

Establishing and implementing a code of conduct and ethics



MCCG Intended Outcome 3.0

The board is committed to promoting good business conduct and maintaining a healthy corporate culture that engenders integrity, transparency and fairness.

The board, management, employees and other stakeholders are clear on what is considered acceptable behaviour and practice in the company.

MCCG Practice 3.1

The board establishes a *Code of Conduct and Ethics* for the company, and together with management implements its policies and procedures, which include managing conflicts of interest, preventing the abuse of power, corruption, insider trading and money laundering.

The *Code of Conduct and Ethics* is published on the company's website.

(The application of this Practice in its entirety entails the **establishment of a Code of Conduct and Ethics** by the board and **implementation of its policies and procedures** alongside management as well as the **publication of the Code of Conduct and Ethics on the company's website**.)



The internalisation and application of the content "Why" and "How" should be read in tandem with the line of sight outlined by the Intended Outcome.

Why

The case for change

Lessons learnt from the numerous episodes of corporate misconducts (e.g. corruption, fraudulent reporting and insider trading) in recent years point towards a common denominator, which is **ethics**. Accounts of such incidences may be peppered with references to terms such as "market complexity", "financial intermediation" and "creative accounting", but at their very heart lies the failure of ethics. In many instances, unethical behaviour went unchecked, proliferated and eventually became the norm within the company.

A close examination of misconducts revealed that lapses in the ethical framework allowed some individuals to push, and in several cases, break the boundaries of what is permissible. As quoted in a speech by the President of Federal Reserve Bank of New York, William Dudley, "ethical problems in companies originate not with a few bad apples but with the barrel makers"¹. In other words, the problems originate from the **ethical culture** of the company.



What could go wrong:

- Corporate misconducts are not detected at the "get-go" (early) stage.
- Frequent incidences of imprudent risk-taking within the company.
- Adverse reputational effect to the company (due to poor ethical behaviour) despite complying with legal requirements.
- Breakdown of internal controls.

¹ Dudley, C 2014, *Enhancing Financial Stability by Improving Culture in the Financial Services Industry*, Federal Reserve Bank of New York



Point for reflection

Ethical culture reflects the prevailing attitudes and behaviours within the company. It is how individuals react not only to legislations ("black and white"), but to all of the ethical dilemmas ("shades of grey").

For an ethical culture to become part of a company's DNA, the existing ethical framework must be supplemented by **human governance**, a governance structure that is human-centric, principles-based and relies on conviction to make decisions.

A company's culture is largely shaped by the **company's leadership**. Ethical principles and values need to originate from the leaders and be cascaded across the company. This notion is well encapsulated by the oft-cited phrase of "tone at the top, tune in the middle, and beat at the feet".

Tone at the top

Board members and senior management encourage employees across the company and business partners to behave ethically.

Tune in the middle

Front-line and mid-level managers turn principles into practice by actively engaging with employees in developing an ethical culture within the company.

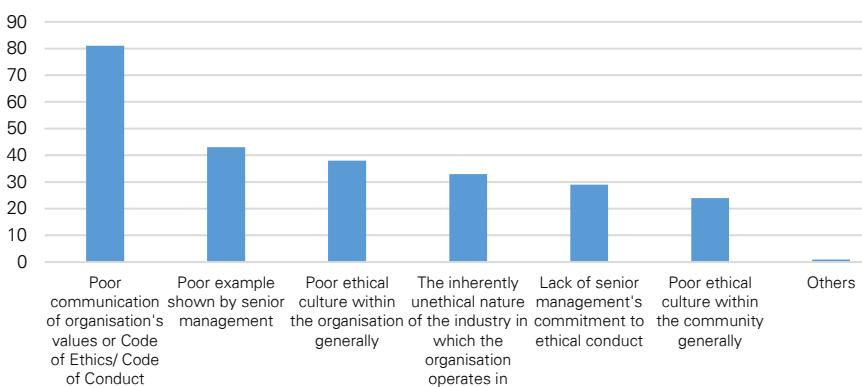
Beat at the feet

The company rewards and promotes individuals in the company for their adherence to ethical values. Good behaviour is rewarded and negative behaviour is punished.

To this end, a well-designed Code of Conduct and Ethics could go a long way in shaping the corporate culture and driving conduct within a company. It serves as both an internal guideline and an external statement of corporate values and commitment. It could also act as a central point of reference for employees to support day-to-day decision-making.

On the contrary, lack of ethical guidance could lead to **diminution of personal accountability**. In a survey performed by KPMG in 2013 across a cross-section of approximately 100 listed issuers in Malaysia, respondents opined that the most prevalent factor which contributed to unethical behaviour was poor communication of the company's values or Code of Conduct and Ethics.

Factors that contributed to the unethical behaviour occurring in the respondents' organisation



Source: KPMG Malaysia Fraud, Bribery and Corruption Survey 2013

Recognising the need to foster an ethical culture that is grounded on ethical, prudent and professional behaviour, **Standard 18.1 of Bank Negara Malaysia's Policy Document on Corporate Governance** (as with **Practice 3.1 of MCCG**) has emphasised the need for boards of financial institutions to formalise a Code of Ethics and ensure its implementation².

HOW

The practice in substance

The board should therefore commit to ethical values through a Code of Conduct and Ethics and ensure the implementation of appropriate internal systems to support, promote and ensure its compliance.

The board should also satisfy themselves that the Code of Conduct and Ethics is taken seriously throughout the company, and make it known that they will take serious action against any conscious and recurring breaches. The policies of the Code of Conduct and Ethics should be integrated into company-wide management practices and be periodically reviewed.

Key considerations relating to the application of this Practice are outlined below:

What are the factors that should be taken into account in developing a Code of Conduct and Ethics?

David Murray lists the following critical success factors for the formulation of a Code of Conduct and Ethics³:

Clear purpose The board and senior management should know why they want to develop a code and what benefits it entails. There has to be a development process and this has to involve participation from employees at all levels, as well as the inclusion of stakeholders.	Understanding of predecessor codes If a previous code is outdated, there should be clarity on why this is the case and, if there is an industry specific code, adequate care should be taken that there is no conflict between the two.	Understanding of existing values and principles The code has to be based on these existing values, otherwise employees will not be able to associate with or endorse the contents.
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In addition, companies would need to answer the following basic but critical questions, which are:

- Does the company adhere in practice to a Code of Conduct and Ethics?
- What should be the coverage of the Code of Conduct and Ethics? (Note: **Guidance to Practice 3.1 of MCCG** states that the Code of Conduct and



Dos

- ✓ Undertaking a periodic review of the Code of Conduct and Ethics to ensure that the document is current and relevant.
- ✓ Reinforcing the ethical standards espoused in the Code of Conduct and Ethics via training programmes and other engagement efforts within the company.
- ✓ Designating a board committee to oversee ethical matters.



Don'ts

- The following would render the application of this practice ineffective:
- ✗ Inadequate attention accorded to ethical matters by the board and senior management.
 - ✗ Not establishing communication channels for matters concerning ethics to be disseminated across the company.

² As stated in **Standard 18.1 of Bank Negara Malaysia's Policy Document on Corporate Governance**, the implementation includes maintaining a record of breaches of the code of ethics and addressing such breaches in a manner that upholds high standards of integrity.

³ Lagan, A 2000, *Why Ethics Matter: Business Ethics for Business People*, Information Australia

Ethics should articulate practices and guide the behaviours of directors, management and employees.)

- How to obtain buy-in for the company's Code of Conduct and Ethics?
- What are the measures which can help to reinforce the practices contained in the company's Code of Conduct and Ethics?

What should be encapsulated in a Code of Conduct and Ethics?

As stated in **Guidance to Practice 3.1**, the Code of Conduct and Ethics should describe measures put in place to:

- handle actual or potential conflict of interest;
- prevent corrupt practices which include the offering and acceptance of gifts and other form of benefits;
- encourage the reporting of unlawful or unethical behaviour;
- protect and ensure the proper use of the company's assets; and
- ensure compliance with laws, rules and regulations.

In addition, companies may consider the following list of issues and risk areas that could be addressed in the said document, either under their own subject heading or as part of a broader topic:

Example of areas that can be covered in a Code of Conduct and Ethics (non-exhaustive):

- anti-trust/competitive information/fair competition;
- tender/procurement/purchasing;
- anti-money laundering, anti-terrorism financing and proceeds of unlawful activities⁴;
- confidential and proprietary information;
- record keeping and document retention;
- political participation, contribution and lobbying;
- outside employment and other activities;
- holding directorships in other entities;
- donation and sponsorship;
- gifts, entertainment, gratuities, favours and other items of value to/from stakeholders;
- health and safety;
- marketing, sales, advertising, and promotions;
- securities trading and insider information;
- personal conduct;
- harassment (sexual and other forms of discrimination); and
- employment practices and affirmative actions.

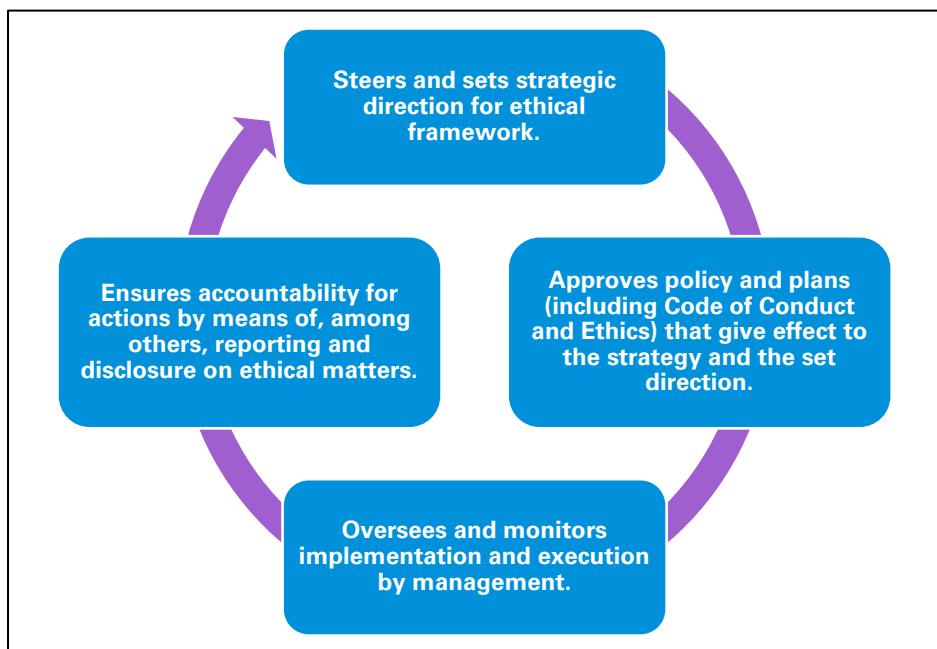
⁴ The **Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001** and the accompanying guidelines issued by **Bank Negara Malaysia** provide for the offence of money laundering and terrorism financing and the measures to be undertaken for the prevention of money laundering and terrorism financing offences.

How can the board set the tone in driving ethical culture within the company?

The foundation of an ethical culture largely depends on the leadership, and the responsibility begins with the board.

The directors should lead by example and embody the ethical values that are being espoused. The board together with management should also put in place policies and procedures which engender ethical conduct throughout all levels of the company. This includes the implementation of appropriate internal systems to ensure adherence to the Code of Conduct and Ethics.

The roles and responsibilities of the board in driving effective ethical leadership are depicted as follows:



As illustrated above, ethical leadership is results-driven. It is about achieving strategic objectives and positive outcomes.

In this regard, the board is responsible to steer the strategic direction of the company in terms of ethics. The board should determine the way in which ethical considerations are to be approached, conducted and addressed. In order to give effect to the company's ethical strategy, management then implements and executes the strategy in accordance with the policy and plans (including the Code of Conduct and Ethics) which are approved and overseen by the board. The board finally ensures that there is accountability for the actions through, amongst others, reporting and disclosure by the management to the board on ethical matters. This in turn forms the basis for reviewing strategic direction which starts the cycle anew.

Corporate Integrity System Malaysia

In 2011, the Corporate Integrity System Malaysia ("CISM") initiative was introduced to secure the co-operation of companies to develop their own anti-corruption programmes. This initiative was driven by the Malaysian Anti-Corruption Commission alongside other regulatory bodies and government agencies.

The CISM initiative encourages companies to take personal responsibility for matters concerning ethics and integrity. It outlines a framework to help companies and businesses in identifying gaps and obstacles that they face in pursuing corporate integrity⁵.

Under CISM, companies are called upon to **sign the Corporate Integrity Pledge** (a unilateral declaration that the organisation will not commit corrupt acts) and **submit an annual report on integrity initiatives**.

As of the end of 31 December 2016, there are over 800 signatories who have committed to this initiative.

⁵ From Pledge to Practice: A Guide to implement the Corporate System Malaysia 2014, Corporate Integrity System Malaysia

Where

Regional/international perspectives

Alongside Malaysia, enumerations for companies to have a code of conduct and ethics have been established in many countries including Australia and South Africa.



Country	Provision(s)
Australia	<p>A listed entity should:</p> <ul style="list-style-type: none">(a) have a code of conduct for its directors, senior executives and employees; and(b) disclose that code or a summary of it. (Recommendation 3.1)
South Africa	<ul style="list-style-type: none">6. The governing body should ensure that codes of conduct and ethics policies:<ul style="list-style-type: none">a. encompass the organisation's interaction with both internal and external stakeholders and the broader society; andb. address the key ethical risks of the organisation (Practice 6)7. The governing body should ensure that the codes of conduct and ethics policies provide for arrangements that familiarise employees and other stakeholders with the organisation's ethical standards. These arrangements should include:<ul style="list-style-type: none">a. publishing the organisation's codes of conduct and policies in the organisation's website, or on other platforms or through other media as is appropriate;b. the incorporation by reference, or otherwise, of the relevant codes of conduct and policies in supplier and employee contracts; andc. including the codes of conduct and ethics policies in employee induction and training programmes. (Practice 7)

Country	Provision(s)
	<p>8. The governing body should delegate to management the responsibility for implementation and execution of the codes of conduct and ethics policies. (Practice 8)</p> <p>9. The governing body should exercise ongoing oversight of the management and ethics and, in particular, oversee that it results in the following:</p> <ul style="list-style-type: none">a. Application of the organisation's ethical standards to the processes for the recruitment, evaluation of performance and reward of employees, as well as the sourcing of suppliers.b. Having sanctions and remedies in place for when the organisation's ethical standards are breached.c. The use of protected disclosure or whistleblowing mechanisms to detect breaches of ethical standards and dealing with such disclosures appropriately.d. The monitoring of adherence to the organisation's ethical standards by employees and other stakeholders through, among others, periodic independent assessments. <p>(Practice 9)</p>