MODEL CODE OF ETHICS

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A REPORT OF THE

SRO CONSULTATIVE COMMITTEE OF THE

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Preface and Background

The members of the International Organization of Securities Commissions[1] SRO Consultative Committee[2] (SROCC) believe in a Code of Ethics ("Code of Ethics" or "Code"). The objective of a Code of Ethics as described in this paper is to provide the collective views of the self-regulatory organizations that comprise the SROCC. Through this paper it is the SROCCs intent to provide a framework that could strengthen a culture of ethical behavior and guide the financial services industry[3] in all the places that no explicit set of rules can hope to cover[4]. In this regard, the SROCC supports the development of a Code of Ethics by firms engaged in the financial services industry that would govern the conduct of financial services professionals.

Such a Code is meant to be a living document that promotes an ethical culture at all times and to provide guidance particularly where no explicit rules are available. This will keep the financial services industry as far beyond reproach as humanly possible. To do that, the SROCC supports a full complement of thoughtful rules; self-policing and self-compliance; and an ethical culture so firmly rooted that every person in every financial services firm has a good idea -- even in the gray areas between the rules -- of what is the right thing to do.

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[1] The membership of the International Organization of Securities Commissions (IOSCO) is composed of securities regulatory agencies from around the world. IOSCO's membership stands at 183 members and is growing rapidly. The Organization's members regulate more than 90% of the world's securities markets and IOSCO represents an important international cooperative forum for securities regulatory agencies.

[2] Self-Regulatory Organizations (SROs), that are affiliate members of the Organization, are members of the SROCC.

[3] For purposes of this paper, the SROCC intends for the term "financial services industry" to cover those entities that are regulated by the various SROCC member organizations.

[4] This is not to say that some self-regulatory organizations do not already have rules and regulations that cover ethical behavior. For example, some self-regulatory organizations have rules that prohibit regulated entities and individuals from engaging in certain unethical practices, and require adherence to standards of commercial honor and just and equitable principals of trade. Compliance with existing rules and regulations are not abrogated in any manner through a Code of Ethics.

Ethical behavior is fundamental to the success of the financial services industry and financial services professionals must always practice the highest ethical standards. Investors expect and demand that financial services professionals adhere to robust ethical standards in all aspects of their activities, and financial services firms must align their business practices with ethical behavior. Therefore, SROCC members endorse the development of a model Code of Ethics by financial services firms that reaffirms the importance of ethical conduct and provides guidance to financial services professionals in addressing and resolving ethical issues.

The benefits of a Code of Ethics are numerous. First, it will serve as a statement that the self-regulatory organizations are unified in their collective view that high standards of commercial honor and just and equitable principles of trade shall be observed by members of the financial services industry. Second, it will validate the collective recognition by the members of the financial services industry of their responsibilities. Third, a Code of Ethics will serve as a reminder that ethical behavior is the norm. Fourth, a Code represents a guide on how to address various ethical dilemmas. Fifth, a Code of Ethics will serve as an educational tool, providing a focal point for discussion in professional and educational meetings. Finally, a Code will indicate to others that the financial services profession will not tolerate lapses in professional conduct.[5]

A model Code of Ethics would consist of: (1) guiding ethical principles; (2) models for resolving ethical dilemmas; and (3) ethics training for financial services professionals.

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[5] Center for the Study of Ethics in the Professions at Illinois Institute of Technology, Codes of Ethics Online, *Introduction,* available at < http://www.iit.edu/departments/csep/codes/Introduction.html > (last visited Feb. 14, 2005).

I. GUIDING ETHICAL PRINCIPLES

The SROCC recommends that firms engaged in the financial services industry adopt the following ethical principles:[6]

- ❑   Integrity and Truthfulness

- ❑   Promise Keeping

- ❑   Loyalty –   Managing and Fully Disclosing Conflicts of Interest

- ❑   Fairness to the Customer

- ❑   Doing No Harm to the Customer or the Profession

- ❑   Maintaining Confidentiality

Integrity and Truthfulness stresses the critical element of trust that is essential in all business relationships. Trust is dependant upon one's confidence in the integrity and truthfulness of other parties in any relationship. Integrity is honesty and the adherence to values and principles despite the costs and consequences. Integrity also demands forthrightness and candor, which must not be subordinated to personal gain and advantage. Integrity cannot co-exist with deceit or subordination of principles.[7]

Promise Keeping involves the ability to keep one's word regardless of whether there is a legal obligation to do so. This is key to being an ethical individual or an ethical business.

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[6]   David P. Twomey et al., *Anderson's Business Law & the Regulatory Environment Principles & Cases* 40-43 (14th ed. 2001), lists and describes these six guiding ethical principles.
[7]   The Financial Planning Association, *Code of Ethics,* available at
<http://www.fpanet.org/member/about/principles/Ethics.cfm> (last visited Feb. 15, 2005).

Loyalty – Managing and Fully Disclosing Conflicts of Interest covers any conduct that could compromise one's loyalty to his or her company or clients. Although certain conflicts may be inevitable, to the extent feasible they should be avoided, or at least appropriately managed. For example, while not necessarily sufficient to cure a conflict, firms, at a minimum, would ensure full, fair, accurate, timely and understandable disclosure.

Fairness requires impartiality, objectivity and honesty.

Doing No Harm means avoiding conduct that jeopardizes investor trust and confidence.

Maintaining Confidentiality refers to developing a relationship of personal trust and confidence with clients and employers by safeguarding information entrusted to the professional. A professional must refrain from using confidential information, or appearing to use it, for unethical or illegal advantage. Information that employees obtain through their employer's work would not be used by the employee either personally or through a competitor.

II. MODELS FOR RESOLVING ETHICAL DILEMMAS

Several models can be used to address ethical dilemmas. When confronted with an ethical dilemma these models serve as guidance for achieving an ethical response.

A. Concise Model for Resolving Ethical Disputes [8]

1) *Is it legal?* When answering this first question, a manager should examine applicable law within and outside the company. "Laws" would be interpreted in an expansive manner; as such they would include not only governmental rules and

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[8] Kenneth Blanchard and Norman Vincent Peale, *The Power of Ethical Management* (1986).

regulations, but also SRO and exchange requirements, as well as industry best practices, among other things. If a violation becomes apparent then the analysis can stop there.

2) *Is it balanced?* The question of balance involves the principle of fairness.

3) *How does it make me feel?* This question encourages a manager to personalize a decision and examine its physical impact (ex. – Do I lose sleep over the issue?).

B. Ethics Checklist for Making Difficult Decisions[9]

1) What are the facts?

2) What are the critical issues?

3) Who are the stakeholders?

4) What are the alternatives?

5) What are the ethical implications of each alternative? In answering this question regarding the ethical implications the decision maker should ask:

   a) Is it legal?

   b) How would it look in the light of day?

   c) What are the consequences?

   d) Does it violate important values?

   e) Does it violate the Golden Rule (meaning the moral principle: "treat others as you want to be treated.") ?

   f) Is it just?

   g) Has the process been fair?

6) Finally, the decision maker should ask whether more than one alternative might be right.

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[9] Jeffrey F. Beatty & Susan S. Samuelson, *Business Law for a New Century* 212 (2d ed. 2001).

C. Guidelines for Analyzing a Contemplated Action[10]

   1) Define the problem from the decision maker's point of view.

   2) Identify who could be injured by the contemplated action.

   3) Define the problem from the opposing point of view.

   4) Ask whether you (as the decision maker) would be willing to tell your family, your investors, your supervisor, your CEO, and the board of directors about the planned action.

   5) Ask whether you would be willing to go before an investor forum or other public forum to describe the action.

   6) With full consideration of the facts and alternatives, reach a decision about whether the contemplated action should be taken.

D. Goal Setting and Outcome Predicting[11]

   1) State the problem.

   2) Choose your goals or objectives in dealing with the problem.

   3) Determine the facts and other contextual factors in the situation. Contextual factors include:

      a) Identifying the stakeholders

      b) Learning the stakeholders' demands and expectations

      c) Ascertaining what resources are available to satisfy stakeholders and whether those resources are available to the decision makers

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[10] David P. Twomey et al., *Anderson's Business Law & the Regulatory Environment Principles & Cases* 40-43 (14th ed. 2001).
[11] Bruce D. Fisher & Michael J. Phillips, *The Legal, Ethical, and Regulatory Environment of Business* 4-5 (8th ed. 2004).

d) Noting the relevant institutional framework (Is this matter within a company, or does it involve community matters such as positive law issues?)

e) Learning the customary practices in settling such matters

f) Identifying major social trends or movements that could affect the problem

4) Project the probable outcomes for each course of action, and select the course that conforms to positive law as well as has the highest likelihood of achieving the goal with the least adverse impact on stakeholders while affording the greatest benefits.

A final test for resolving ethical issues is the "newspaper test."[12] Under this test, when analyzing any action with ethical implications, an organization or individual would ask him or herself whether he or she would want to see the act or decision described by a reporter on the front page of the local newspaper, to be read by the employee's family, friends, and customers. Even if an act were not deemed to be illegal, organizations and individuals should not behave in a manner that the community, including investors, would deem as inappropriate.

III. ETHICS TRAINING

It is important to ensure that a Code of Ethics is more than statements. There must be in place a robust ethics education program. Individuals must understand the specifics of the Code of Ethics and the Code must be enforced. Every organization must commit itself to the creation of a rigorous on-going educational program designed to reinforce the obligations, principles, and aspirations outlined in a Code of Ethics. This educational program would be characterized by a

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[12] Janet Love, *Warren Buffet Speaks: Wit and Wisdom from the World's Greatest Investor* (Wiley 1997).

rigorous and thought provoking discussion concerning the Code of Ethics. The educational program would ultimately provide a clear set of rules, principles, and guidance that sets out acceptable behavior and addresses how violators of high standards of commercial honor and just and equitable principals of trade are punished. Each financial services firm would have the ability to tailor the educational program to its operations.

In order to develop an effective ethics educational program it is helpful to gain a realistic understanding of what ethics training programs can accomplish, as well as an awareness of their limitations. A frequent mistake in ethics training is viewing it as a substitute for "competent direction, guidance and on-the-job coaching."[13] Ethics training cannot replace effective leadership. "What ethics training achieves is the legitimization of the ethics conversation. Perhaps the most significant outcome is that employees learn how to recognize the ethical content of the problems they are addressing and the ethical consequences of the actions they take. They also have a more thorough understanding of the issues and are thus better able to present and defend their positions from an ethical as well as pragmatic perspective."[14]

A. Creating an Ethical Culture

Experts emphasize that the goal of ethics training should not be to simply instill knowledge of the standards or the law, but rather to create an ethical culture in which employees are guided by a shared ethical compass that incorporates the principals behind the standards and the law.[15] In order to instill such a compass, an organization has several options, but the most effective appears to be a "values-based cultural approach." This approach seeks to motivate

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[13] Ethics Resource Center, *Overview Training Philosophy*, available at
<http://www.ethics.org/catalog/o_philosophy.html> (last visited Feb. 14, 2005).
[14] Id.
[15] Holly Dolezalek, "Eye on Ethics", *Training Magazine* Nov. 2003, available at
<http://www.ethics.org/resources/article_detail.cfm?ID=837> (last visited Apr. 5, 2004).

employees to aspire to ethical conduct, encourage them to question authority where ethics are at stake and hold them accountable for ethics violations. Furthermore, this values-based approach requires the sincere commitment of leadership at all levels, including ongoing attention to key issues such as fair treatment of employees; rewards for ethical conduct; concern for external stakeholders; and consistency between words and actions.[16] In order to instill this value based cultural approach to ethics, an organization would:[17]

- ❑ *Have the basics.* Namely an ethics or compliance function and articulated professional ethics standards. It is important to note that these are just the bare necessities on which the other parts build.

- ❑ *Develop a well-known policy of "program follow-through"* which not only tries to detect violators but also follows up on the ethical concerns raised by employees. This is key as it helps demonstrate that the company and specifically the company leadership are committed to an ethical culture.

- ❑ *Recognize that ethical and effective leadership creates "an ethical tone"* in companies, which employees detect and to which they respond. This ethical leadership should not be overlooked or understated as employees look to their leaders and managers for their own ethical tone. Thus, employees will have a more serious view of ethics if they perceive that their leaders and managers pay attention to and promote ethical behavior.

- ❑ *Make ethics discussions a part of the normal day-to-day activities.* Ethics discussions should be woven into the corporate culture by making the discussions and ethics concerns part of the norm.

- ❑ *Implement a simple rewards system* for ethical conduct that demonstrates the company's endorsement of an ethical culture and gives additional public examples of the company's focus on ethical actions.

- ❑ *Reinforce ethical standards on a regular, repeating basis.*

- ❑ *Monitor and keep in touch with employee concerns about ethics.* This provides valuable insight both into where, and how, real ethics violations are going to occur and into how employees perceive the ethical culture within the company.

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[16] Linda K. Trevino, et al., *Managing Ethics and Legal Compliance: What Works and What Hurts,* 41 California Management Review 131, 140 (1999).

[17] Linda K. Trevino, et al., *Managing Ethics and Legal Compliance: What Works and What Hurts,* 41 California Management Review 131, 140-145 (1999).

B.   Recommendations for Developing an Effective Ethics Training Program

The following training methods should do more than communicate a code of conduct; they should give employees an increased level of confidence and comfort when making business decisions that address ethical challenges.[18] Guiding principles, practical decision-making models and training also must be accompanied by dedication on the part of company leadership to ethical decision-making. With these building blocks in place, financial services professionals will be able to develop a culture centered on ethical conduct that should become one of their greatest assets.

1) Basic Approach to Successful Ethics Training[19]

    a) Help employees understand ethical judgment

    b) Give employees the ethical expectations and rules

    c) Identify specific industry/profession areas of concern

    d) Help employees understand their own ethical tendencies

    e) Offer a realistic and practical view of the challenges in ethical decisions

    f) Practice and return with questions

2) Strategy Designed to Follow the Creation of a Code of Ethics[20]

    a) Help employees understand the code and its usefulness

    b) Review the code's provisions with a focus on how these provisions apply to job responsibilities

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[18] Id.
[19] Robert A. Giacalone, Belk College of Business Administration, University of North Carolina Charlotte, *The Six Components of Ethics Training,* available at <http://www.belkcollege.uncc.edu/ragiacal/components.html> (last visited Apr. 1, 2004).

[20] Ethics Resource Center, *What to Do After Your Code of Conduct is Written*, available at <http://www.ethics.org/resources/article_detail.cfm?ID=840> (last visited Feb. 15, 2005).

c) Learn what behaviors and decision making processes the organization wants employees to apply when confronting ethics challenges

d) Raise questions about ambiguities or uncertainties resulting from the code's language and examples

e) Practice applying the standards communicated by the code to "typical" ethics challenges faced by employees

f) Learn what the organization wants employees to do when:

    i. Facing ethical uncertainties

    ii. Observing ethical misconduct; or

    iii. Perceiving pressures being applied (to oneself or others) to commit ethical misconduct.

3) Practical Advice for Developing a Comprehensive Ethics Training Program[21]

a) Start with company values and an ethics code of conduct

b) Involve executive management and secure adequate funding

c) Develop a range of materials

d) Consider innovative delivery strategies

e) Know when not to use technology

f) Tailor to firm operations

g) Integrate key ethics concepts into training courses

h) Make training programs both global and local

i) Evaluate the program

j) Consider using case studies from both inside and outside the industry

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[21] Business for Social Responsibility, Resources, *Ethics Training,* available at
<http://www.bsr.org/BSRResources/IssueBriefDetail.cfm?DocumentID=437> (last visited Apr. 1, 2004).

k) Consider a train-the-trainer/cascading process

l) Consider outside trainers

Finally, there must be a mechanism for periodic review of the Code of Ethics programs.