

Ethics in Practice

A Practical Guide for Financial Practitioners



This book is jointly published by the organizers of Professional Ethics Programme for the Securities, Futures and Investments Sectors



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1.1 Introduction

Hong Kong, being an international financial centre, has well developed financial markets. Fund management and corporate finance businesses have also grown increasingly sophisticated with a strong presence of international financial institutions. To maintain Hong Kong's leading position as an international financial centre in the Asia Pacific region, through upholding high ethical standards, is in the interests of every financial practitioner and investor. In short, ethics in financial practice is not an optional issue. It is a necessity.

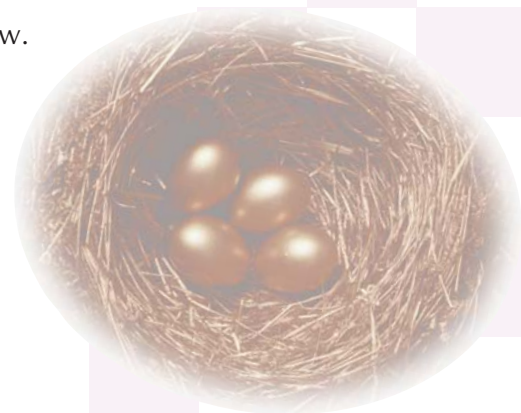
1.2 What is business ethics?

1.2.1 Ways of conducting business

Business ethics covers the whole spectrum of interactions between individuals, companies, industries and the society. It is about how we conduct our business affairs fairly and legally, irrespective of an individual's or a company's standing and size of operation in the market.

1.2.2 Above legal requirements

People often tend to define business ethics as meaning merely operating within the law. However, it means far more than that. Ethics, in business, is a set of standards above the legal minimal requirements, that clearly defines the approach to handling ethical issues in this mercurial business environment where there are few fixed rules, but many "grey" areas.



1.3 Why is business ethics important to financial practitioners?

1.3.1 Basic registration requirement

In most financial markets throughout the world, practitioners providing securities, futures and foreign exchange services are required to be authorized by a regulated authority. In Hong Kong, practitioners are required to be licensed by or registered with the Securities and Futures Commission (SFC) before conducting business. It is an offence to conduct such financial services business without the appropriate licence or registration.

In order to obtain or maintain such a licence or registration with the SFC, a person must satisfy and continue to satisfy the SFC that he is a "fit and proper person". That is to say, the onus is on the applicant to prove himself that he meets the necessary requirements for licensing or registration, whether he is an individual or a company.

The detailed guidelines are set out in the "Fit and Proper Guidelines" issued by the SFC. It places emphasis on the high standards of conduct for applicants apart from their educational, experiential and professional qualifications. They must conduct their business with integrity, fairness and diligence, and organize their internal affairs in a responsible manner. The SFC will inevitably impugn the fitness and propriety of those financial practitioners whose behaviour is unethical.

1.3.2 Prevention of non-compliance

The principles of business ethics underpin the "fit and proper" guidelines and related regulations in the financial industry. When such self discipline of practising above the legal minimal requirements becomes a state of mind, financial practitioners are guarded against regulatory sanctions and thus avoid the costs of non-compliance such as reprimand, suspension or revocation of licence, or being restricted and intervened.

Prevention is always better than cure. Spending effort up front in adhering to the ethical standards expected by the regulatory authorities is far better than rebuilding the hard-earned reputation of a financial intermediary that has been impaired by unethical practice. As such, adopting a high standard of business conduct is not an esoteric concept. It is a realistic one which ensures the future success of financial practitioners.

1.3.3 Effective marketing tool

A number of survey studies revealed that an average of 70% of consumers, including investors, considered the ethical conduct of an individual or a company a major bearing on their decision in selecting its products or services (1). The marketing equation is thus simple: Investors will seek business relationships with organizations that they can trust. The implementation of business ethics within a company creates an environment of confidence, familiarity and predictability which is crucial to customer loyalty and long-term business relationships with clients. In other words, business ethics and revenues are inextricably bound regardless of differences in the structure and size of companies.

1.4 Why is business ethics important to financial markets?

1.4.1 Enhancement of competitiveness

In the face of severe competition, especially in the Asia Pacific region, profit making or improvement of service quality is not the only element to maintaining the competitiveness of Hong Kong. Both local and overseas investors are less tolerant of unethical practices nowadays. In the course of

(1) *The percentage is quoted from "Hunting - Who cares about socially responsible business practices? Seventy percent of consumers, that's who." written by Gayle Sato Stodder, 1998.*

business dealing, they are seeking assurances about market integrity and fairness, a level playing field in competition and transparency. To this end, the commitment of all financial practitioners to observing the laws and practising business ethics is the key to building up the trust and confidence of investors and enhancing the competitive edge of the financial markets in Hong Kong.

1.4.2 Requirement of international standards

These days, people around the world are more aware of the notion of right and wrong. Sound business practice has reached new heights in market compliance and ethical literacy. The financial markets in Hong Kong have to move with the times and are in tandem with the international requirements of placing heavy emphasis on the market's transparency, accountability and the business conduct of financial practitioners themselves.

1.4.3 Ultimate benefit of the profession

Few will risk their investments in an unethical and corrupt market. The prospect of the profession in the financial industry hinges on an environment regulated by ethics and professional discipline. When business ethics is adequately enforced in the financial markets, it ultimately benefits all practitioners. The reverse is equally true if business ethics is neglected. Unethical practitioners may find themselves in trouble when public opinion turns against them and the business opportunities are lost to competitors.

1.4.4 Essential ingredient of professionalism

The continuance of public confidence in the financial markets largely depends on the professional ethics of practitioners in protecting the interests of clients and stakeholders including employers, employees and the industry itself. Furthermore, the fulfilment of professional standards through ethical business practice is a social responsibility which should be borne by all financial practitioners.

2.4.4 Application of the conduct requirement

Scenario 1 Offering and accepting an advantage both constituting an offence

Peter is a dealing director of a brokerage company. Due to the favourable performance in the local property market, the Hang Seng Index is driven up and many of his clients place orders to buy blue-chip stocks. In order to deal with the clients' orders expeditiously, Peter decides to direct a portion of the business to an external broker.

Without taking the service quality into consideration, Peter offers the business to his golfing partner, David. In fact, David charges a much higher brokerage rate than other brokers. One day, in a prestigious country club, David thanks Peter for giving him the business. He tells Peter that he is now on the executive committee of the country club and is able to secure for Peter one of the highly sought after memberships. David even implies that if Peter continues to provide him with business in the future, Peter will have more advantages. In response, Peter accepts the offer gratefully.

Analysis: *Peter violates the Codes of Conduct by abusing his official position to refer business to David in return for accepting an advantage in the form of a country club membership. Peter fails to fulfil his obligation to protect the interests of his employer and clients as David may not be the broker who provides the best service to his company, not to mention the excessive brokerage fee charged.*

If Peter does not obtain prior permission from his employer to accept the advantage, both Peter and David are in breach of Section 9 of the PBO. That is, Peter commits an offence of accepting a bribe and David commits an offence of offering a bribe. Even if Peter refers the business to David because the latter can offer the same quality of service at the same brokerage fee as other brokers, they still violate the PBO. In court, Peter cannot excuse himself by saying that his employer did not suffer any loss as a result of his act. Whether his act has caused damage to the employer is only one of the factors to be considered in mitigation by the judge.