



A supervisory focus on ethics, culture and behaviours at intermediaries

It is fair to observe that the words “ethics”, “integrity”, and “professionalism” have been missing from our industry’s daily discourse for too long. I see that an important part of my job is to bring them back into conversation and back into vogue here in Hong Kong.

What is missing, in my view, in the regulatory responses post financial crisis, is consideration of the human element – that is how human decisions and behavioural considerations caused the financial crisis and indeed caused the front page conduct issues we have seen since then.

I want to emphasise an important point I have just alluded to. When we speak of conduct, behaviour and processes at firms we have to take a step back and remember that all these things originate from decisions of individuals within firms and from decision-making processes by those firms. Accordingly how decisions are made, what the incentives and disincentives behind them are, what processes apply and whether people actually realise a decision has been made is an important focus point for us as supervisors. But they should also be a key focus point for the industry itself.

Returning to the broader point about culture – personally I believe that corporate culture is made up of a number of component cultures – including, importantly, an ethical culture, a leadership culture and a culture of professionalism.

Whilst I am not the type of person to quote profusely from code and legislation during a speech, I think that it is very important for all of us to remind ourselves, at this point, of our overarching obligations to the market and to clients under the General Principles of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

General Principles 1 and 2 requires licensees, both individual and corporate, to “act honestly, fairly and in the best interests of its clients and the integrity of the market”. Meanwhile, the fundamental requirement of each and every licensee, whether an individual or a corporation, is to be fit and proper and section 129 of the Securities and Futures Ordinance (SFO) has some very important guidance to us on what that means, including the requirements of:

- Competence
- Honesty
- Fairness
- Reputation
- Character and
- Reliability

These requirements are fundamental to the notion that professionalism, ethics and values are important to the outcomes of our industry. It also reinforces the point about the “root causes” of behaviour, decision-making and conduct within the industry and the need for supervisory focus on a firm’s people and not only on its processes.

At the SFC, this all means that we will be broadening our supervisory approach so that when we look at the control systems and procedures at firms, we will also consider the “control culture” – that is, the culture and leadership dimensions of firms - in order to more fully



understand how a firm's control systems operate in practice. In essence, more supervisory attention will be paid to the human dimension, the human element, particularly to the drivers of decision-making and conduct within firms.



There is actually a cost benefit here. Regulatory sanctions are expensive, and it is in everyone's interests that issues that would lead to sanctions are avoided at the very root. This means that the entire management structure has to take real responsibility for regulatory matters and avoid overly delegating responsibility to compliance or other control functions.

Leadership structure / Decision making

Nevertheless culture, values, ethics, professionalism and integrity will not go very far unless there is a "delivery and distribution mechanism" within market participants. This is where the second component – leadership – comes into play. Unless people in authority (note I did not say only "the Chief Executive Officer") lead – that is, inspire, motivate and cause to follow – on ethics, professionalism and values then they cannot be imbedded into a firm and cannot assist in ensuring a workable control environment.

Organisational culture and leadership is important since professionalism, ethics and values can only be individually generated up to a certain point. These values cannot be "brought to



Business ethics, values and principles

Turning to the third aspect I mentioned earlier – good corporate culture can, and should, differ between firms. There is no “one size fits all” corporate culture. Nevertheless we all know a good work place when we experience it



Creating a virtuous cycle and self-regulation

Returning to the challenges of professionalism, culture and leadership, I have already highlighted the enhanced role of regulators. Nevertheless, only through industry-led initiatives can there be real on-the-ground change. Ultimately I am speaking of a market ecosystem where there is a self-reinforcing culture of adherence to high standards by market participants.

What I have also observed in my almost 12 months at the SFC is that firms do not externally expect high enough standards of each other. Each firm appears to be reluctant to express, let alone require, the best standards of its counterparties.

I do not intend to romanticise the past, as there were other significant faults and failings in earlier periods of the capital market. Nevertheless something that did exist, but has gone out of fashion, is “cold shouldering” by the industry itself. Indeed, Mark Carney⁶ has forcefully come out to say that “professional ostracism” should be practised when bad behaviours arise. This element of self-regulation has been entirely delegated to the regulatory process – which is a shame.

Again it would be worthwhile for organisations like the Hong Kong Investment Funds Association (HKIFA), and its members, to look into ways and means that the industry can create a virtuous cycle of heightened expectations rather than the current stand-off that led to a decline in the standards of integrity and ethics in the market. Adherence to the HKIFA’s code of ethics by all its members is a good starting point. Rule 4 of that code is especially relevant, given that members are required to act in a manner which recognises that “integrity and responsibility are essential to win and maintain the confidence of members of the public in all aspects of the fund industry”.

Ladies and gentlemen, I will end with a challenge to you all: only by the industry taking up its responsibility to uphold and sustain a virtuous cycle of conduct and good behaviour by expecting more of each other, will we begin to restore the industry’s trust with the public.

Thank you.

⁶ Mark Carney, “Inclusive Capitalism: creating a sense of the systemic” (27 May 2014)