Module # 1 Component 1

Knowledge Criteria

Demonstrate knowledge and insight into legislation, regulations, and codes relating to corporate governance and ethics in a selected business sector.
Apply the principles that underpin ethics and professionalism to a code of conduct.
Critically evaluate the implementation of an organization's ethical code or value system.
Develop a plan to initiate or improve commitment and compliance in the implementation of a code in an organization.

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Introduction

Legislation, regulations and codes relating to corporate governance and ethics in a selected business sector

This Module deals with:

- ☑ The ethics related requirements in different legislation, regulations and codes applicable to a selected business sector with reference to the effect on business values, practices and procedures.
- ☑ The implications of triple bottom line reporting on a selected business with reference to the ethical aspects of reporting on safety, environmental, health and social responsibility.

There are clear similarities between ethics and legislation, but there are also significant differences. Both ethics and legislation strive towards determining what is right in human interaction and society. Legislation does so through a political and public process and employs the power of the state to ensure that everybody abide by the stipulations of the specific piece of legislation. However, ethics emanates from personal values. In a sense everybody has an obligation to do what is right internally (own free will) as opposed to the external pressure (no free will) of legislation.

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What is Business Ethics?

Business ethics is a form of applied ethics that examines ethical principles and moral or ethical problems that arise in a business environment.

In the increasingly conscience-focused marketplaces of the 21st century, the demand for more ethical business processes and actions (known as ethicism) is increasing. Simultaneously, pressure is applied on industry to improve business ethics through new public initiatives and laws (e.g. the FAIS act on Financial Intermediaries).

Professor Deon Rossouw, the president of the International Society for Business, Economics and Ethics (ISBEE), defines ethics as follows:

> Definition of ethics:
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> Ethics concerns itself with what is good or right in human interaction. It revolves around three central concepts:
>
> - ☑ Self
> - ☑ Good
> - ☑ Other
>
> Ethical behaviour results when one does not merely consider what is good for oneself, but also considers what is good for others.

When ethics is applied to business we consider the implications of economic activity on the interests of all who are affected by such activity.

Professor Rossouw defines business ethics as follows:

> Definition of business ethics:
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> Business ethics is about identifying and implementing standards of conduct that will ensure that, at a minimum level, business does not detrimentally impact on the interests of its stakeholders. At an optimum level, business ethics is about standards of behaviour that will enhance the interests of all who are affected by business.

Ethic Related Requirements in the Financial Services Environment

As financial products and services are so intangible in nature, it is easy for clients or investors to suffer significant loss in the event of an unethical financial planner giving inappropriate advice. In order to minimise unethical behaviour within the industry a strong ethical foundation must be built. Without a strong sense of ethical behaviour, it is unlikely that objectives of consumer protection will be met.

The Importance of Ethics in the Industry

As an employee in the Financial Services Industry, you should know that there is an increasing focus on the need to consider the various questions around ethics in our environment.

The reasons for this "new awareness" are:

- Recent reported cases, both locally and internationally, have increased client awareness of unethical behaviour.
- The loss of clients" money increases the burden on the state as more members of our community have to be supported.
- Unethical behaviour by employees in the Financial Services Industry impacts on how the general public views our profession. This could ultimately have an impact on, not only our own wellbeing, but also the wellbeing of our nation and country.
- People have different views on what constitutes ethical behaviour. This unfortunately has to be managed.
- There is a worldwide trend towards more ethical behaviour in the workplace. In South Africa, the King II report stresses the need for businesses to look at issues of ethical behaviour far more seriously. The King II was later updated or replaced by the King III in 2008.

Ethical Problems in the Industry

A few of the ethical problems facing the industry are:

- Failing to disclose the options available to clients.
- Financial advisors who give advice to clients without the requisite knowledge and skills.
- Financial advisors who give clients misleading or incorrect information.
- Financial advisors who invest clients' money in investments more beneficial to the advisor than to the client.
- Financial advisors who have no regard for the legislative requirements that are designed to protect the client and to assist in creating a professional environment based on the principles of trust and honesty.

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Ethical Obligations in the Industry

Looking at our industry, the ethical obligations towards clients are probably greater than in other industries. A financial advisor may frequently be confronted with this issue. It is easy to make a "wrong" ethical choice when there is no ethical structure, such as a policy on ethics.

A strong ethical culture also plays a major role in creating and developing relationships of trust with clients and we know that trust is easily broken through unethical decision-making which may have a negative impact on clients. Once trust is broken, it is difficult to re-establish a relationship of trust even if the behaviour does not affect the client directly. As ethics and trust is the cornerstone on which the financial services industry is built, it is critical to check the basis of all ethical decisions regularly.

Our obligations include the following:

- ☑ Trust
- ☑ Confidentiality
- ☑ Disclosure
- ☑ Respect for the client
- ☑ The client's right to information
- ☑ Your obligation to appropriate knowledge and skills
- ☑ The client's right to be served by an advisor with appropriate knowledge and skills.

A Code of Ethics in the Financial Services Industry

As an example we will now look at the Code of Ethics of the Financial Planning Institute (FPI) – a professional body in South Africa affiliated with the international Certified Financial Planner Board of Standards.

The FPI's Code of Ethics deals with six key principles that is crucial to be adhered to by any employee in the financial services industry – even if you are not a certified financial planner.

The six key principles are:

Integrity:

An advisor shall offer and provide professional services with integrity.

Objectivity:

Objectivity requires independence and impartiality and is essential for any professional in order to make prudent professional judgements.

Fair and honest disclosure:
An advisor shall perform professional services in a manner that is fair and reasonable to clients, principals, partners and employers, and shall disclose conflicts of interest in providing such services.

Competence and diligence:
An advisor is obliged to maintain a high level of professional knowledge and skill and act diligently in providing professional services.

Confidentiality:
An advisor shall not disclose any confidential client information without the client's specific consent unless in response to proper legal process.

Professionalism:
An advisor's conduct in all matters shall reflect credit upon the profession.

The General code of conduct as noted in the FAIS legislation as well as your company's Code of ethics or conduct can also provide guidance in terms of Ethical requirements.

Legislative Requirements

The requirements of the following pieces of legislation focus on the protection of the consumer in the event of the giving of financial advice, and the purchase of financial products and services. We also look at money laundering legislation.

Policyholder Protection Rules

Prior to the FAIS Act, the Policyholder Protection Rules regulated the selling of long term and short term insurance products to a limited extent. However, when the FAIS Act and its subordinate legislation in the form of regulations and schedules became fully operational, many of the rules were incorporated into the FAIS Act, to the effect that a Board Notice was published titled: "Exemption of financial services providers and representatives from the Policyholder Protection Rules". This notice determined the rules that remain and those that are now exempt.

The rules that still apply from the Policyholder Protection Rules are as follows:

Basic Rules for Direct Marketing

These rules require a direct marketer to render services honestly, fairly and with due skill, care and diligence. The direct marketer must act professionally. They are required to make certain disclosures, records must be kept for a minimum period of 3 years and certain information must be made available to the policyholder. Where information is provided orally, it must be confirmed in writing within 30 days.

Rules on agreement with Intermediaries

The insurer must only enter into an agreement with an intermediary to sell its products if such an intermediary is licensed under the FAIS Act. Such agreement will lapse upon non-compliance with the FAIS Act by the intermediary.

Rules on Cancellation of Policies & the Cooling Off Period

This is a common method of consumer protection. It protects consumers from persons who are selling for commission, rather than acting in the best interests of the policyholder. This rule bolsters consumers' rights to cancel a contract and to claim back any premiums within a 30 day period.

Rules on Fund Policies

Certain rules have been enacted to protect policyholders in the case of a fund policy. In addition to disclosures made in terms of the rules for direct marketers, an insurer is required to deliver a fund policy to either the principal officer of the fund, the trustees of the fund or any other person managing the fund.

Assistance Business Group Schemes

An insurer may only conduct business with an assistance business group scheme, or an administrator, if it has entered into a written agreement with such a scheme or administrator.

These rules also state what the agreement must contain and when it may be cancelled, together with certain other requirements regarding such agreements.

Additional Insurer Duties

The rules stipulate that when an insurer rejects the claim for a benefit under a policy, or where it disputes the amount of the benefit, the person is entitled to reasons, in writing, as to why the claim has been rejected or why the amount of benefit has been disputed.

A further stipulation under this section is that a policyholder may not sign a blank or partially completed form necessary for any transaction where another person will be required, permitted or allowed to fill in other required details.

Policy Loans and Cessions

The insurer must disclose various details to the policyholder on entering into a policy loan, including details of interest on a quarterly basis, repayment arrangements, the amount and value of the loan on an annual basis, and details regarding the cessation of benefits. The insurer is also obliged to disclose to the policyholder various details on receipt of notification of a cession.

Triple Bottom Line

Until very recently the success of a company was measured by looking at its financial bottom-line. When investors evaluated potential investment options, they were essentially interested in whether the company was making money, and what the prospects were of it continuing to do so. In the last decade, the realisation that making money and being a sustainable business required much more than focusing solely on the financial bottom-line, led to the development of the notion of a triple bottom-line. The Triple Bottom Line concept recognises that a "bottom line" should not solely reflect the economic return on investment of a business. Other assets, which deal with issues of environmental sustainability and social capital, ranging from product responsibility and labour practices to community upliftment, should also be included.

The concept is underpinned by three societal objectives:

- ☑ Economic prosperity
- ☑ Social responsibility
- ☑ Environmental sustainability

Therefore the ability of a business to persist in a truly sustainable state will result from producing a positive and balanced return to all three forms of capital - economic, environmental, and social – hence the Triple Bottom Line.

Definition of Triple Bottom Line:

Triple Bottom Line can be defined as the process of identifying, assessing and reporting on an individual company's business activities in terms of its impact on society, the environment and economic sustainability. It also entails the confronting of basic issues around the core values of a company and consistent application of a company's core values to all its activities.

In South Africa, the King II Report has firmly put the need for Triple Bottom Line (TBL) reporting on the agenda of all listed companies (listed on the JSE). Later on it was replaced by the King III in 2008.

Let's look at some differences between the King II and the King III report:

- ☑ King II was a non-legislated code applicable to JSE Listed companies, corporations in the financial services environment & public enterprises and based on a "comply" or "explain" basis.
- ☑ The King III is recommended for all entities regardless of the manner of establishment and is also on an "apply" or "explain" basis.
- ☑ King III highlights corporate citizenship and integrated sustainability, the so-called triple bottom line.
- ☑ King III builds on this principle by emphasizing on sustainability.

Apart from economic reporting, social investment and environmental issues must also be addressed in companies" annual reports. Although the shift in business thinking, to embrace the Triple Bottom Line and sustainability, has taken off from a relatively small base, it is accelerating at an extraordinary pace.

The performance indicators for companies are both qualitative and quantitative and can be grouped in three categories covering the economic, environmental, and social dimensions of sustainability.

Economic indicators are concerned with an organisation's impact, both direct and indirect, on the economic resources of its stakeholders and economic systems at local, national, and global levels. Economic responsibility refers to the profit-making business of the company and should also reflect the growing global economic integration of the company.

Environmental indicators are concerned with an organisation's impact on living and non-living natural systems, including eco-systems, land, air and water.

Included within environmental indicators are the environmental impacts of products and services: energy, material and water use; greenhouse gas and other emissions; effluents and waste generation; impacts on biodiversity; use of hazardous materials; recycling, pollution, waste reduction and other environmental programmes; environmental expenditures; and fines and penalties for non-compliance.

Environmental responsibility (including health and safety) means that business should be run in a way that provision of goods and services does not mean the increase of pollution and further environmental degradation.

Social indicators can be grouped into three clusters:

- ☑ Labour practices such as diversity, employee health and safety;
- ☑ Human rights such as child labour and compliance issues, and
- ☑ Broader social issues such as bribery, corruption and community relations.