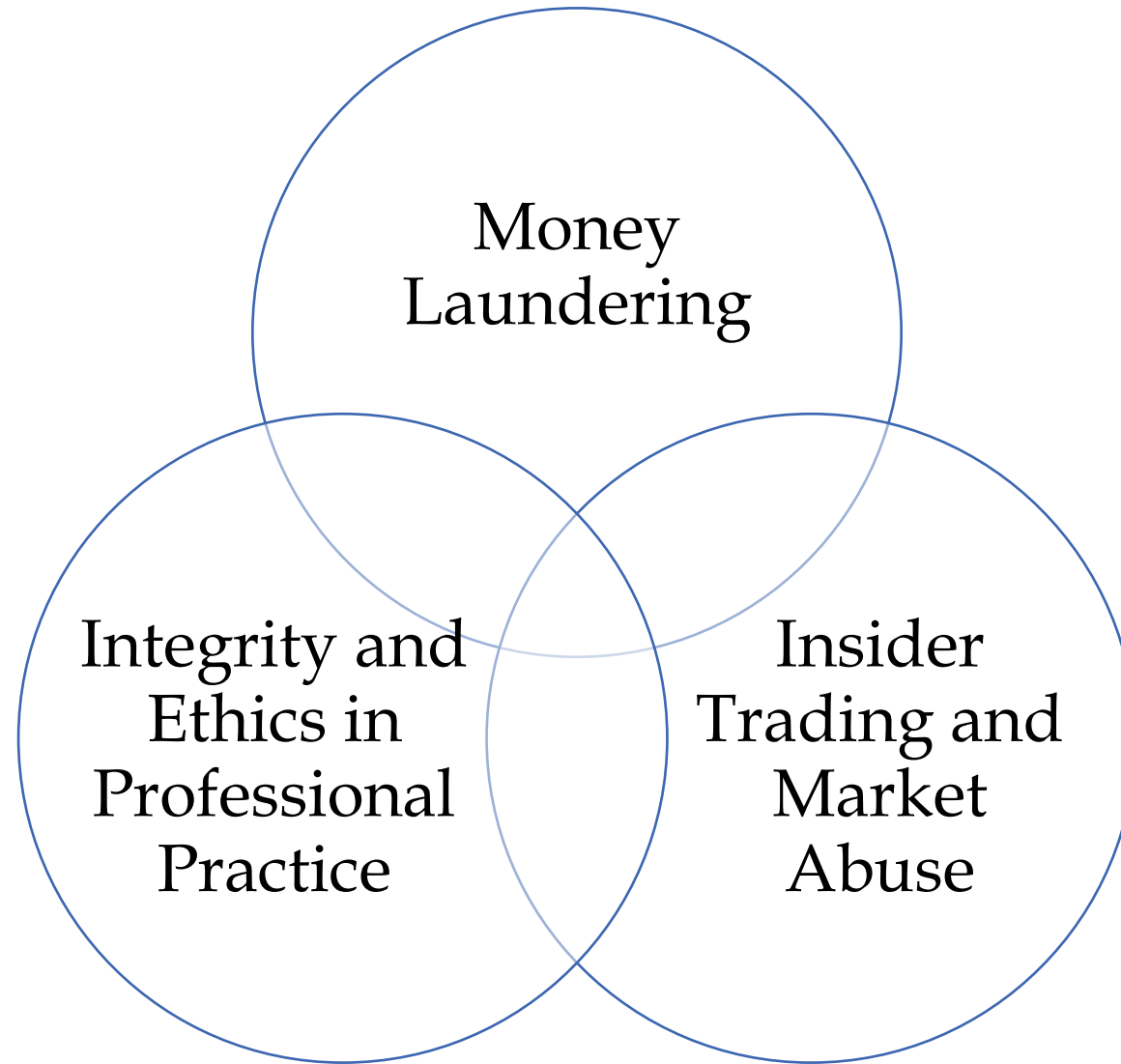




Chapter 8 – Regulation and Ethics

5 Questions





The Need for Regulation – Background and Development

Risk of Losing Money

As markets developed, there grew a need for market participants to be able to set **rules** so that there were **agreed standards of behaviour** and to provide a mechanism so that **disputes could be settled readily**. This need developed into what is known as **self-regulation**.

With the development of global financial markets came the need for improved and common standards, as well as international co-operation. Self-regulation became increasingly untenable and most countries moved to a **statutory approach** and established their own, independent regulatory bodies.

The need for international co-operation between regulatory bodies also led to the creation of an international organisation, the

International Organization of Securities Commissions (IOSCO) - designs objectives and standards that are used by the world's regulators as international benchmarks for all securities markets. E.g. money laundering rules



Regulatory Principles

- Maintain and promote fairness, efficiency, competitiveness, transparency and orderliness
- Promote understanding by the public of the operation and functioning of the financial services industry
- Provide protection for members of the public investing in or holding financial products
- Minimise crime and misconduct in the industry
- Reduce systemic risks
- Assist in maintaining the market's financial stability by taking appropriate steps.



Stages of Money Laundering

Placement

- The first stage and typically involves placing the criminally derived cash into some form of bank or building society account

Layering

- The second stage and involves moving the money around in order to make it difficult for the authorities to link the placed funds with the ultimate beneficiary of the money. Disguising the original source of the funds might involve buying and selling foreign currencies, shares or bonds.

Integration

- The third and final stage. At this stage, the layering has been successful and the ultimate beneficiary appears to be holding legitimate funds (clean money rather than dirty money). The money is integrated back into the financial system and dealt with as if it were legitimate.

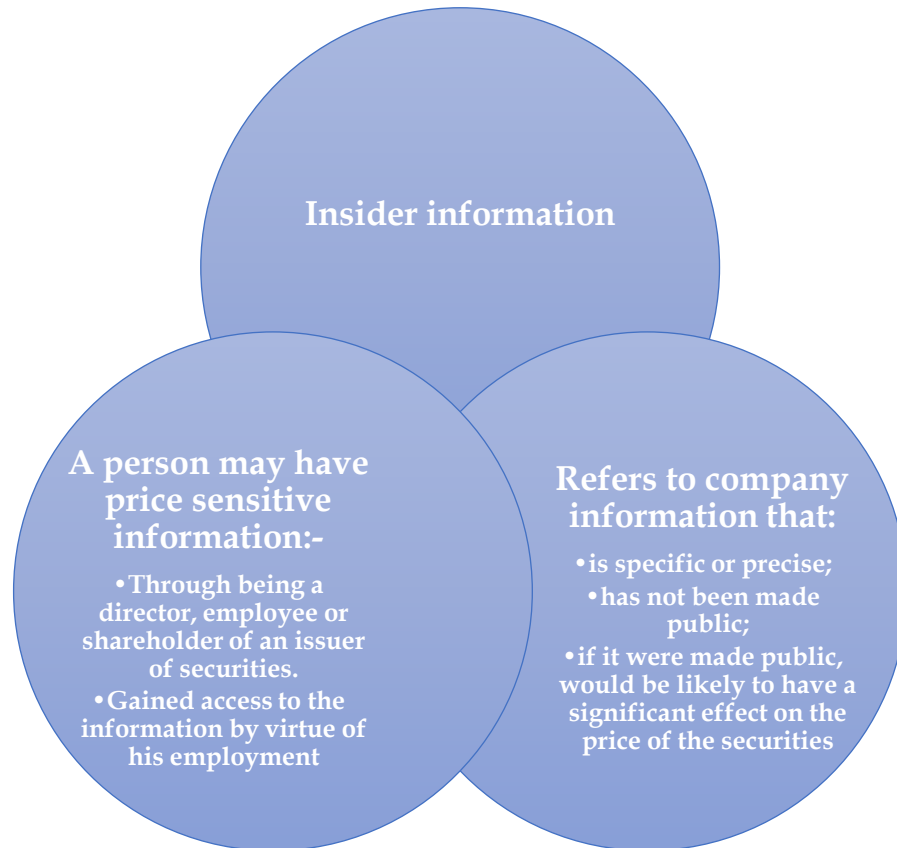


Reporting Money Laundering

- Regulations surrounding financial crime make it an offence to fail to disclose a suspicion of money laundering
- Staff must be trained to recognise and deal with transactions that may be money laundering transactions.
- Disclosure of suspicions is ultimately made to the legal authorities
- Suspicions are usually disclosed to Money Laundering Reporting Officer (MLRO)
- MLRO who decides whether the suspicion that has been reported to him is sufficient to report to appropriate authorities
- Reporting to MLRO or authorities fulfils responsibilities under the law



Insider Dealing & Market Abuse



Market abuse



Refers to behaviour -

- Based on information not generally available to public
- Likely to give false or misleading impression
- Likely to distort the market



In all three cases the behaviour is judged on the basis of what a regular user of the market would view as a failure to observe the standards of behaviour normally expected in the market



Instruments covered by Insider Trading Rules

- **Usually broadly described as ‘securities’, which include:**
 - Shares
 - Bonds (issued by a company or a public sector body)
 - Warrants
 - Depositary Receipts
 - Options
 - Futures
 - Contracts for difference (based on securities, interest rates or share indices)
- **Note that the definition of securities does not embrace:**
 - Commodities
 - Derivatives on commodities (such as options and futures on agricultural products, metals or energy products)
 - Units/shares in open-ended collective investment schemes



Question: Why do people behave unethically?

An Ethical Corporate Culture

Stephen Green, former group chairman of HSBC, said: *'Part of the responsibility of top management is to ensure that the culture of the organisation reinforces the ethical behaviour that is a prerequisite of our industry. The example set by the people at the top will always have a huge influence on how the rest of the organisation behaves.'*

Example - Ethical Decision Making

A builder (supplier) offers a customer an apparent incentive: the frequently seen 'discount for cash payment'. But what is his primary motivation? While it may be to give the customer a good deal and so to win the business for himself, this is being achieved through the likely under-reporting of his income and thus under-collection of legitimate taxes, both income and VAT.

So what would you do?



The Positive Effects of Ethical Approaches on Corporate Sustainability

- **Research shows more business leaders now understand that the way they do business is an important aspect of fulfilling their financial obligations to their stockholders, as well as other stakeholders.**
 - More companies are putting in place corporate responsibility policies or ethics policies
 - Accept that an ethics policy is one of the essential ingredients of good corporate governance.
 - Modern corporate governance procedures include risk assessments
 - Recognising reputation and branding issues around lack of integrity as a possible source of future problems.
 - Employee Retention
 - Customer Retention



Assessing Dilemmas

- There will often be situations, particularly at work, when we are faced with a decision, when it is not immediately obvious whether what we are being asked to do is actually right.
- A simple checklist will help to decide. Is it:
 - ✓ **Open** – is everyone whom your action or decision affects fully aware of it, or will they be made aware of it?
 - ✓ **Honest** – does it comply with applicable law or regulation?
 - ✓ **Transparent** – is it clear to all parties involved what is happening/will happen?
 - ✓ **Fair** – is the transaction or decision fair to everyone involved in it or affected by it?
- A simple and often quoted test is whether you would be happy to appear in the media in connection with, or in justification of, the transaction or decision.



Ethics versus Compliance approach

Ethics	Compliance
Prevention	Detection
Principles-based	Law/rules-based
Values-driven	Fear-driven
Implicit	Explicit
Spirit of the law	Letter of the law
Discretionary	Mandatory

Once again it is back to the choice of doing things because you *ought* to, it is the right thing to do,(ethics) rather than because you *have* to (rules).



CISI Code of Conduct

Act honestly and fairly at all times

Act with integrity

Observe applicable law, regulations and professional conduct standards

Observe the standards of market integrity, good practice and conduct, and confidentiality required by, or expected of, participants in that market.

Manage fairly and effectively and to the best of you ability, any relevant conflict of interest

Actively maintain a level of professional competence appropriate to your responsibilities and commit to continued learning and development of others.

Uphold the highest personal and professional standards



Conclusion

Let us consider the words of Guy Jubb, investment director and head of corporate governance at Standard Life, when speaking at the CISI annual ethics debate (2009).

'It's personal, we as individuals are the City. We must take our responsibility for restoring trust and there can be no abdication of responsibility to third parties; we must conduct our affairs as good stewards; we must sort out right from wrong and behave accordingly... members must live out being good stewards in the interests of their clients.'

Do you agree...anything missing?

