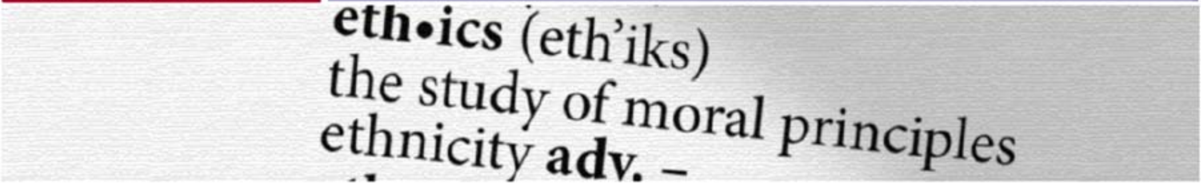
Ethics and Business

Addendum part 1 and part 2



Addendum to CII Ethics online course

This addendum provides a top-up to the CII Ethics online module which renders it suitable for 'gap-fill' activity against the ethical themes covered in the core **ApEx standard "Financial Services, Regulation and Ethics".**

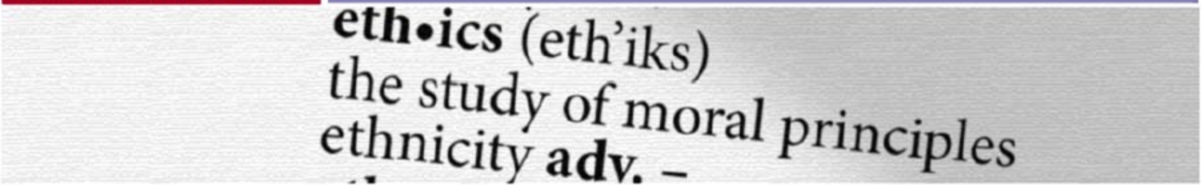
Part 1: 9.1 and 9.3 of the ApEx standard and Gap 8
Develops the discussion in 'The Industry' section of the online module about ethics and regulation so as to support parts 9.1 and 9.3 of the ApEx standard, with regard to:

- the Principles for Businesses and the obligations they place on regulated firms;
- the links these have with other regulatory tools such as FIT and APER;
- the approach adopted for one particular ethical risk: conflicts of interest.

Part 2: 10.2 of the ApEx standard and Gap 11
Develops the discussion in the "Practical' section of the online module about ethical scenarios so as to support part 10.2 of the ApEx standard, with regard to:

- how to identify an ethical dilemma;
- the steps involved in managing ethical dilemmas.

The final page of this document can be submitted as evidence of gap-fill activity.



Addendum part 1: Principles for Businesses and Approved Persons

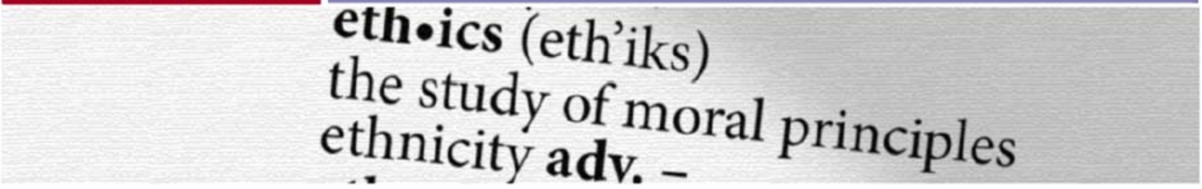
Let's return to a particular theme covered in the 'Industry' section of the online ethics course and explore it in a little more depth. By page 7 the following argument had been put forward: ethics sustains honesty and integrity, which in turn builds trust, which in turn makes markets work more efficiently for the good of all.

This argument has not been lost on the Government and its regulators, for it lies at the heart of the **Financial Services and Markets Act 2000** and, in particular, in its statutory objective to deliver market confidence. The Act is the primary piece of legislation from which the Financial Services Authority (FSA) derives its powers and functions. So how has the FSA taken forward this argument about ethics, trust and markets?

The FSA has established a set of principles setting out the fundamental obligations of all firms under the regulatory system. There are eleven Principles for Businesses, which are as follows:

1.	Integrity	A firm must conduct its business with integrity.
2.	Skill, care and diligence	A firm must conduct its business with due skill, care and diligence.
3.	Management and control	A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4.	Financial prudence	A firm must maintain adequate financial resources.
5.	Market conduct	A firm must maintain proper standards of market conduct.
6.	Customer's interests	A firm must pay due regard to the interests of its customers and treat them fairly.
7.	Communications with clients	A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
8.	Conflicts of interest	A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9.	Customers: relationships of trust	A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.
10.	Clients' assets	A firm must arrange adequate protection for clients' assets when it is responsible for them.
11.	Relations with regulators	A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

These eleven Principles are fundamental obligations – all regulated firms have to abide by them all the time. There is some discretion in the steps that regulated firms can adopt to abide by them, but none at all in whether they have to. They are 'fundamental' to the extent that if one of the rules detailed in the FSA Handbook were to appear to contradict one of the Principles, it would be the Principle that took precedence.



Ethics permeate the eleven principles. It is at the forefront of Principle 1 on integrity and Principle 5 on market conduct. It is a clear part of Principle 6 on customer's interests, Principle 8 on conflicts of interest and Principle 9 on relationships of trust with customers. Indeed, it would be fair to say that ethics is reflected in every one of the principles, even financial prudence and relationships with regulators. This perhaps explains why the term 'ethics' isn't referred to in any of the principles – the term is a little too pervasive when one is working at the level of principles. The FSA prefers instead to draw attention to a range of specific behaviours.

Approved Persons

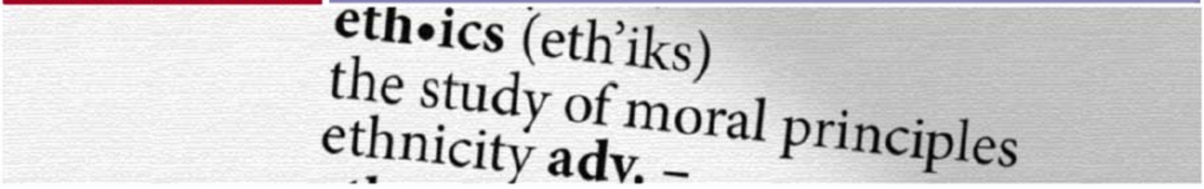
The Principles for Businesses apply to regulated firms. The FSA also has what can be summed up as Principles for Approved Persons. Let's look at what these mean and the role that ethics plays in them.

An approved person is someone who the FSA has approved to perform a controlled function at a firm authorised to carry out a regulated activity. A list of controlled functions is maintained by the FSA and it encompasses directors and partners, actuaries, money laundering officers and compliance officers, to name but a few. Within that set of controlled functions are a further subset of 'significant influence functions'; for example, a director and an actuary.

Approved persons are subject to two tests: APER and FIT. APER stands for 'Statements of Principles and Codes of Practice for Approved Persons', while FIT stands for 'The Fit and Proper test for Approved Persons'. In broad terms, APER sets out the fundamental obligations that approved persons must uphold, while FIT sets out the minimum standards for becoming and remaining an approved person.

Under APER, the FSA has issued seven Statements of Principle setting out the fundamental obligations of an approved person. An approved person performing a controlled function is subject to the first four, while an approved person performing a significant influence function is subject to all seven. The seven Statements of Principle are as follows:

1	An approved person must act with integrity in carrying out his controlled function.
2	An approved person must act with due skill, care and diligence in carrying out his controlled function.
3	An approved person must observe proper standards of market conduct in carrying out his controlled function.
4	An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice.
5	An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.
6	An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.
7	An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.



Again, it is clear that ethical behaviour permeates the fundamental obligations of approved persons. It is prominent in principles 1, 2 and 3, while the accountability and transparency inherent in principle 4 has close links with ethical behaviours.

Each Statement of Principle is supported by a code of practice. The code for the first Statement of Principle about integrity lists a number of behaviours that would not comply with that Statement of Principle, such as falsifying documents, keeping inaccurate training records and improper use of client funds.

It is interesting to note that the Statements of Principle set out how an approved person should behave, while their accompanying codes of practice set out how an approved person should not behave (the exception being the code for principle 3). Note also that the word 'ethics' doesn't appear in either the statements or the codes. Think of it like this: if ethics were to appear in one of the Statements of Principle, it could then be inferred that the other Statements of Principle have nothing to do with ethics. We know however that they do, so the FSA prefer to talk about specific behaviours.

Under FIT, the FSA uses three main assessment criteria for candidates who wish to undertake a controlled function within a regulated firm. These are:

- honesty, integrity and reputation;
- competence and capability; and
- financial soundness.

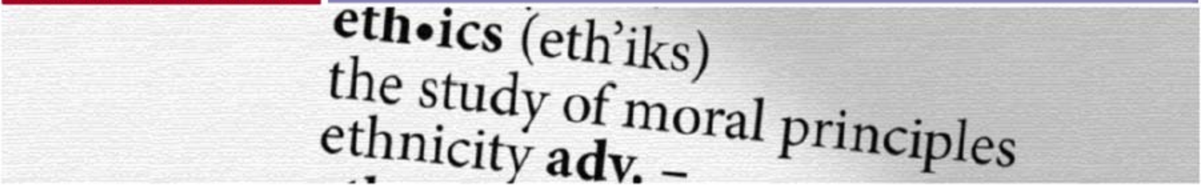
While these are the main and not the sole criteria, you can again see the prominence given to ethics in assessing a candidate's suitability. The FSA doesn't define what it means by honesty, integrity and reputation, but instead lists a range of factors which it will take into consideration under that general heading: for example, insolvency and a criminal record are two such factors.

Ethics can also be seen in a regulatory link between the Principles for Businesses and the principles for approved persons. Threshold conditions set out minimum standards for a firm to become and remain authorised (they're like the 'firm' equivalent of FIT). Threshold condition 5, entitled Suitability, contains a clause that allows the FSA to question a firm's suitability to carry out its regulated activities if it has doubts about the suitability of one or more approved persons. So for example, if an approved person fails the honesty and integrity assessment in FIT in such a way that calls the firm's ways of working into question, the firm itself could come under regulatory scrutiny.

If we now stand back and look at the overall framework for the FSA's attention to ethics, you can see that it works at both the firm level and the individual level, with links between the two. The framework identifies principles that represent high level ethical obligations and provides guidance on what sort of behaviours would run counter to those principles. Ethics isn't mentioned per se, but integrity is referred to throughout the framework.

Conflicts of interest

Let's look a little more closely at the eighth Principle for Businesses, which deals with conflicts of interest. This is a key ethical risk that regulated firms must manage effectively. Principle 8 states 'A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.' How the firm should go about this is set out in the 'Senior Management Arrangements, Systems and Controls' section of the FSA Handbook, under section 10.

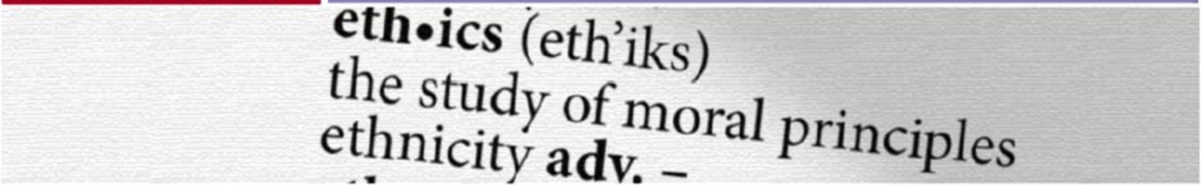


The approach in section 10 follows a typical management cycle of identifying risks, putting policies and procedures in place to manage them and monitoring and disclosing the firm's performance. All this should reflect the size and complexity of the firm's business and cover both how to avoid a conflict of interest in the first place, as well as how to manage one that cannot be avoided.

Conflicts of interest are a key ethical risk for insurance intermediaries, whose business by its very nature puts them in close contact with a variety of people. For example, one team could be placing cover for company X, while another is securing new business from company X's main competitor. In such circumstances, both teams would be expected to be familiar with their firm's conflicts of interest policy and use its stipulations to manage the situation. The directors of their firm would be expected to oversee both teams in ways that avoid adding further to the risks from such a conflict of interest: for example, by how they allocate staff to each team, by how records are kept and by how team performance is rewarded.

You can see from this simple example how the obligations to act with honesty and integrity sit at the level of both individuals and firms: the ethical behaviours of each should support the other. You can also see how some ethical risks that firms face, such as conflicts of interest, have been formalised into regulations and laws, much more than other ethical risks have been. Society has set a high bar for its expectations of how firms in insurance and financial services should manage this particular ethical risk.

This raises the obvious question of what might a regulated firm do to raise its reputation for ethical behaviours in respect of conflicts of interest. After all, complying with the law does not, per se, mean that you can refer to your firm as ethical in how it works – society often expects more than just compliance with the law to be ethical. In this case however, the law is so particularly thorough on conflicts of interest that it's hard to identify further, meaningful steps. One that you might consider is being open and transparent on the issue and by so doing, provide clients and employees with the accountability they are looking for from your firm.



Addendum part 2: ethical dilemmas

Let's move on to another theme from the online ethics course, raised in the 'Practical' section. One of the ten practical steps that a firm can take to embed ethics into its everyday management processes is to provide employees with some ethical scenarios, to show them what an ethical lapse might look like in practice. If you'd like to remind yourself of what ethical scenarios look like, follow the link on page 15 of the 'Practical' section.

Ethical scenarios like these take the form of a short story to illustrate what an ethical lapse might look like in practice. However they don't show you how to weigh up the difficult choices that ethical problems can often present. This part of the addendum shows you how to identify such 'ethical dilemmas' and sets out some practical steps for managing them.

How to identify an ethical dilemma

You can do two things to identify an ethical dilemma: firstly, be prepared, and secondly, look for a few simple signs.

Preparation is hugely important. If you're familiar with the values that your organisation and profession wants you to uphold, then you will understand what is expected of you in how you go about your work. If you have personal values which you hold dear, then you will understand what you expect of yourself. Those values (personal, organisational and professional) will form the lens through which an ethical dilemma will be seen and weighed up.

How well that weighing up goes will be influenced by another preparation: the extent to which you've taken time to understand those values and ethics. Some examples of how to go about this would be listening to an ethics podcast, reading some case studies or discussing with a friend or colleague what is right and wrong about some everyday situations. In other words, you've opened up your understanding of those values and ethics to other points of view. In so doing, your familiarity with them, and confidence in handling them, will have increased. Your radar for ethical dilemmas will have improved as a result.

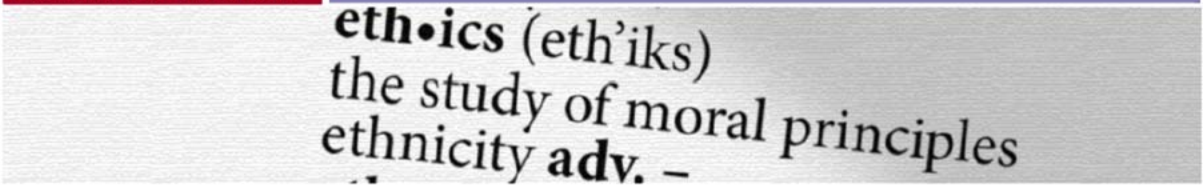
So if your radar for ethical dilemmas has improved, what do they look like when they first appear on your screen? In all likelihood they'll bear more than a passing resemblance to the many other types of dilemmas found in a business environment. A dilemma is a dilemma after all. So what then causes some dilemmas to be labelled 'ethical'? Let's look at a few simple signs.

One sign is that an ethical dilemma will touch more heavily than others on matters of principle. Examples of principles are impartiality, accountability, confidence and openness, to name but a few.

Another sign is that some of those principles are in conflict. We are talking about a dilemma after all. For example, whistleblowers often face a conflict between the principle of truth and the principle of loyalty, when weighing up whether to report a colleague for putting their interests before those of a client.

A further sign will be the route by which an ethical dilemma is best resolved being one in which values (personal, organisational and professional) are very influential. This is not to say that values aren't a tool for resolving other business dilemmas; it's just that they tend to play a bigger role in ethical ones.

Having identified an ethical dilemma, let's now move on to consider how best to manage them.



The steps to managing ethical dilemmas

The first step in managing an ethical dilemma is to avoid thinking that the approach you should adopt has to be something specialised or unique. The steps you should follow are those that you should apply to any difficult management decision. Ethical decision making bears a remarkable resemblance to good quality, every day management decision making. So you don't need to learn anything new; you simply need to remember how to do every day decision making well.

Here are the steps you should consider taking when managing an ethical dilemma:

1. **Identify who's involved** so that you've got a clear picture of who's got a stake in how the dilemma emerged and how it might be resolved.

2. **Make sure you're clear about all the facts** by checking what you've been told and asking for clarification of any grey areas.

3. **Set out the dilemma in clear terms** so that it fairly represents the interests of the key people involved.

4. **View the dilemma through the lens of organisational values and professional ethics** because they're there to help resolve questions of principle.

5. **Identify the options for how the dilemma could be resolved** so that you have alternatives that you can weigh up and then estimate the impact of.

6. **Choose the option that fits best with those values and ethics** because if they're to mean anything, it's in situations like these.

7. **Ask a work colleague for a second opinion on your preferred option** because receiving feedback from a critical friend will test the robustness of your case, as well as allow the meaning and intent of those values and ethics to be exchanged and shared.

8. **Make your final decision and implement it clearly and concisely** by communicating it to those involved, so that they have a clear understanding of what's to happen and why.

9. **Take steps to minimise the impact of your decision** where that's possible, while still upholding your decision and how you arrived at it.

10. **Review company policies and processes to avoid repetition** because ethical dilemmas are experiences that most people have something to learn from.

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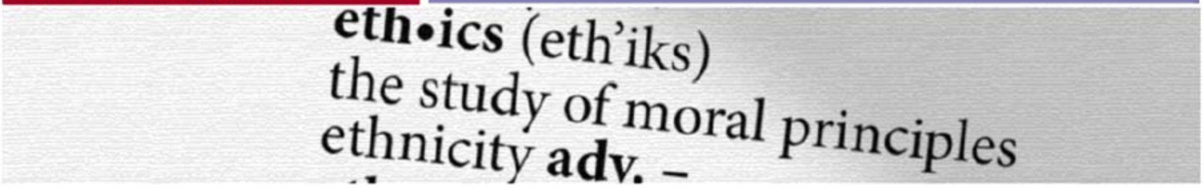
Module completion document



Record of completion

I confirm that I, ______________________________ Print name

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completed the CII Ethics online module (including addendum)

RDR qualification gap fill

CII

The CII Ethics online module (including addendum) is passed as suitable by the CII as gap-fill activity for the ethical themes covered in the core ApEx standard "Financial Services, Regulation and Ethics", learning outcomes: 9.1, 9.2, 9.3, 10.1,10.2, 11.1, 11.2, and 11.3.