call for increased company and banking regulation to prevent such a thing happening again. The call was motivated by problems at the highest level in government which have a general application to today's on-going inquiries.

> "When the holders of the most respected offices in government - the Premier, the Speaker and the Agent-General - are all involved in allegations of fraud, dishonesty and manipulation, even the widows in Bournemouth must begin to suspect that somewhere, somehow, something is wrong."[5]

DEREGULATION: THE MACRO-ECONOMIC RESULTS

Even setting aside examples of misfeasance and fraud, we have the sad fact that since wholesale deregulation of the banking industry, in the words of a leading article in the *Business Review Weekly*, "foreign entrants have fallen by the wayside". "They were like front-line troops sent to attack the formidable bulwarks of oligopoly and the entry

barriers set up by the incumbent domestic banks. Like most front-line troops, the foreign banks never really had a chance to succeed."[6]

Of the sixteen banks which entered a deregulated market in 1985, only five have managed to show a profit with an average return on equity of less than 5%. Those banks not in the black had accumulated in aggregate a loss of US$577 million and many were either being sold or scaling back to core business. It remains to be seen whether or not allowing branch operations as proposed by the Martin Committee will suffice to return them all to profitability. It has been said that by operating as subsidiaries the Reserve Bank could more easily protect depositors - whether a wholesale change to branch status will improve the position has been said to be "debatable".[7]

On a macro-economic scale, it has been suggested that the "freeing up" of the financial markets and the general increase in the availability of credit has played some part in the present state of the economy. Despite that deregulation, however, it does not appear that many of the present banking difficulties flowed from inadequate capital ratios. The problem has sprung from a much lower level and timeless cause, mismanagement and peculation.

NO PROTECTION AGAINST FRAUD - "ALL IS NOT GOLD THAT GLITTERS"

It may fairly be said that, during the bull-run now ended, very little would have saved the banks from themselves. No question of equity ratios or adherence to the Basle Accord would have prevented the disasters on a micro-level which have devastated deposit holders and the banks and building societies which have lent too much too often. For a time, all too long in hindsight, basic rules of banking and secured lending appear to have been forgotten. It is usual in a banking class to tell the students never to lend against security on the basis that cash-flow is all important.

In many cases which may be culled from the reports the lenders did not **even inquire about the existence of the proffered security**. It was as if they had taken as their credo that of the chief manager of Penn Square Bank in the United States which was ultimately responsible for the "up-stream" demise of Continental Illinois - "This deal's too safe for me!"[8]

To illustrate that point, I will give but two egregious examples, drawn at random from a casual perusal of the law reports. The sad end of a principal protagonist has meant that the full details of the position surrounding the National Safety Council will never likely come to light; the lending policies of banks to that organisation make interesting reading as a matter of banking practice.

You will recall there that it was possible for very large amounts of money to be borrowed without there being any physical collateral in existence at all.[9] Nor was there any great subtlety used in disguising this fact. Indeed, surprisingly for safety equipment, as Tadgell J noted, none of it was available at all for inspection or use. The most casual inquiry by a lender or an honest director would inevitably and immediately have revealed the missing machinery.

In a similar sort of arrangement, two banks were cajoled into entering a transaction in which the relevant security was non-existent, in an unedifying display of lack of legal care.[10]

"SMOOTH-TONGUED WIZARDS" - CULPAM COMES POENA PREMIT[11]

What role have the "smooth-tongued wizards" played in all this? Some have been jailed; some have fled the country and are unable, we are told, to return; some have demonstrated that remarkable resiliency and ability to fight back which contributed to their rise in the first place; some are living with new paramours on funds and assets which materialise as if by magic. They are wizards indeed.

There is one salient feature of our recent experience which Mr Hartnell has commented upon. The legal system is ill-equipped to detect or deter the wizards or to sanction them after their spells have failed. The system (or lack of it) has permitted the otherwise humorous result of allowing a bankrupt wizard to leave the country after a meeting of creditors permitted the return of his passport using the legal stratagem of having small creditors vote. It has permitted a sophisticated wizard to postpone, seemingly indefinitely, personal bankruptcy thereby pushing back the period of relation back and preference in order to bolster the position.

It must be conceded that the legal system has proven remarkably ill-equipped to deal with possible fraudulent activity. Whether it is a problem of overcharging, or the inability of a jury to get to grips with complex commercial facts, or the sinuosities of the law itself, little has yet been done to bring those suspected of gross peculation to book. The delay in doing so is the subject of continuing controversy and dispute between the Chairman of the ASC and others. I will leave it to Mr McCusker to discuss why the problem has arisen and what might be done about it.

INTERNATIONAL COMPARISONS

It is, however, well-worth recognising that we are not alone in facing such problems. The current rash of serious fraud trials in England has yielded little by way of result. In the Barlow Clyde scandal, Mr Peter Clowes was sentenced to 10 years in jail. When his company collapsed it had liabilities of GBP115 million and only 1.9 million in gilts which was the enticing form of investment proposed. That fraud was fairly straightforward but the trial lasted for 112 days and 113 witnesses were called; only two of the four accused were convicted.[12] A third trial into the Guinness take-over appears now to be unlikely, mainly because it was difficult for the Serious Fraud Office to demonstrate that its stockbrokers had criminally assisted it to support its share price. The second Guinness trial had been aborted after a four month hearing when one of the defendants, Mr Seelig, appearing for himself, seemed likely to collapse.

The Blue Arrow trial also failed to produce a large number of convictions. After a trial costing over GBP40 million five out of ten defendants have been acquitted on the judge's direction.

Similarly, and more unfortunately in Hong Kong, you will be aware that the Carrian trial, the longest trial in common law history collapsed after a direction by the trial judge that the indictment was bad for duplicity and that there was no case to answer. The judge unfortunately died shortly after that decision and his early retirement but it is true that his decision was greeted with incredulity at the time and was the subject of sustained criticism in the Hong Kong Court of Appeal.

A similar weakness in the system may be perceived in certain inquiries operating now in which a witness may refuse to answer further questions on the basis that to do so may lead to self-incrimination. Mr Justice Rogers in the Commercial Division in Sydney has inveighed against such tactics but they are entirely open on the law as it stands at

present. A similar position may be seen in the stance taken by the sons of Robert Maxwell in the face of inquiries by the House of Commons committee into the disappearance of vast amounts of pension money.

In order to circumvent these difficulties a number of controversial remedies may be necessary.

(a) it may be necessary to denature the "right to silence" - in many impugned transactions the perpetrators are the ones who know most about it and should be called on to provide some explanation;

(b) it may be necessary to avoid "overcharging" on the part of prosecuting authorities - it is surely far more effective to obtain a series of convictions on fairly simple offences with consecutive sentences imposed than to fail in some mammoth trial where offences of doubtful validity are explained to a perplexed jury of laymen.

These suggestions are, of course, very poor palliatives **after** disaster has struck. What is required is some means of preventing misconduct. Certain discovery and condign punishment would provide the surest prophylaxis against it. In the nature of things, that will be very difficult to achieve.

THE ROLES OF THE AUDITOR AND LEGAL ADVISERS

In order to improve the prevention of misconduct, it may be necessary to fasten increased liability upon third-party advisers who are notionally at arm's length with the bank or company carrying on the business.

This is already occurring in the United States where, in the aftermath of the thrift failures, several law firms have agreed to administrative settlements with the Resolution Trust Corporation set up to deal with failed thrifts rather than face possible sanction. For example, in relation to Lincoln Savings and Loan, the New York firm of Kaye, Scholer, Fierman agreed to a settlement running into millions of dollars with the RTC rather than face possible prosecution for conniving at Lincoln's deliberate flouting of regulations.

The possibility of such sanctions against those who are independently seized of knowledge about financial misconduct raises very difficult ethical questions. We have already witnessed the problems which may arise with respect to rendering professional advice on the structuring of taxation liabilities.[13] It may well be extraordinarily difficult to draw the line between what is allowed and what is impermissible. As a New South Wales court pointed out long ago: "combination is one thing and improper combination, amounting to a conspiracy to commit a crime or a civil wrong, is another thing."[14]

A constant theme running through many of the recent banking debacles was the close connection between advisers and those executing the transactions. As Justice Brennan pointed out in **Leary v FCT**:[15]

> "Entrepreneurial activity does not attract the same privilege nor the same protection as professional activity; and the promotion of a scheme in which particular clients may be advised to participate is pregnant with the possibility of conflict of entrepreneurial interest with professional duty."

Recent events have provoked a fairly heated debate about the extent of an adviser's duty,[16] and a barrister with some insight into the activities of the wizards has argued:

> "And what is wrong with testing the boundaries of the law? No doubt the person who goes over it (that is the boundary) may be punished. But is not everyone entitled to find out where the boundary is?"[17]

On the basis that what happens in America, will, subject to constitutional and other constraints, happen here about 15 years later, it seems probable that regulators will endeavour to increase the burden and risk for professional advisers. Such advisers are pre-eminently well-situated to detect "misconduct" in its early stages; determining what to do about such detection will place increasing ethical strains on both the legal and accounting professions.

At last year's conference, Professor Athol Mann examined in detail the present common law position with respect to auditors' liability and suggested various possibilities to limit the present exposure. It seems much more likely, in the current regulatory mood, that there will be greater sanctions imposed on advisers. Since the common law remedies are a singularly slow and inefficient method of proceeding, it may be that administrative remedies of a quasi-penal nature would be more appealing to regulators. Simultaneously, obligations of positive disclosure could be imposed on advisers with statutory protection in the event of any breach of contractual duty of confidence. A good example of such legislation is contained in the Hong Kong Proceeds of Drug-Trafficking Ordinance which specifically protects any third party adviser who suspects and reports the laundering of drug-proceeds from any civil claim for breach of confidence.

The Martin Committee has recommended that the Reserve Bank should have increased prudential ability to allow it to monitor banks more closely. In particular, it has been suggested that treatment of doubtful and non-performing loans should be more carefully scrutinised. However, in order to achieve this laudable objective it surely makes most sense to throw primary responsibility upon those who are most familiar with the bank's business, the auditors and legal advisers.

"THE HEARTS OF THE MEANEST WERE HUMBLED"

"Meanest", of course, has no pejorative meaning in this context. What Kipling meant here was that those who could least afford it were the ones to suffer most from the wizards' depredations. There has, to my knowledge, been no systematic study of the impact of the failure of various financial institutions on the various small investors. Liza Carver will be addressing that point in her talk. It suffices to notice the present absence of any form of deposit insurance to protect the small investor. I will return to this topic a little later in the examination of Hong Kong banking.

THE HONG KONG EXPERIENCE

BANKING

In Australia, since 1983 at least, the trend has been towards increasing deregulation. By way of contrast, the Hong Kong banking system has been subject to increasing regulation over the last 6 years.[18]

The mid-1980s saw the collapse of a number of small family run banks which were being used as private money-boxes by those in control. Frequently the abuse took the form of "insider-loans" by means of which those close to the control of the bank were able to borrow huge amounts unsecured. Often the interest rate offered by these banks was fractionally more than that offered by the cartel of major Hong Kong banks and the "loans" themselves were written up in the books as overdrafts. Inevitably, upon subsequent examination, the credit control procedures for the granting of the facilities

were found either to be hopelessly inadequate or non-existent with no proper credit reports of proposals for which the monies lent were to be applied.

To overcome these difficulties, new regulations were instituted in 1986 with the introduction of the new Banking Ordinance.[19] Under the new Ordinance, authorised institutions were initially required to have capital adequacy (capital to risks) of at least 5% and liquidity (liquefiable assets to total deposits) of not less than 25%. Both ratios could be increased at the discretion of the Commissioner and have now been raised to bring Hong Kong into line with international adequacy standards.

THE STOCK EXCHANGE AND FUTURES COMMISSION

A frequent complaint in relation to the Stock Exchange was that it operated largely on inside information. Until recently, with the introduction of new Insider Trading legislation, the only sanction against such activity was the possibility of a finding of "culpable trading" on the part of the Securities Commission. That has now changed and a treble damages regime similar to that which operates in the United States has been introduced. (To give some idea of the problems which used to exist, one need look no further than the on-going trial of several former members of the Exchange's listing committee who, it appears, regularly obtained a certain tranche of shares in any newly listed company as one of the natural perquisites of their position.)

In order to combat "insider" problems, new regulations have been introduced which now require any person defined as an "insider" to disclose the existence of and the extent of the borrowing. This borrowing is not permitted to exceed more than 5% of the capital of the bank unless certain disclosure requirements are satisfied.

Problems of deregulation extended also to the stock-market. As many of you will be aware, Hong Kong was in the ignominious position of being the only stock-market to close after the calamitous drop in share prices on Black Monday in October 1987. The market closed then for a period of 5 days and the Financial Secretary was severely criticised for permitting it to close. Following Black Monday a thorough investigation into the operation of the Stock Exchange and the Futures Exchange was ordered. In relation to the Futures Exchange, only the intervention of the government and the largest clearing banks prevented the collapse of the entire system when it was found that huge open positions without collateral and on very high margin had been permitted. Since the market opened "at bottom" on successive days there was no way in which those people with "open positions" were able to close out before the Futures Exchange automatically stopped trading for the day.

I have been involved with several of these large trading cases and in many of them the trading was being conducted without proper credit investigation through the medium of Liberian-registered shelf companies which, of course, upon recourse proved to be absolutely lacking in substance or exigible assets.

CIRCUMSTANCES PECULIAR TO HONG KONG

In considering earlier banking problems in Hong Kong, however, two facts must always be kept in mind. First, in the past, the government has intervened to support failed financial institutions either by directly injecting capital itself or by organising a "rescue" operation through the offices of the largest banks, headed by the Hong Kong and Shanghai Banking Corporation. Secondly, the government itself is believed to have very large hidden reserves which are used to support the Hong Kong dollar. (By way of aside, the Hong Kong dollar is "pegged" since 1983 to the US dollar at the rate of 7.8 to US 1. In order to support this rate when the interest rates in the respective jurisdictions

become unaligned (as briefly occurs from time to time) the government is believed to have stored away very large amounts from the budget surpluses conventionally run in Hong Kong.)

Accordingly, there was, until the recent BCCI debacle, a belief that the government would always be in a position to intervene to provide support and reassurance should any bank be placed under pressure.

Secondly, the question of political risk in Hong Kong must never be discounted. The government has recently begun several large infra-structure projects, the largest of which is the building of a new airport and supporting facilities at Chek Lap Kok, on Lantau Island which is an island to the west of Hong Kong. The PRC authorities (who intervene frequently in the Hong Kong media through the New China Newsagency which is the unofficial PRC representation in the Territory) have expressed concern that the introduction of such a large project within foreseeable view of the "handover" to occur in July of 1997 may result in the cupboard being bare when that handover occurs. As a consequence of continuing uncertainty over the line of succession in Beijing upon the death of Deng Xiao Ping, any financial uncertainty has large repercussions on a scale unlike that in Australia.

BCCHK

The latest difficulty to assault the Hong Kong banking system has been the problem surrounding Bank of Credit and Commerce Hong Kong. The difficulties they experienced underscore my earlier comments about the political equation in Hong Kong. For the closure of BCCHK not only brought depositors out into the streets in force. It also provoked a run on both Citibank and Standard Chartered, one of the two note-issuing banks in the Territory. These later events prompted a senior government official to commence a ludicrous inquiry by the ICAC to find and punish those alleged to be spreading "rumours", an obviously inchoate offence which is still, one hopes, unknown to the common law. The Ombudsman has since commented: "I take a firm view that senior civil servants must be responsible for their own statements, even though made in the heat of the moment."[20]

The BCC group operated under the aegis of a Luxembourg holding company which had two main subsidiaries, one incorporated in Luxembourg and the other in the Cayman Islands. The Hong Kong entity was a direct subsidiary of the Luxembourg holding company. It had a deposit-taking subsidiary based in Hong Kong. After incurring the losses, the Abu Dhabi Government injected new capital into BCC Holdings and became the owners of 77% of its shares in 1990.

The general supervision of the BCC Group on a world-wide basis was remarkably loose, perhaps because it seemed to be operating in a large number of diverse jurisdictions. A "College of Supervisors" had been set up in 1988 to regulate its affairs. Banking regulators from the United Kingdom, Luxembourg, Spain and Switzerland were involved. The Hong Kong Banking Commission also joined this group in July 1989. In order to improve control, a restructuring of the group had been proposed and was in the course of being carried out.

The Hong Kong entity had made provision for bad and doubtful debts of HK$565 million in 1990 and recorded a loss of HK$431 million for that year. Since the loss had capital ratio implications which in Hong Kong is a minimum of 8%, the Commissioner had required the minimum ratio to be raised to 11% and this was accomplished by a capital injection of $125 million by major shareholders in June of 1991 in the form of a subordinated loan.

For reasons which are still unclear, the regulators in England decided very suddenly to close the United Kingdom operations.

Notwithstanding these difficulties, the Commissioner who had only been in the post for a week or two, decided to allow the bank to open for business on the Saturday. He did so, he has told us, for five main reasons:

(a) the Hong Kong operation was a separate legal entity with its own management and balance sheet. It was not a branch and it appeared that its group exposure had been substantially reduced;

(b) the local operation did not appear to be implicated in the allegations of fraud;

(c) it appeared to be financially sound - despite the 1990 losses the underlying entity continued to make a profit;

(d) the prudential ratios were met as required by the Banking Ordinance; and

(e) BCCHK appeared to have its shareholders' continuing backing.

Furthermore, in making the decision to allow the bank to remain open, Mr Carse commented publicly that BCCHK was "sound and viable" and that the Exchange Fund was ready to help out "on commercial terms". The bank closed for good on 8 July after re-opening for half a day on Saturday, 6 July.

It has been argued that the Exchange Fund could not be used since its only proper use is to protect the value of the currency in the event of strain on the pegged rate.

After a prolonged period during which attempts were made to sell the Hong Kong entity, BCCHK was finally put into liquidation. It was said that the attempts to sell were forestalled by the sudden onrush of claims being made by liquidators in other jurisdictions who alleged that the HK operation had "parked" several large transactions with them and which therefore generated claims in the Hong Kong liquidation.

THE OMBUDSMAN'S REPORT

Not surprisingly, the actions of the Commissioner in approbating and reprobating within a matter of two days caused immense concern to those who, acting on his assurances, had left money in the bank when it opened for business on the Saturday. There even had to be a public denial that a motive for doing so was to allow a large number of transactions concerning the government itself to be effected before the shutters were finally lowered.

There has to date been no public inquiry although there has been agitation for one to be established. Several individual depositors have been appointed to the Committee of Inspection but I have been advised that the powers conferred on the liquidator are such as to allow him carte blanche, thereby obviating the need for any but infrequent reference to the Committee.

The Ombudsman commented that there were two key problems with the statement of the Banking Commissioner. First, although the continued support of the Abu Dhabi Government was absolutely fundamental to the continued operation of the bank, the Commissioner omitted to stress in his first announcement that support from the government while still being sought had not been confirmed. Secondly, in referring to

the Exchange Fund, the Commissioner may have given depositors the impression that the Hong Kong Government was itself prepared to intervene.

> "This is because the Government had previously used the Exchange Fund on several occasions to bail out banks in trouble, a fact probably not appreciated by the Commissioner of Banking due to his short time in Hong Kong, but this should have been well known to the Office of the Exchange Fund which had been consulted on the announcement."[21]

In summary, the Ombudsman concluded that the Commission gave a clean bill of health to the Hong Kong operation even though:

(a) BCC's fate was indirectly tied to that of the parent and was not operating independently from the world-wide group;

(b) HK's fate might be affected by other members of the group (this in fact subsequently proved to be the case, forcing the bank into liquidation);

(c) the success of any rescue depended upon further support for the major shareholder and this had not been guaranteed.

The Ombudsman concluded that the Commissioner's assurances were "unwise" and "over-confident" and "miscalculated" the effect of the world-wide closure.

Legal action has been taken against the Commissioner by several depositors. It seems unlikely in the state of the authorities that such a claim will ultimately succeed.

More serious for the future has been the suggested lack of coherence in co-ordinating a response to the crisis. It is not clear in what circumstances the Exchange Fund may be used legally to bolster the credit position of a failing bank. Nor is it clear how well the head of the Exchange Fund, the Financial Secretary who controls its use, and the Commissioner of Banking, are able to co-ordinate their mutual response to a problem.

It is easy to envisage circumstances in which the Hong Kong banking system could once again come under sustained pressure. It is not clear what view the PRC will take of the Hong Kong Bank's move to acquire control of the Midland Bank and a possible move away from Hong Kong - for one thing, it is unlikely that the PRC will allow a de facto central bank to be based elsewhere than in Hong Kong. Similarly, the likely events in China upon the death of any of the paramount leaders may lead to problems in Hong Kong.

A DEPOSIT INSURANCE SCHEME

In order to circumvent problems like those of BCCHK, it has been suggested that a Deposit Insurance Scheme should be set up. It has been argued that such a scheme is antithetical to the way in which Hong Kong does business; in particular, it has been contended that such a scheme introduces an unacceptable "moral hazard" and is unfair to the larger banks. Such a scheme was initially suggested in 1985 but rejected after the larger banks opposed its introduction. A DPS is based upon a number of assumptions:[22]

(a) that the Banking Commissioner will continue to exercise prudential control over banks after 1997 as envisaged by the Joint Agreement of 1984 between the Chinese and British Governments;

(b) that the scheme could cover deposits up to HK$100,000 or its foreign currency equivalent in all banks licensed in Hong Kong. The coverage would be 75% of the deposit.

It has been suggested that the initial contribution would be in cash and any claims would be met from the invested contribution and from bank guarantees up to an agreed maximum. "A bank could hypothecate against a possible liability on investment in government bonds. ... The commitment would be on a case-by-case basis and the drawdown would in turn be compensated from the eventual proceeds of the liquidation."[23]

A consultation paper proposing such a scheme has been introduced. It will be interesting to see if Hong Kong moves to adopt such a scheme which would represent a further large concession to regulation and protection of investors and a further retreat from the free-wheeling times of the past.

THE GODS OF THE COPYBOOK HEADINGS? GENERAL CONCLUSIONS

Many of the problems of the past few years have arisen, not because of any macro-difficulty of liquidity ratios which are too low, or licensing requirements which are too loose, but from moral hazard pure and simple. How is one to legislate against that?

In a banking context it will be very difficult. When credit is easily available in the market and banks are fighting for market share, there is a strong incentive to believe that "all that glitters is gold and that two and two do not make four". In the good times, a cynic would recognise that there is very little reason not to lend since many of the transactions will be booked by bankers who will not be there by the time things go bad.

Kipling is one of the greatest democratic poets which is to say that he could state a platitude better than almost anyone else. He took a dim view of the possibility of improving upon the vices of human nature which stand at the forefront of any problem of regulation and his final stanza is worth considering by all those who believe that regulation will have any appreciable effect. No matter what regulation is introduced, human nature is such that the "Dog will return to its vomit, and the Sow return to her mire, and the burnt fool's bandaged finger will go wobbling back to the fire". In a few years, "as surely as water will wet us, as surely as fire will burn, the Gods of the Copybook Headings with fire and slaughter return".

FOOTNOTES

1. R Kipling, "The Gods of the Copybook Headings", *Collected Verse*.

2. A good personal parallel is the evidence now required to obtain or renew an Australian passport; excessive regulation here was introduced to combat the fake passport use of drug couriers in the early 1980s. There is no empirical evidence that it has had great success in doing so and it is a large and unnecessary burden to the great majority of honest citizens seeking to renew their passports.

3. Davies, *Hong Kong to 1997: A Question of Confidence*, (Economist Intelligence Report), p42.

4. On the dangerous uses of history in interpretation, see, McQueen, "Why High Court Judges make Poor Historians: The Corporations Act and Early Attempts to Establish a National System of Company Regulation in Australia", (1990) 19 *Fed LR* 252, 254.

5. Sykes, *Two Centuries of Panic*, (1988) p192, quoted by McQueen, *op cit.*

6. Banker's Trust managing director, Rob Ferguson, quoted in Kavanagh, "Foreign Entrants fall by the wayside", *Business Review Weekly International*, February 1992, p30.

7. Kavanagh, "Foreign Entrants fall by the wayside", *Business Review Weekly International*, February 1992, pp30, 31.

8. See, Singer, *Funny Money* which describes in detail the demise of Penn Square Bank in Oklahoma as a result of reckless lending to charlatans in the natural gas industry. As a result of sales of debts "up-stream" to Continental Illinois that bank, too, suffered unprecedented losses.

9. Tadgell J in **Commonwealth Bank v Friedrich** (1991) 9 ACLC 946.

10. **State Bank of South Australia v Rothschild Australia Ltd** (1991) 8 ACLC 925.

11. "Punishment comes as a sure companion to guilt"; the motto of a fine police force.

12. *Economist*, 15 February 1992, p80.

13. **Forsyth v Rodda** (1987) 72 ALR 49; (1989) 87 ALR 699 (Full Federal Court).

14. **R v Tighe and Maher** (1926) 26 SR (NSW) 94, 108-109.

15. (1980) 32 ALR 221, 239-240.

16. See, McHugh, "Jeopardy of Lawyers and Accountants in Acting on Commercial Transactions", (1989) 5 *Aust Bar Review* 1; AJ Myers, "Tax Advice: The lawyer's ethical responsibility", (1990) 19 *ATR* 80.

17. AJ Myers QC, *loc cit*, p86.

18. For a detailed analysis, see Ghose, *Hong Kong Banking Law*.

19. For a full discussion, see Ghose, *op cit*, and Davies, *Hong Kong to 1994: A Question of Confidence*, (Economist Intelligence Unit), pp41-47.

20. Report of the Ombudsman reported in the *South China Morning Post*, 15 March 1992, "Money" section, p2.

21. Report of Mr Garcia, the Ombudsman, published in the *South China Morning Post* of 15 March 1992, "Money" section, p2.

22. The former Banking Commissioner, Robert Fell, set out some of the issues in an article in the *South China Morning Post* of 15 March 1992, "HK needs a DPS - economically and socially".

23. Fell, *loc cit*.