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Financial Services Authority

An ethical framework for financial services

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Foreword

Our four statutory objectives - ensuring financial stability, protecting consumers, promoting consumer understanding and preventing financial crime - matter.

We have constructed a framework of principles, supported by more detailed rules and guidance, and developed a risk-based approach to regulation. We do not seek compliance for its own sake. In any case, mechanical compliance has done little to prevent problems in the past, often with serious repercussions for those affected.

The principles – our high level standards – are based on ethical values. But it is not clear that this ethos is fully understood or applied consistently by everyone working in the industry.

This paper considers why that might be and how we might move beyond rhetoric and aspirational goals to have a tangible impact on firms' and individuals' motivation to do the “right thing”.

We explain what we mean by ‘ethical behaviour’ and why it matters, not only for the financial services industry but also society more widely. We argue that everyone will benefit if we can minimise the scope for wrongdoing happening in the first place. We also offer a framework for discussion and action to achieve higher ethical standards.

We invite you to engage with us in this debate.

Howard Davies
Chairman
October 2002

1 Introduction

The financial services sector is quick to seize on recent episodes at Enron and Allied Irish Bank and condemn them out of hand. But the public perception of most financial firms as interested in making money at the expense of all other considerations seems to be unchanging. Why is this? Is it simply wrong? Can financial firms and those that work in them do anything to alter this perception? And as the regulator – should we and can we do anything to change behaviour, if indeed it needs changing?

The financial services sector has an increasingly difficult task balancing the demands of a lengthening list of ‘stakeholders’ – shareholders, the community, investors and pressure groups – not to mention our demands as the regulator. Nearly everyone is a stakeholder of the sector, conducting a relationship with it. So, it is not surprising that the sector is subjected to so much public scrutiny.

The sector undoubtedly feels the pressure. Take our new regulatory regime as an example – with a long and detailed Handbook. This highlights perfectly the crux of the issue. Surely, if the sector conducted its business in line with the overall standards and principles in the higher level sections of the Handbook, the progressive regulatory restriction felt by many would be avoided. However, some parts of the sector seem to be at the stage where the question is more likely to be “show me where it says we can’t...?” rather than “how can we improve our standards and conduct our business with integrity...?”.

The professions also have detailed codes of conduct, including rules and guidance dealing with ethical standards and conflicts of interest. Despite the existence of such codes, levels of trust have to be seen to be subject to challenge. Some regard the handling of complaints as indicative of a tendency to “protect their own”.

Our overall regulatory approach, driven by the Financial Services and Markets Act (FSMA) is values-based. We feel that we have a role to play, to stimulate a wide-ranging discussion on how to raise standards generally, and ethical

standards of behaviour in particular. This does not mean though that we presume to be the sole conscience of the financial services sector in the UK: we are part of the collective conscience.

This paper has no intention of suggesting the introduction of new or more rules. The purpose is to ask questions that raise key concerns about standards. We are seeking to test assumptions about what types of behaviour are acceptable, what might constitute sharp practice and where and how people draw the line. We are looking at specific actions that make the difference.

We also want to consider how public perception might change, so that the sector continues to provide the necessary expertise, but does so with an integrity that fully responds to modern society's expectations and engenders mutual trust.

And we want to establish a clear and explicit, shared understanding about what integrity means in practice.

2 Why ethics matter

Reputation, reputation, reputation! – behaviour perceived as unethical can carry a significant bottom line cost – and not only for one year. The ‘ripple effect’ of being linked, or being seen to be linked, to an unethical firm or situation can be very damaging for other parties too. And the stench can be difficult to get away from. Reputational issues rarely respect national boundaries!

Secondly, there is increasing pressure from consumers and Government to ‘put something back’. A good example is the growing interest in policies to combat social exclusion, particularly from a financial standpoint.

Thirdly, consumers are increasingly understanding an ethical stance – it has appeal to some consumers, arguably without them having to do very much. The level of confidence enjoyed by the industry could be strengthened, but not if consumers see firms as having moved from one form of ‘legitimate’ aggressive business strategy to unethical corner-cutting. If consumers have diminishing trust in the sector, they will hesitate to use the products and services available.

Closer to home, a firm that demonstrates a good standard of ethical behaviour can generate loyalty internally. Furthermore, promulgation of that stance throughout its business dealings can significantly raise staff awareness of ethical issues, which in turn can lead to early identification of problems and have cost and reputation savings for the firm. Clearly, a positive ethical stance has to spring from a genuine desire on the employer’s part to promote higher standards of behaviour – otherwise their efforts risk being seen as empty, manipulative and opportunist.

It would be easy to disregard some of the above as being relevant only at the level of *individuals* acting on a desire to increase ethical standards. This is not in itself a problem as a sense of willingness in the sector to increase standards will, essentially, come from heightened interest to do so on the part of the individuals within the sector. However, when pooled, the efforts of such

individuals could represent a significant opportunity to maintain and increase market confidence. Distinguishing the UK financial services sector as being renowned for good ethical practice could help it to absorb some 'shocks'.

In summary, reputation is the key to the business case for ethics, and reputation of the sector and the firms within it is important to all of us. We threaten no 'stick' as such, but we would emphasise a significant 'carrot'; good, ethical behaviour can also be a competitive advantage, and, in time, a way to lighter regulation.

3 Where ethics and regulation meet

Ethics and regulation meet because standards of behaviour affect our ability to achieve our objectives set down by FSMA.

Poor ethical standards clearly have detrimental effects. They pose risks to market confidence and consumer protection. They can increase the scope for financial crime and have a negative impact on public awareness and confidence.

In contrast, the highest ethical standards can generate significant benefits for all stakeholders.

Here are some examples of the potential benefits:

- **Market Confidence**

Differentiating the UK financial services sector as being renowned for good ethical practice. A good ethical track record for the sector could help it (and its regulator) to absorb some 'shocks'.

- **Consumer Protection**

Improved ethical standards might include a better relationship between firms and consumers which would be reflected in, for example, improved financial promotions.

- **Financial Crime**

To change the perception that it is easy to launder money in the UK, and to reduce the scope for our firms and markets to be targeted by criminals in the first place. This can be done by developing individual responsibility and a sense of involvement by all staff.

- **Public Awareness and Confidence**

Higher business and individual standards of behaviour promoting the integrity and the general probity of all working in financial services will enhance public perceptions and trust in the firms and individuals concerned.

Figure 1 offers a model for the development of values and culture, and the nature of the relationships between firms, consumers and us. The model works in terms of individual firms, or a sector, or the industry as a whole. It is also not assumed that firms move in one direction consistently, they may slip back or develop at differing rates at different times. However, the model gives a direction and an ethical dimension for firms/sectors/the industry.

Figure 1



We do not seek to make unsubstantiated, high-ground claims about how a moral case complements the business case – there may not be a pure business benefit every time. There is always perceived to be, even when there is not, a gap to bridge between a purely business case and doing the right thing. However, this doesn't mean an ethical approach is incompatible with increasing shareholder value.

There have been several high-profile efforts to improve businesses' corporate governance in recent years, much of it consolidated in the Combined Code on Corporate Governance¹. There have also been new legal challenges, not least the incorporation into UK law of the European Convention on Human Rights. There have been major, highly-publicised failures, for example Enron and Worldcom. These have added more pressure on firms (and indeed everyone in business) to increase openness and transparency.

There is the perception in relation to regulators' reactions, that 'the sins of the few spoil the virtues of the many'. Those firms that behave unacceptably always make things difficult for those who have displayed higher standards.

We are considering how we might differentiate between consistently good and consistently bad ethical behaviour, another reason for valuing the input of the sector.

¹ derived from the Committee on Corporate Governance from the Committee's Final Report and from the Cadbury and Greenbury Reports.

4 How problems arise

Unethical behaviour can arise for a number of different reasons. This section suggests some of them.

- The pressure of short-term gain could be seen to encourage undesirable behaviour. Staff bonus payments may often seem to be geared to pure bottom line success. How risks and tensions can be identified is a constant issue – e.g. truth versus loyalty, one person versus the many? In all of this it is usual for the values and actions of senior management to influence employee levels.
- Some individuals behave unethically because they think it is worth the risk. This may be related to a short-termist agenda, or may be simply personally selfish. People weigh up the pros and cons and take a chance. It is a deliberate risk/reward trade off.
- Others may believe they are behaving ethically but come to operate by a different yardstick to that used by others. They might do something which is deemed unethical, but which seems acceptable from their own perspective.
- Others (and some of these groups are not mutually exclusive) may be unaware of the values embedded in existing regulatory standards. So, they comply (or don't comply!) blindly with the 'letter of the law', rather than thinking about the wider effects their behaviour might have.

5 What could firms do?

Financial services is an important industry, affecting the lives of most people. The industry needs not simply to provide the necessary expertise, but to do so with *integrity*.

It is not always easy to decide what the right course of action in a given situation is, especially where choices appear to have equal merit or where it is impractical to seek assistance or discuss the matter with colleagues at the moment of having to decide. We are all busy people and it is often tempting to carry on our business activities unthinkingly – almost as a matter of routine.

We have developed a framework to help. This is explained below and reproduced as a laminate sheet for ease of reference.

An ethical framework

The Financial Services and Markets Act and the FSA's principles and commitments embody a framework of *core* values. In summary they can be seen as:

- *open, honest, responsive and accountable;*
- *committed to acting competently, responsibly and reliably;*
- *relating to colleagues and customers fairly and with respect.*

The following *questions* are designed to help recognise, apply and balance values in everyday decisions and actions:

Open, honest, responsive and accountable

- Who is left out or kept in the dark? Why?
- How happy are we to be associated with our decisions/actions?
- Are we listening or just hearing?
- What can we learn? How do we help others to understand us?
- How do we recognise and deal with conflicts of interest?

Relating to colleagues and customers fairly and with respect

- Do we treat everyone as we would like to be treated?
- Do we deal with people with respect and without prejudice?
- How do we keep rights and obligations in balance and proportionate?
- When do we hold to our commitments and resist ‘fudging’?
- Who benefits and who loses out? Should they?

Committed to acting competently, responsibly and reliably

- Do we do what we say we will do?
- Under pressure do we swap co-operation for coercion?
- Do we dither or delay? How is error treated?
- Do people trust us? If not, why not?
- Can we meet our commitments and plans?

To embed these values the following is needed:

Developing vision and a values-led approach

- What needs changing? What prevents change?
- What is the long-term outcome? What is sustainable?
- Do we sufficiently recognise and act on our stakeholder responsibilities?
- How do we develop shared purpose, loyalty and fulfilment?
- Do we apply ethical criteria simply to gain an advantage or because we believe we should?

Practical examples

We also recognise the value of discussion of practical examples of day-to-day situations. These can help to tease out the kind of issues that people can have to face, how they might deal with them and the value judgements they consider in doing so.

To help, we have developed a variety of hypothetical situations to illustrate where it might not be easy to decide what the right course of action might be. They are very short as they are essentially thought-starters to be used as part of a wider discussion about ethical behaviour more generally, which you may wish to have with your colleagues.

Scenario 1

You live and work in London where a major disaster has affected settlement of credit card withdrawals to such an extent that they may never be settled. This has not stopped people flocking to ATMs to withdraw cash, hoping that they will be getting ‘money for nothing’.

Questions

Would you join in?

Would you tell others?

Scenario 2

You work in the compliance area of a large securities firm. A tape is sent to you anonymously which appears to be the recording of a conversation between two of your firm’s staff. In it, the staff seem to be discussing the weak controls in one area of the firm and colluding to commit a fraud.

Questions

Do you tell anyone about the tape?

Who do you tell?

How do you approach it?

Scenario 3

You work on a voluntary basis for a small, inner-city credit union. You are thoroughly committed to your role but the pressure of your paid work (which you need to support your family) is gradually preventing you from doing your credit union role as well as you would like. You are just about keeping afloat but you know little things are beginning to fall between the cracks.

Questions

Do you admit you need to reduce or stop your credit union role?

What is your thought process in coming to a decision?

Scenario 4

You work in a senior role in financial control in a life assurance firm. The CEO has asked you to propose a ‘downsizing’ of the firm as costs are spiralling. He has asked you to be informed in your decision by employees’ performance appraisals of the last 2 years.

You notice that in some areas some employees have not been formally assessed for performance over that period. You raise this with the CEO who tells you to just decide on the basis of salary as everyone in that division is not meeting their targets.

Questions

What’s the right thing to do?

Can you do the right thing without making your position at the firm untenable?

Scenario 5

You are a journalist for the city department of an evening newspaper. Pickings are a bit light one day and your city editor tells you he heard rumours of a big city takeover involving two large investment banks. You explain that you have good, reliable contacts with these firms and had heard nothing. Your editor concedes that there is really no rumour yet insists, nonetheless that you run a speculative headline and are told to “make it sound real”.

Questions

What do you say to your boss?

If he doesn’t listen, what do you do next?

Scenario 6

You have been taken on as a financial consultant in a medium-sized firm of Independent Financial Advisers. You are asked in your first week of employment to navigate round the firm’s IT systems to familiarise yourself with them. To your surprise, you come across some memo exchanges which appear to admit that the firm widely mis-sold a certain type of bond during the past 12 months but was now going back over client ‘factfinds’ so that the mis-selling might not look so obvious. You are aware that the FSA is shortly due to visit to look at the selling practices of your firm.

Questions

Do you alert anyone to your 'discovery'?

If so, whom?

Scenario 7

You are employed as a customer service assistant in a call centre credit card operation for a major UK bank. You receive a complaint over the 'phone from a customer who claims that he has wrongly been debited £10 for an annual credit card fee when the card he was issued carried no fee. You confirm with the customer that this will be dealt with and move to amend the on-screen details. However, you remember your supervisor having told you a week or so before that given the firm's tight financial position, you should only action a customer complaint if he/she complains more than once about the same matter – even though you know this is contrary to written call centre procedures. You know that more of your calls and entries are being routinely monitored.

Questions

Do you action the customer's complaint?

What are the issues you need to consider?

What could be the impact for you?

Scenario 8

A friend tells you how he has just obtained £4000 interest free credit by getting a new credit card. He was supposed to have transferred an outstanding balance from another card to get it but the company did not check and just gave him the amount he had asked for. He did not intend to keep the card beyond the six months credit free period. He suggested you should do the same.

Questions

Do you consider taking advantage of the offer?

Are there any ethical considerations here?

Scenario 9

You are a project manager for an internet portal. You are selecting a project team for a major piece of work that could last up to 6 months. Your boss has recommended you make use of a particular member of staff who has much of the technical skills you need. However, from past experience, you know that this person has difficulty working in a team, tends to turn up to important meetings late or get the date wrong, and you had difficulty communicating this to him last time you managed him on a project.

Questions

Do you raise the issue with your boss?

What are your considerations?

Scenario 10

You work in a corporate finance firm and you have accompanied your immediate boss to a late afternoon meeting with clients at a top-notch hotel. There is more to discuss than you first realised, so the meeting spills over into dinner.

Your clients are staying overnight in the hotel. Your boss goes to the bar with the most senior client and comes back on his own. He asks you to go to the client's room to discuss the proposed deal further and to 'give him the personal touch'.

Questions

How do you respond in this situation?

What could you say to your boss assuming you wanted to defuse the situation?

Scenario 11

You run a successful but small treasury operation for a bank with a good reputation for ethical practice. A close family friend is worried about his son's job prospects and exhorts you to take him on even though there are many more suitably qualified candidates for the advertised role.

Question

What would you say to your friend?

Scenario 12

In your spare time, you do a lot of administration for a charitable organisation in your home area. The organisation clearly wants to keep overheads as low as possible so as to give as much money to its cause as it can. You often find yourself in the office of the mortgage adviser you work for after hours wading through the admin. You often forget to bring the necessary equipment with you so find yourself using the office stationery such as staplers, floppy disks, wallet files etc. You're not sure how you feel about this but try to avoid being seen doing it.

Question

Is this OK as long as it's only a small amount of stationery or is there a more fundamental issue here?

6 Next steps

We have aimed in this paper to outline a case as to why ethics matter and our interest in opening a debate on the subject. We have indicated that there is a connection between the ethical climate in any one firm, and the industry generally, and our regulatory relationship with firms.

We have also offered a framework and scenarios for discussion by readers, on their own and with colleagues.

We want to encourage you to think about and discuss the issues raised in this paper. This is a necessary first step because until we can do so with ease, we shall all surely be doubtful about how we might respond when faced with ethical dilemmas.

We are considering running workshops to take the debate forward. **If you would like to offer your thoughts about how these issues can be taken forward, or be engaged in ongoing developments, we would like to hear from you.** Please note the contact details on the inside cover.

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