CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

The Worshipful Company of International Bankers
For Financial Services Professionals

Institute of Business Ethics

INTEGRITY AT WORK
IN FINANCIAL SERVICES

A practical guide to trust and integrity dilemmas

INTEGRITY AT WORK

IN FINANCIAL SERVICES

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INTRODUCTION

When, 15 or so years ago, this Institute was founded by a group of former individual members of the Stock Exchange, it established objectives not only to set and assess professional standards, but also to sustain and develop more widely the standards of behaviour epitomised by the Exchange's motto 'My Word is My Bond". To this end, the Institute set a Code of Conduct to help its members meet these standards.

Late in 2004, we decided that this Code was in need of revision, to adapt to changing market circumstances. At the same time Lord George had become Master of the Guild of International Bankers and had determined that he would mark his period in office by encouraging the development of a set of Principles of Behaviour to be adopted by the membership. When this work had been completed Lord George, knowing of this Institute's work in this area, prompted the Guild to discuss its work with us. This discussion showed a high degree of common thinking, and we resolved that, subject to our colleagues' agreement, the Securities & Investment Institute should endorse the Guild's five key principles, and add two more, which were relevant to our broader individual membership, and work jointly to promote them widely through the financial community.

We were always well aware, paraphrasing Adam Smith, that the purpose of production is consumption, and that the real challenge was not to delineate the Principles, but to encourage financial services practitioners to think about them, and apply them in their day-to-day activities.

A wide range of our corporate members have endorsed the Principles, some embodying them in internal staff handbooks and training courses. The initiative which has perhaps stimulated most interest amongst individual members has been the monthly Grey Matters, ethical dilemmas discussed in the *Securities & Investment Review*. This interest in applying the Principles in practical matters of trust and integrity prompted the publication of this collected volume of Grey Matters, together with a broader review of the role and importance of trust and integrity in our industry. We are very pleased to have secured the collaboration of both the Guild of International Bankers and the Institute of Business Ethics in this work. I hope you find it of value.

Scott J Dobbie CBE, FSI(Hon) - Chairman, Securities & Investment Institute

ACKNOWLEDGEMENTS

Grateful thanks to the members of the Securities & Investment Institute's Integrity & Ethics Committee, who have contributed their years of wisdom and experience in the review of the cases in this book. Thanks also to those members of the Institute who kindly have contributed cases based upon their own professional experience.

The result is a collection of scenarios which are based upon, or in some cases are close reconstructions of, actual events. These cases formed the basis for the monthly Grey Matters series in the Securities & Investment Review.

Although in each case there is an optimum solution offered to readers, it is not claimed that there is a definitive right answer to many of the situations and there are those where readers may feel that an alternative solution to that offered would be equally acceptable.

FOREWORD

I remember well when, as a fresh trainee in the City, I was shown the Policy & Procedures Manual of the organisation. The word 'manual' was of course a misnomer, as even in those days the procedures stretched to some half-dozen or so volumes, each over three inches thick. My mentor drew attention to the first page of the first volume. One sentence only, placed alone in the centre of the page in heavy bold type, caught my attention. It read: ***"All the policies and procedures written are no substitute for common sense"***. A use of a hackneyed expression perhaps, but surely it sums up what ethical behaviour is all about. Regulators are trying to achieve this with formal rules because, I suggest, some amongst our industry apparently do not know the right way of going about business.

Today, I try to impart ethical standards to young colleagues entering the arena with a couple of perspectives. The first asks them to consider each action or decision they make during their careers in the context of how it would look if featured in the press the next day. The second, and I use this with my family when they suggest we should go through HM Customs green channel when we might have goods to declare, is to remind them that in my career I am guided by the mantra that *"the only thing between me and oblivion... is my personal integrity".*

Lord George, during his year as Master of the Guild of International Bankers, first introduced the Principles of Business Conduct at the Company's annual banquet at the Guildhall in February 2005. Many of us were rather astonished when he sang to the audience of 500 an extract from that old Christmas song "Be Good for Goodness Sake!" Being "good", that is having the common sense to know how to treat clients decently, does so much more than just making good business sense.

In sport, perhaps overused for analogies, I think the difference between playing hard and playing dirty is a parallel to being competitive as opposed to cheating. In my rugby days I spent much of my time trying physically to intimidate or overwhelm my opposite number. Sometimes the opposite occurred! But these competitive instincts were always tempered by fair play. Inevitably, thirty men, who had spent an hour and a half trying to beat the living daylights out of each other, would end up in the bar in an atmosphere of goodwill and mutual respect.

We are all disheartened when we look at the daily papers, because not a day seems to go by without some reference to a break down in ethical behaviour. Of course it is not fair to suggest that the financial services industry is alone in attracting such criticism, but I do believe that because we are charged with the nation's wealth we are held to a higher standard. And so it should be. Sadly there are many examples of widespread unethical behaviour internationally. Only the other day a European government was being forced into considering its position over the purchase of Eurofighter, following revelations that the lobbyist for the manufacturer paid a substantial sum to a company controlled by the wife of the country's air force commander. Enron, Andersen, Parmalat, and WorldCom are now infamous names. What story will tomorrow's papers bring?

I have to admit that, over the thirty-five years that I have spent in international banking, ethical standards have certainly not improved and indeed may have worsened. How can we stem the continuing erosion of standards?

Reading this excellent book is one way. A compendium of articles and examples carefully collected, I hope it will assist by pointing out some of the pitfalls which the unwary may not immediately recognise. The experience of those who have been in our marketplace over many years is invaluable, and should be shared. Ethical standards should be embedded in every institution's core training. I commend this book to all as a reminder of what "oblivion" can look like. And don't ever forget to apply common sense!

Michael J. Kirkwood, CMG FCIB FRSA
Citi Country Officer UK and Head of Corporate Banking UK & Ireland
Immediate Past Master of the Guild of International Bankers

CONTENTS

A CALL TO ETHICS

By David Lascelles

Greed, short-termism, bonuses, the hard sell. Britain's financial services industry may be booming, but it has been getting a bad press. Judging by the newspapers, the public sees people in finance as objects of dislike: wheeler dealers who cannot be trusted, who grossly overpay themselves, who will do anything for a buck, even to the point of destroying whole communities by stripping their assets and cutting jobs. This animosity is stirring politicians to set up strings of inquiries into alleged misdeeds, and regulators to pile on even more rules to keep the business in order.

A caricature, certainly, but not one that can be ignored. The fact that the UK's financial services sector now ranks among the country's most successful industries — and in many respects leads the world — does little to allay public concern that it is ethically suspect, that it lacks standards of decency and good behaviour, and that it is driven by selfishness and greed. When the authorities announce new measures to discipline financiers, they are greeted with applause rather than with a caution that these might damage an industry which employs hundreds of thousands of people and delivers billions of pounds worth of overseas earnings.

Public mistrust, it must be said, has its roots in patches of fertile ground. There have been enough scandals in recent years to justify a certain degree of cynicism in the man in the street: endowment mis-selling, raids on pension funds, overcharging, dodgy investment products, fat cat pay-offs. This mistrust has been overlaid more recently by controversy about the activities of the private equity crowd — little understood outside their hectic specialist world — whose huge influence seems to be matched only by their secretive ways. There is also a suspicion, even among those close to the business, that the financial world really doesn't care about ethical behaviour because all that matters is profit. Profits are easy to come by in an industry which appears to be cosy and uncompetitive.

In many ways, all this is highly ironic because there has never been a time when the UK's financial services industry was more conscious of the need to behave responsibly, and of the importance of instilling ethical behaviour into its practitioners. There is scarcely a bank, a fund management firm or a stockbroker in the City which has not devoted a great deal of time and resource in recent years to developing codes of conduct, setting up ethical compliance machinery, even forgoing business opportunities that might have generated a handsome profit but would have breached some self-imposed ethical ordinance. Trade organisations, professional bodies and even the financial regulator have all played their part in reinforcing this process.

This transition has not been easy for the City, coming as it does from a tradition of clubbishness and self-regulation, with a low tolerance of outside interference and moralising. In the old days its famous motto “My word is my bond” provided a guarantee of integrity, but the reality was a rather murkier world where people set their own rules, and frequently ignored them “because everyone else does”. Insider trading, front-running and conflicts of interest were commonplace though also, it has to be said, perfectly legal. Although professional standards were applied to the City’s affairs, these were narrowly based. The concept of ethics with its connotations of values and widely accepted standards of behaviour did not have much currency. Transparency and accountability were conspicuously lacking.

With the tradition of self-regulation so deep-rooted, it took more than ten years from the 1986 Big Bang — when the modern City can be said to have been born — to get the rules on to a statutory and more open footing. Only then did the City begin to evolve business standards that could be described as transparently created and publicly accountable, covering ethics, corporate governance, disclosure and a host of other aspects reflecting the spirit, not just the letter, of the law. And these were not merely ethical principles as the City chose to understand them, but ones which were approved by broad strata of society. The City’s contemporary approach to ethical issues needs to be seen against this background which, though now largely obliterated, accounts for the resistance that is still occasionally encountered among its members to the idea that they should behave like everybody else.

But, by dint of an enormous amount of work, the City can now be said to have a well-grounded system of business ethics which is as good as any in comparable financial centres. One of the tests is what happens when people contravene it. Where previously such behaviour would have been met with nods and winks, it is now a grave disciplinary matter which can cost people their jobs. At the international level, London may have had its scandals, but it has been spared its Enrons and dotcom busts, and is widely considered to have established a more solid ethical framework than Wall Street; one where ethical codes are respected, where shareholders have a bigger say over management in areas like pay and the appointment of directors, and where governance is stronger. These are extravagant claims which could be exploded by a single major scandal tomorrow. But what can be said with certainty is that ethics has become serious business, a matter of top-level concern, and a subject of constant and evolving debate.

But is it enough? Almost certainly not, judging by the persistence of negative perceptions. If so, what more does the financial services industry need to do to regain public esteem and trust? And how can ethical standards be firmly grounded in an industry packed with highly motivated individuals lured by glittering rewards? Is it even possible for an industry which makes its profits by using other people's money to be viewed in a wholly virtuous light?

This is challenging territory. Taking the last point first, people will always mistrust financiers as a matter of social culture. But this is no reason for the City to let up on the ethical front, though it will make the task harder. Ethical standards, if they are to reassure a sceptical public, will always have to be higher and more rigorously enforced in finance than in other businesses which have the public "on their side", so to speak. The importance of capital and the financial system to the country at large imposes a particular obligation on the finance industry to behave in a responsible way, and public expectations are high.

"Is the City worse than other sectors?" asks Lord George, the former Governor of the Bank of England. "I don't think so, but it probably needs to be more conscious of the need for ethical behaviour."

But while public suspicion may provide a powerful reason for finance to look to its ethics, it is not the only, or even leading, driver behind the quest for high ethical standards. Depending on your point of view, ethics may be a matter of principle — something that all decent folk should embrace without question — or a matter of good business practice — something that all well-managed businesses should have — or both. It is not just a matter of public relations.

The City being what it is, the business case for high ethical standards is the predominant factor.

The central component of the business case is that finance is built on trust, people trusting financiers to look after their money, to deal fairly with them, to put their interests first — often at key moments in their lives, such as buying a house. As Lord George points out: "There needs to be a real appreciation that trust matters. If you don't have it, people won't use your services. It's very simple. If you want to prosper in the long-term, you must treat your customers fairly." Trust need not be simply about inspiring confidence in customers; it can also encourage co-operative behaviour and loyalty in them, which is good for business. "You should treat others as you would like them to treat you", says Lord George.

Some measure of the value of trust to a business can be gained by looking at HSBC, the UK's largest banking group. According to independent assessments, the brand value of HSBC is in the order of $15bn, much of which rests on its reputation for honest dealing and people's willingness to entrust it with their financial affairs. Stephen Green, the bank's chairman, says that "values are central to value, they are part of a sustainable business." Poor ethical management within the group could easily erode this highly volatile and intangible asset.

Ethical management is, however, a comparatively new discipline in which new challenges are popping up all the time. As the test cases and dilemmas in this book show, the issues can be complex, technically difficult and blurred by conflicting interest. There is the additional consideration in the City that money constantly lies in temptation's way, that individuals are highly motivated and competitive and that the City's hothouse atmosphere can lead people to believe they operate in an exceptional world where common standards do not apply.

According to Mr Green it has to be done with a mixture of controls and leadership. "You need a plethora of controls. But no amount of controls is sufficient with such a large and complex business. Ultimately, there is no substitute for leadership — for the board and top management to ensure that there is a lively sense of values at the heart of the place."

But if a strong framework is needed to create the values and shape the operating environment, the behaviour of individuals who need to be keenly aware of the firm's ethical position and to have the incentive to abide by it is also vital. How do you ensure that salesmen don't use unethical sales tactics, that the corporate finance teams don't suppress conflicts of interest for the sake of a deal, that the bank doesn't take on dodgy clients to meet sales targets? These are all questions that constantly challenge management. The answer is that you cannot provide 100 per cent guarantees. You must, therefore, have the best possible values and controls. "Do we get it right all the time?" asks Mr Green. "No. Do we have rotten apples? Yes. But it is all very different from the swashbuckling days of the 1990s."

HSBC has developed policy guidelines on lending to potentially controversial industries such as forestry, chemicals, water and armaments. On arms, the answer is simple: it doesn't lend to firms which make or deal in armaments. In other areas, it seeks reassurance that the borrower is a responsible entity which meets its ethical standards: if it isn't, the bank tries to persuade them. "We would rather find a way of working with them than cut them off," says Mr Green. "The NGOs (non-governmental organisations) support this approach because the alternatives can be worse. But there have been cases where we have turned business down." Mr Green declines to put a number on forgone business, but reckons it is worth less than the reputational value earned as a result.

But even close attention to ethical issues provides no guarantee in an organisation which operates in 76 countries. Mr Green points to a controversy that HSBC recently found itself in for lending to unsustainable Malaysian logging activities, which he puts down to a failure of controls. The revelation that HSBC lost money on lending to the sub-prime market in the US (mortgages for the underprivileged) has also raised questions about its ethical stance. But Mr Green stresses the positive: "If we didn't lend to such people, they would have to turn to the loan sharks. Big banks should not withdraw from these markets." Since HSBC runs a global brand, the risk is that taint in one country can quickly spread to another, faster than in companies which differentiate their brands from one market to another. This reinforces the need for tight ethical management.

The values themselves may be developed internally by institutions, but it has become important for the finance sector to show that these are not the product of the City club but have wider endorsement, for example from stakeholder groups, NGOs and even the regulator. This has given added impetus to internationally developed sets of standards, such as the Equator Principles for managing social and environmental risk in project finance to which most large banks now subscribe. Mr Green says: “The expectation now is that banks will be responsible in their lending. The Equator Principles have teeth. They ensure that questions systematically get asked.”

Few of the City’s financing activities have attracted as much criticism as private equity, the practice of acquiring companies for private investors in highly-leveraged deals and re-engineering them to increase their value for re-sale. The huge size of these deals — often billions of dollars — and the fact that they target household names like Boots and Sainsbury’s has set alarm bells ringing. What are the ethical principles behind these deals, which can cause tremendous disruption, job losses, but also bring fantastic rewards to shadowy operators and investors?

Lord George believes that much of the criticism that has been levelled at private equity is unfair and overlooks the good that this form of investing can do by bringing about change and modernising underperforming companies. “The private equity business feels that it can run companies much better than existing management. They’re taking a risk, and if it doesn’t work they lose money. When it works, it’s doing good for the economy as a whole, even if jobs are lost. You can’t just hang on to what you’ve got. We’ve learnt that that is a blind alley. It’s misguided. It’s why employment is higher here than in countries which haven’t seen that risk taking.”

Many of the criticisms of private equity focus on allegations of short-termism, the view that it is more about making quick bucks than turning companies round. Mr Green accepts that some of the private equity business is about asset stripping. “It happens. But not enough to condemn an entire asset class. I think it is simplistic to attack it.” Nonetheless, Mr Green is keen to ensure that negative perceptions of private equity do not taint the group as a whole. “I expect the head of private equity to think about the impact on the brand,” he says.

But even if the private equity business believes it applies high ethical standards to its business, it knows it has an image problem. Early in 2007, it set up a working group under Sir David Walker, the former banker and City regulator, to devise a voluntary code of conduct to appease its critics. This will be a challenging task for a business which prefers to keep a very low profile, yet without such a code it is possible that private equity could be severely hampered by public hostility, union opposition and, ultimately, political pressure.

Allegations of short-termism are not, however, confined to private equity. If there has been a long-standing criticism of the City, it is that much of its investment activity is geared towards short-term profit, to the detriment of business development over the long-term. While this criticism in the past focused on the economic impact, increasingly it is viewed as an ethical issue: short-termism is equated with greed, irresponsibility and obliviousness to the interests of wider stakeholders.

Mark Anson is chief executive of Hermes, one of the City's largest fund managers, and a leader on many of the ethical issues surrounding the asset management and pension fund sectors. Most people, he says, are genuinely interested in the long-term: asset owners, companies, employees. So why is there such pressure for short-term results? The usual suspects are stock market analysts, speculators, barrow boys and the media. But Mr Anson says people have been blaming each other for too long, and it is time for asset owners and public companies to "break out". One of the initiatives he points to is the Marathon Club, a group of institutional investors which encourages managers of pension funds and similar institutions to take a longer-term view by providing support and "how to" guides. "There's a growing consensus that this short-term approach has to stop," he says. Lord George also believes that it is becoming increasingly seen as a matter of commercial self-interest to take the longer view. "The best business takes the long view. Short-termism is short-sightedness."

While it is clear that City institutions have been responding to ethical pressure by developing and implementing much stricter standards, there have also been market and structural developments which sometimes make these issues harder to handle. One is the distance between lender and borrower that has been created by innovations in the financial markets. Instead of lending directly to borrowers, banks can now do so through intermediaries, for example by trading in credit derivatives, by securitising loans or by lending to private equity and hedge funds, who use the money to finance their own deals. This means that banks may not be able to enforce their ethical principles. According to Mr Anson, "We are moving from relationship to transaction-based banking. There is more money to be made that way. But it creates an environment where standards can decline."

The application of ethical standards is also a big issue for the fund management industry, though individual funds are usually only deployers of capital belonging to other people, such as pension funds, to whom the decision about how the money should be used really belongs. Some asset managers use this to duck responsibility for applying ethical standards to investment. Mr Anson thinks firms can be more proactive by drawing issues to asset owners' attention, by designing filters to avoid unethical investments, or by being more open about how they select stocks for investment. "You can't turn a blind eye. There should be some ethical obligation on the asset manager," he says. Like the banks with their Equator Principles, the asset management business has been implementing industry-wide principles under external auspices, for example the UN's Principles for Responsible Investment which encourage asset managers to build environmental, social, and corporate governance issues into their investment decisions.

But even here, complications emerge. How, for example, do you treat an investment in tobacco? For many people this is an ethical issue: tobacco is harmful, so it should not receive investment. Yet tobacco companies are very profitable and enjoy strong cash flows through all phases of the business cycle. This can be very convenient for institutions like pension funds which need to make regular payments to their members. Another question for fund managers is how much they should engage with the companies in which they invest. Mr Anson believes that funds should encourage companies to outperform the market, but not to change their business model. "We don't want to shut companies down. Who is to say what is a despicable company?" Furthermore, by excluding sectors or individual companies from the investment portfolio, investors could be damaging their interests, according to modern portfolio theory, which says that the more diversified a fund is, the better it is because it spreads risk.

However, one of the most difficult challenges currently facing the finance sector – as it enjoys the biggest boom in its history – is how to handle the controversy over soaring bonuses. Few issues have triggered as much public ire or raised such pointed questions about the ethics of the City. For people in finance, bonuses are not a question of ethics, so much as deserved reward. There has, therefore, been some astonishment about the strength of public feeling on the issue and a sense that it has been created by the tabloid press and will eventually go away. Certainly, there has been surprisingly little comment from the authorities and not much from political quarters. The City's Lord Mayor even wrote an article for the *Financial Times*, defending the bonus system as ensuring that London remains at the forefront of the international finance business and continues to attract top talent.

Nonetheless, there is considerable unease within City management because of the size of the sums involved and the ever-present danger that these could trigger some kind of regulatory or political backlash.

Lord George says that the problem lies mainly with short-term cash rewards, which the City needs to manage very carefully. "I have no problem with the principle of paying bonuses. But if you really want to have a long-term, trust-generating approach, the reward to individuals for their contribution should be structured in a long-term way."

It has long been recognised that fear and greed are what get financial markets going, and Mr Anson at Hermes points out that "a little bit of greed is good" because it incentivises people to outperform. "The problem," he says, "is a lot of greed, and a focus on your own wealth rather than the client's." Mr Anson, who is from the US, recalls visiting a company chief executive and noticed that the screen on his desk was tuned in not to the company's share price or even business news, but the value of his own stock options. "That man was simply not concerned with the long-term value of his company."

Dealing with the bonus issue presents City management with a particularly sharp dilemma. Mr Green at HSBC says that individual institutions are "prisoners of the market" because they have all got to pay fair compensation to attract and retain good people. "I find it impossible to defend it. But we could not possibly say that we are not going to pay the market rate," he says. One way forward might be to encourage people who receive large bonuses to handle them in a responsible way, spend wisely, donate to charity, and aid those less fortunate than themselves. Mr Green comments: "I think there's scope for the City to improve its image, and for others to point out the social responsibilities of those to whom much is given." Ultimately, however, this is more a matter of individual responsibility than of company policy or official pressure. Nonetheless, the bonus issue, and the manner in which it handles it, do give the City an opportunity to demonstrate to the country at large the level of its ethical awareness.

The fact that the authorities – the Financial Services Authority, the Bank of England and the Treasury – have chosen to take a low profile on ethical issues reflects the widely held belief that these are matters best left to the City. The FSA, the authority most directly involved, has essentially confined itself to encouraging the establishment of professional principles, and implementing codes of conduct, for example Treating Customers Fairly. Nonetheless, there must always be concern that if the City failed to run a tight ethical ship, the authorities would step in in a far bigger way. Lord George comments: "The financial services industry must understand that, unless there is a decent ethical behaviour, the authorities will try and intervene. You will get more intrusive regulation." He points to developments in the US where regulators and lawmakers have been much tougher – and arguably driven finance business offshore.

The risk is always that too much emphasis on rules of behaviour will dampen the competitiveness of the industry and damage the City's international standing as a financial centre. Complaints about over-regulation in London are already loud enough. However, the opposing view holds that an insistence on high ethical standards increases a financial centre's appeal, raises individual firms' self-esteem and attracts new entrants who want to enhance their reputation. The City should, therefore, not fear the call to ethics.

David Lascelles is a former Banking Editor of the Financial Times.

ACQUIRING CONFIDENTIAL INFORMATION

Confidential information comes into the possession of your team, who make use of it. How should you react to this and similar occurrences?

BACKGROUND

You are a senior manager in a major firm of investment managers.

Your employer, an international firm with a publicly stated commitment to the highest standards of ethical behaviour, is due to make a presentation to a major corporate client which, in the light of the recent pensions shocks is seeking a new manager to run its pension fund. Management fees for this activity will provide a lucrative return to the successful bidder for the business and a number of major investment managers have been asked to make presentations and recommendations for innovative ways of dynamising the performance of the fund.

Your firm is keen to win the mandate for the business and has committed considerable resources to its bid, for which initial presentations were held last week. Following the initial presentation, you learn that the proposal was well received and you are on the shortlist against only one other major firm. Your bid team are full of confidence and report that the enhancements that they are going to make to their initial proposal will provide a knockout blow to the competitor.

Whilst, naturally, you are pleased to hear that confidence is high, you are surprised at the level of it and, also, that some of the proposed enhancements to your firm's original proposal actually represent fairly radical change. Nevertheless you leave the team to prepare their final presentation.

During the days approaching this you are conscious of a higher than normal level of tension within the bid team and, in an effort to ease the tension, you jokingly say to the young graduate recruit providing office support to the team that it is almost as though they have a spy in the opposition camp. "Oh, its better than that" he replies gleefully, "we have chapter and verse on their proposal, as they left their pitch book in the waiting room and we have given it a good home!" and he opens his desk drawer to reveal the book.

What a conundrum!

Someone carelessly leaves a document lying about and you innocently find it. It is only human nature that you are going to look at it. And, when you discover that it relates to a competitive bid situation, taking it back to your office to have a good look at it (before you return it to its rightful owner) makes good sense, doesn't it? After all, they would do it to us and all's fair in love and war and this is war!

Actually, it isn't and even in war there are rules. But this is business and whilst it is highly competitive, there are rules and principles to ensure that certain standards are maintained. In this instance, tempting though it may be to take advantage of a competitor's carelessness, your team's actions in actually taking the pitch book back to the office and making use of it have gone beyond what should be considered acceptable behaviour and, bearing in mind the circumstances, might be regarded as theft.

But, having discovered that your firm now has a competitor's property in its possession, what should you do?

Assuming that you do feel uncomfortable at what you have discovered, the minimum possible actions range between shredding the book and telling the owners that you have done so, or returning it to them. In both cases they will be aware that you have seen the information and are likely to assume that you have read it. Is this really enough, or should you do more and, if so, what?

OPTIMUM SOLUTION

This is a question to which many of us might feel there is no easy answer, based upon the premise that, arguably, there is nothing wrong morally or legally with taking advantage of the situation. In reality, whilst there might be some hesitation caused by the certain commercial impact on your firm, the appropriate course of action should be clear. Bearing in mind your firm's reputation (and thus your own) for the highest standards of integrity, options must include withdrawing from the bid process altogether, advising both the client and your competitor of your reasons for so doing. Alternatively, you might consider that it would be sufficient to replace your original bid team with other "untainted" members of staff, but it must be debatable whether that would be practical given the stage which the bid process has reached.

If you still need convincing that honesty is the best policy, the question that you might then ask yourself is what your reaction would be if the boot was on the other foot and you discovered that valuable confidential papers belonging to your firm had come into the possession of a competitor?

Finally, would it make any difference to your response if the team had found the material in the back of a taxi?

QUICK READ SUMMARY

ACQUIRING CONFIDENTIAL INFORMATION

What is/would be unethical

To use the Information for competitive advantage knowing that it was privileged.

Not to sanction or reprimand those who took the pitch book.

Not telling the other side that the book has been read.

Key points summary

At best, on realising that the information had been left behind, a cursory flick through would be understandable. This is unlikely to reveal sufficient depth of information to cause the original pitch to be rewritten.

This team not only read the pitch in depth, but removed it and then analysed the contents.

It's very easy for a team and management in the wrong kind of organisation to take the view that all is fair in business — it isn't; there is a code and this action was essentially deceitful.

Adverse consequences

The other side could report your firm to the FSA for theft of privileged information; theoretically they could report you to the police.

Once your organisation's behaviour is in the open, the client is unlikely to be impressed and may remove you from the bidding process altogether.

There is a very real chance of loss of business and reputational damage. Other clients may regard the behaviour as unacceptable and not renew mandates.

It sends a message throughout the firm that internal standards are low, which can excuse inappropriate behaviour elsewhere. If this situation is condoned, then it is difficult to regulate any other corner-cutting that might take place.

Optimum approach

Discipline those involved.

Advise the other institution and the client on a 'mea culpa' basis.

Offer to withdraw from the process.

Revert to the original pitch.

SII Code of Conduct impact

Principle 2 — act with integrity, do not engage in devious business practices.

Principle 3 — professional conduct.

Principle 4 — disclosure of a known conflict.

Principle 7 — to strive to uphold the highest personal standards.

EXPENSES REIMBURSEMENT

Expenses of a team member may not be what they appear, but she is related to the firm's management. Does this make a difference?

BACKGROUND

You work in the wealth management division of a financial services firm, which has a strict policy on the type of corporate entertainment which is considered appropriate to the reputation of your firm and all employees are required to be familiar with this policy.

One day, Mark, your administration manager, asks to see you looking worried and saying that he has a problem, which he needs to discuss urgently.

He tells you that, as you are aware, he is responsible for paying the expenses claims of your team, after ensuring that they meet the company policies for reimbursement, in terms of the type of expenditure, and the provision of receipts, and they require secondary authorisation when they are in excess of his delegated authority.

Mark tells you that he has been paying expenses claims on a regular basis to Caroline, who is not only one of your most successful team members, but who is also the granddaughter of one of the founding partners of your firm and the daughter of a current director. Caroline has been responsible for introducing and retaining a number of significant new clients and is viewed as having the potential to be a future director of the firm. However you feel that occasionally she takes advantage of this fact and of her family connections.

It transpires that Caroline regularly presents Mark with requests for reimbursement of her entertainment expenses totalling between £300 and £400. These are often accompanied by somewhat dubious looking photocopies of receipts and occasionally without any at all. Mark tells you that he has paid all these in the belief that as they were not for significant amounts and because Caroline is so highly regarded, he would be making an unnecessary fuss if he queried them.

However, he had now been asked to agree an expenses claim for £1,000 and although he has been given a receipt from a restaurant, he is sure that the amount has been altered from £100 to £1,000. Authorisation of this amount, is well in excess of Mark's authority, but Caroline has asked him to sign it in a hurry saying that it was for dinner with her best overseas client, who was accompanied by his three grown up sons and their wives, who she was trying to ensure become clients of your firm. Caroline said to Mark that with his signature on it, the claim would be passed without query by the required second signatory and asked him to "just put it through".

When Mark baulked at this, Caroline told him that one of the scantily documented claims that he has authorised already was actually for the occasion when she took him to the Royal Ascot race meeting (which Mark believed Caroline had paid for) and that if this is made public he will probably be fired.

How should you react to this and what are the principal factors that might be of concern to you?

An important consideration should be to ensure that Caroline does not receive more favourable treatment than Mark, merely because she has family connections within the firm. To ensure this does not happen and, whatever family discussions may take place outside the firm, the firm's disciplinary procedures must be scrupulously followed and documented. Failure to do this breaches both principle 2 of the SII Code and current employment law.

Since you have received only Mark's side of the story at this stage, it is obviously important that you ask Caroline for her version of events and, bearing in mind the nature of the allegations, it would be sensible to involve HR. This may be part of your firm's procedures in any event.

Depending upon what is revealed by your further investigations and, assuming that there is no satisfactory explanation, there are a number of potential options available to you in resolving the situation, in a way that is not only ethical, but also is not damaging to the firm.

OPTIMUM SOLUTION

Because of Caroline's links to the executive of the firm, there is an obvious temptation that your first reaction is to consider involving her father, hoping that the matter is somehow dealt with quietly, without creating problems for you. However this remains contrary to principle 2.

To overcome this, you might consider involving the chairman of the firm, presenting him with details of the situation and a recommended course of action to resolve it.

On a pragmatic basis your recommendation to the chairman might be to advise Caroline to leave the firm voluntarily, having repaid any monies paid to her to which she was not entitled. This would leave you free to deal with Mark in the manner felt most appropriate, which, bearing in mind the need to act proportionately, effectively means no sanction can be taken.

Assuming that such a course of action is felt appropriate, there are two significant further considerations. Assuming that Caroline was a registered person, should you advise the FSA of the reason for her leaving your firm and, how do you respond if approached for a reference at some future date?

With regard to the registration issue, you do have an obligation to advise the FSA of the reasons for the termination of registration. Although you may feel that, in reality, it is unlikely that most employers would make anything other than a clean report, such a course of action really is inappropriate. It should not be overlooked that Caroline's activities are blatantly dishonest and had her actions been in respect of client money, you would not adopt a laissez-faire attitude. To do so here suggests that you operate double standards.

The subject of references is, potentially, a contentious issue, as result of which any response that your firm might give is likely to be non-committal. However, you might consider whether there is any justification for responding in a manner different to that advised to the FSA and similar considerations should apply.

Although this scenario does not envisage the involvement of the police, since the scale and type of the wrong-doing would not normally cause a firm to take that step, this is only a question of degree. There is a strong argument to support referral to the police on the basis that it sends a powerful message of intent to staff, both in respect of expected standards of honesty and that all staff will be treated equally, irrespective of who they may be.

QUICK READ SUMMARY

EXPENSES REIMBURSEMENT

What is/would be unethical

To take no action against Caroline in view of her 'connected' status.

To dismiss Mark on the basis that he has paid out against false claims.

To dismiss Caroline and then state on her form C3 that she simply resigned — that would be deliberately misleading the FSA and any future employer.

Key points summary

Abuse of expenses policy is very serious and sadly commonplace — the first step in any organisation is to ensure that the expenses policy is well written, clear and known to everyone. This is because many grey areas emerge and can be exploited by the unscrupulous, if policy ambiguity makes it difficult to take action.

Caroline has fabricated receipts for claims over a sustained period of time, which is dishonest and grounds for dismissal.

Mark could have raised the issue earlier but could also rightly claim that the receipts appeared genuine enough. He remains blameless even though he unwittingly enjoyed hospitality that was outside the firm's policy.

Adverse consequences

No action sends a signal to other like-minded individuals that a level of dishonesty is tolerated and that abuse of policy is acceptable.

It sets all the wrong standards for the firm.

The firm is losing money through spurious and dishonest claims.

It suggests that patronage and connection are an excuse for dishonest behaviour and a reason for concealment.

Optimum approach

Investigate and depending on findings, dismiss Caroline.

If allegations are proven, dismissal must follow — any attempt to fudge with an ‘elegant solution’ is unethical.

Consideration might be given to taking further action, to reinforce the message that dishonesty will not be tolerated.

Require Mark to exercise company policy on payment of expense claims more rigorously in the future.

SII Code of Conduct impact

Principle 2 — acting with integrity and displaying high standards of conduct.

This is about personal standards of behaviour, not market regulations or law or even company procedures.

GIFT AID TAX RELIEF

A seemingly attractive income earning opportunity arises, but it may not be quite what it seems.

BACKGROUND

You are a senior client manager in a private client investment company. A significant amount of your new business is introduced by professional intermediaries (accountants/lawyers) and you have good relationships, bordering on dependency, with many of them.

One accountant introduces you to a Gift Aid tax relief scheme - essentially a mechanism by which your clients can benefit from tax mitigation by donating shares to charity. The accountant also invites you to participate in a personal capacity.

You investigate the scheme and discover that it works in the following way.

An investor buys shares in an unlisted company that is acquiring intellectual property rights to innovative technology. When the company is AIM-listed (which will happen shortly after the shares are purchased) the company is re-valued using an approved HM Revenue & Customs formula. The shares are expected to increase 10 times in value.

To secure the tax benefit the shares are gifted to charity by the investor who claims relief, which is subsequently made as a cash payment of up to 40% of the total tax paid that year.

You are wary of this scheme for the following reasons:

1. The inflated value of the shares is partly artificial and may collapse once the charitable gifts have been made. The charity is left with an administration issue as the shares have to be registered/held in custody etc and there is a significant lock-in period before the shares can be sold. During this time the charity cannot gain value from the donation and the share price is likely to fall.
2. The introducer will receive significant fees for arranging this scheme; each investor is charged at 11% of the revaluation of his investment. He also earns additional fees for listing the company.
3. The new listed company is a cash shell and does not trade.

In addition, you are aware of stock exchange concern about these schemes. The LSE believes that it is inappropriate that companies should seek admission to AIM primarily to secure Gift Aid tax relief, because it distorts the secondary market and the reputation of AIM.

But your clients (and indeed you, if you participate) will have a significant tax saving opportunity. The scheme is legal but under review by the Inland Revenue. As an investment adviser, it is your role to recommend tax efficient solutions to clients and this scheme is commonplace. It will release further funds for you to invest and, therefore, contribute to your total revenue generation.

One of your clients has heard about the scheme elsewhere and asked for your opinion. You are concerned that by not recommending the scheme this client will participate through another adviser and you may, as a result, lose the relationship and the funds under management.

The accountant has been a good business introducer and you feel obliged to reciprocate, but how should you respond and what might be your considerations?

As an investment manager, your first duty is to your client who has mandated you to maximise the return on those investments of theirs which are managed by you. This scheme will certainly fit that mandate and objective but, by entering into it, you and the client will be alerting HM Revenue & Customs that the client is prepared to consider this kind of scheme at a time when the UK tax authorities are closing as many avoidance loopholes as they can. Even though the scheme is currently not outlawed or illegal, it is possible that the client will face much closer scrutiny of their tax affairs and possibly an investigation into tax arrangements in general.

Moreover, you have seen a letter from the LSE to your company asking you not to support these arrangements for the reasons given in the preamble. Again, while it is not illegal for you to facilitate the clients' participation in the scheme, a key industry stakeholder is making it clear that it objects to the scheme and this entreaty has to be considered alongside the principle of 'clients' best interest.'

OPTIMUM SOLUTION

It is important that you act honestly and fairly in front of your client and you may well consider participation in the gift aid scheme. However, you will have to decide whether in doing so you could damage the reputation of your company by promoting these arrangements. Fast money schemes and special arrangements at the fringe of what is generally acceptable tend to bring an undesirable reputation to investment houses. They are generally short-lived affairs that do not build long term credibility for the promoters. There is, of course, the overarching possible reputational market issue of potentially worthless cash shells gaining false credibility post-listing and clogging an important market (AIM).

You could consider protecting yourself against any redress or future claim against the client from HM Revenue & Customs, by signing an appropriate disclaimer or waiver, but you are still left with the potential reputational issues resulting from active promotion.

Your dilemma is compounded by the fact that this recommendation fits the client mandate and is therefore well within any suitability assessment but is in conflict with the spirit of the principles that the industry follows. The difficulty is that if a recommendation compromises these principles but is not illegal, you will have to make a value choice which will sometimes be between your client, yourself, your profession and the company that you work for.

Essentially, the nature of the scheme requires you to consider how it stands up in relation to the seven principles in the SII Code of Conduct and, against that yardstick, it may be called into question under every principle.

QUICK READ SUMMARY

GIFT AID TAX RELIEF

What is/would be unethical?

To enter the client into the scheme without further thought or consideration.

To participate yourself on the same basis.

To proceed, knowing that the intended beneficiary is unlikely to see real gain, if any at all, and may unwittingly be party to a mitigation scheme that is marginal at best and may even be outlawed.

To rank intermediary relationships above your principles.

Key points summary

A dilemma arises from knowing about a scheme that meets client requirements and generates revenue that registers for incentive purposes but is clearly not in the spirit of ethical tax mitigation and is flagged as undermining market integrity.

The tax authorities and the stock exchange have made public statements of dislike, but it is legal and commonplace.

Adverse consequences

The revenue keep a watch on organisations that promote this kind of scheme. They also maintain a database of individuals who are willing to participate. By implementing this arrangement for your client, both your firm and the client are likely to attract their unwelcome attention.

The client's tax affairs will receive extra scrutiny in future and the firm may gain a reputation for unduly pushing boundaries, leading to reputational harm.

Having been warned by the stock exchange about the unsuitable nature of these arrangements it's entirely possible that the listing side of your firm, ie, the corporate finance department, could see their licence revoked.

Optimum approach

Advise the client of the various consequences that might arise from participation but also be clear about the potential benefits. Should the client wish to proceed then pass them to another house or introduce them directly to the scheme promoter. In doing so, you take a risk that the client may think less of you for not proactively supporting this kind of opportunity, but this is of less importance than the potential adverse consequences.

SII Code of Conduct impact

Principle 1 —to act honestly and fairly.

Principle 2 —to act with integrity.

Principle 5 —to avoid conflicts of interest.

Principle 7 —to strive to uphold the highest personal standards.

ANALYST INDEPENDENCE

An independent analyst receives information which reinforces his negative view of a company, but has he been compromised and how should he react?

BACKGROUND

Tony Adams is an analyst at Premier Investment Bank covering the pharmaceuticals sector. Tony is shortly to publish a single stock piece on Gooner Pharmaceuticals and has diligently carried out fundamental research into the company. However, unlike some of his peers, he has a negative view of the stock, principally because he is not sure whether Gooner's new drug, Zapazit (a revolutionary anti-boil treatment) will receive FDA approval in the USA. His draft forecast figures are considerably below the market consensus and, following Premier's revised and more honest approach to recommendations, he plans to downgrade from hold to reduce.

Gooner Pharmaceuticals plc are shortly to enter their close season and Tony is keen to issue his report as soon as possible. He has arranged to meet with the finance director, Brian Bull, to discuss his draft.

When Tony arrives, he finds that Gooner's head of R&D, Dennis Bergen, and an analyst from Hotspur Investment Bank will also be present at the meeting. Hotspur Investment Bank is broker to the company.

The Hotspur analyst asks how Zapazit is progressing with the FDA. Dennis looks uncomfortable but is immediately interrupted by Brian who says that they are restricted in what they can say because of the UKLA guidance on the dissemination of price-sensitive information. The rest of the meeting is fairly bland and nothing is said which changes Tony's negative stance on the stock.

After the meeting, Brian escorts Tony to his car and, whilst shaking his hand, says, "I think I know what you're thinking and you may well be right."

THE DILEMMA

Has Brian, the finance director, acted with integrity?

How should Tony act in order to preserve his own reputation for integrity?

How should Tony's firm (Premier) react if he reports the visit and what occurred to his legal/compliance department?

THE ARGUMENTS

Although the finance director (FD) may not have made a deliberate attempt to circumvent rules, it does look as though he is trying, in a misguided fashion, to assist Tony. Clearly the FD needs to understand that the responsibilities of his position mean that he cannot give "nod and a wink" type guidance. He has explicit responsibilities as a director and under relevant statute and regulation. Consequently it is something of a moot point as to whether the FD has acted without integrity, or just out of ignorance.

Tony has been placed in a very difficult position. Whilst the conversation was a private one between him and the FD, very little has been said and in essence it merely confirms what he already suspects. Tony could argue that nothing material has changed; he is just slightly more certain than he was before. Accordingly, he might choose to keep the discussion to himself.

However, there is extreme danger to Tony's reputation if, at some later point, the conversation is revealed. The FD is clearly indiscreet. Can Tony rely on him to keep the conversation private? What will the consequences be if the exchange between Tony and the FD becomes public knowledge? What will the FSA or the UKLA do if the conversation is revealed in an investigation into Gooner Pharmaceuticals?

Because there is some doubt as to whether they do have privileged information, Tony and Premier are in an awkward situation.

Is there any regulatory or reputational risk that arises from the discussion? If there is, how can it be managed?

OPTIMUM SOLUTION

In this instance, acting in an ethical manner (doing the right thing) means both Tony and Premier should assume that they have been compromised by the FD's actions. Tony, having discussed the matter with his manager and the compliance department, should call the FD to convey his concern at the impact of his ill-judged actions and to encourage the company to manage the release of the information to the market.

Within Premier, Tony and his manager should put the following in writing to the compliance department:

1. Details of the information received from the FD.
2. The manner of its delivery.
3. An expression of their belief that they have been given price-sensitive information.
4. Why they believe that to be the case.
5. Their proposed course of action.

This will demonstrate, should it become necessary, that they are aware of their responsibilities and obligations and have acted in an appropriate manner.

Tony must remember that he owns this problem and must take steps to protect himself. He should, therefore, record the chronology of events and resist pressure to do anything with which he feels uncomfortable. Even if his manager tells him to proceed without disclosing what has happened, if he feels compromised, he should raise the matter directly with the compliance department.

QUICK READ SUMMARY

ANALYST INDEPENDENCE

What is/would be unethical

There are three parties who are in the position of potentially or actually acting unethically.

Brian the finance director of Gooner has, by his covert action, effectively made Tony, the analyst, an insider by giving him price-sensitive information. Brian conveyed his message in a less than straightforward manner but his meaning is clear.

Although Tony is an independent analyst, it would be difficult for him now to publish his research, since his independence has been compromised by Brian's action.

One might question whether Brian acted deliberately, to spike Tony's publication of a negative article, or out of carelessness. The end result is the same.

The Hotspur analyst, as broker to the company might feel the need to publish a report but, given the circumstances of the meeting, he would find this difficult without misleading the reader one way or another.

Key points summary

Tony has undertaken significant research on Gooner and has formed a contrary view to the market.

In a meeting with the finance director, Tony receives price-sensitive information in an oblique manner, which confirms his view.

The exchange is sufficiently indefinite that Tony's decision as to whether he can publish his research is unclear.

Adverse consequences

Danger to Tony's reputation should it become public that he received potentially inside information. Possible legal consequences if the FSA determine that Tony has benefited from inside information.

Danger to Premier's reputation for similar reasons in allowing publication of research based on inside information.

Optimum approach

Given the uncertainty, Tony should advise his manager and his compliance department of the nature of the contact and the result of it.

Premier should assume that Tony's report has now been compromised and they should encourage Gooner at an early opportunity to make public the information that appears to have been given to Tony and possibly to Hotspur also.

SII Code of Conduct impact

Principle 2 — to act with integrity.

Principle 3 — to observe applicable law, regulations and professional conduct standards.

Principle 7 — to strive to uphold the highest personal standards.

DEALERS' PRUDENTIAL TRADING LIMITS

Lax enforcement of internal procedures leads to an avoidable situation involving the potential loss of key staff.

BACKGROUND

Your firm has strict rules relating to the observance of trading limits by dealers and your internal audit department has reported recent violations of these by two dealers.

Dealer A is relatively inexperienced and has been with the firm for less than a year. However, his violation of his limits was more technical than intentional and was restricted to a single instance. Dealer B is a senior dealer and you are aware that this is not the only occasion on which she has exceeded her authority, although there is nothing in her file to support your belief.

All dealers are aware that significant sanctions, including dismissal, may result from breach of these limits and you are asked by the chief dealer to endorse his proposed handling of these violations.

The chief dealer is considering whether to terminate the employment or publicly to censure and halve the bonus for next year of Dealer A in order to send a message to the dealers that your firm takes the importance of adhering to limits very seriously.

However, the chief dealer suggests that Dealer B requires more delicate handling as she has been with the firm for eight years and is important to its profitability. Dealer B regularly exceeds her stretching targets and has built up an excellent corporate network and growing media profile.

Dealer B has recently been expressing discontent over the size of her last bonus and suggested that she might be intending to move. Accordingly the chief dealer has asked that she is spoken to strongly by senior management, but that nothing should appear on her record.

As a recently appointed senior member of the compliance team, what are your considerations? What would you advise and why?

RESPONSE

There are a number of considerations in this case involving management, commercial and legal issues.

From an ethical perspective, it is important to keep to the principle that whatever action is taken with both dealers, it is, and is seen to be, proportionate, fair and equivalent.

Accordingly, Dealer A should be treated no more severely than Dealer B and so the response to the breaches by Dealer B will determine what action you might take against Dealer A.

Viewed in isolation, one might suggest that Dealer B's employment should be terminated, because she has breached the firm's rules a few times before and is an experienced dealer who knows the potential sanctions.

If this path is followed, you might be forced also to terminate Dealer A's employment, in order to be consistent. The potential danger in not doing so would be a legal action for sexual discrimination though in mitigation, Dealer A's action could be explained on grounds of inexperience.

However, the danger in trying to terminate Dealer B's contract (unless by mutual agreement) is that because she has breached her dealing limits before without formal sanction, termination on this occasion might lead to a successful action for both wrongful dismissal and/or sexual discrimination which in turn might lead to an FSA investigation into unrecorded rule breaches. She could also be expected to use her media contacts to embarrass the firm.

OPTIMUM SOLUTION

From a commercial and practical perspective, Dealer B is highly profitable, close to being a "rainmaker" — and a high profile one - and you are under pressure not to rock the boat. However, you cannot ignore the fact that the strict limits were broken.

Practically, your available course of action in this instance is determined largely by what has been done, or not been done, in the past. As breaches of limit have been condoned, apparently without any major form of censure, it would be difficult to take a radically different stance in this case.

Nevertheless, as a new appointee, the examples provide you with an opportunity to address the issue with both dealers, as well as the remainder of the dealing team to establish the rules of conduct, which should then be enforced. A suitable note of the meeting should be placed on their files stating the facts of the case, that no disciplinary action has resulted on this occasion, and that no report will be made to the FSA as it is recognised this might jeopardise their Approved Person status.

From a practical perspective, regular breaches of limit might suggest either inadequate limits, or lack of control, or both. Accordingly, it would be sensible to take appropriate and demonstrable action which will also be useful as evidence to an FSA inspector that the bank has appropriate systems and controls in place at all times.

QUICK READ SUMMARY

DEALERS' PRUDENTIAL TRADING LIMITS

What is/would be unethical

To treat Dealer A strictly in line with company policy, whilst ignoring the rule breaches by Dealer B.

To continue to ignore the rule breaches by Dealer B because of her value to the firm.

Suddenly to impose the rules on both, having consistently turned a blind eye to previous breaches.

Key points summary

The company has rules in place governing practices and procedures. Historically, these appear to have often been breached.

The chief dealer is now proposing to apply these selectively against members of staff, in inverse proportion to their seniority, thus discriminating against a junior member of staff whilst ignoring rule breaches by a more senior and highly valued member of staff.

Adverse consequences

To follow the initially proposed course of action may well result in legal action being brought against the bank by Dealer A, as the bank is applying its rules selectively. Conversely, to terminate both Dealers A and B might cause legal action to be brought against the bank by Dealer B on the basis that the bank has consistently ignored similar breaches in the past.

Continuing to ignore rule breaches will make it harder to enforce them when an occasion arises where a breach is felt to be so serious that it can no longer be overlooked.

The company's systems and controls appear inadequate with potential consequential action by the regulator.

Optimum approach

Take the opportunity to establish proper control of the dealing room monitoring and control, by issuing a documented formal warning to both Dealers A and B. At the same time remind all staff of the consequences of failing to adhere to established policies, and that such failure is a termination offence.

SII Code of Conduct impact

Principle 2 — to act with integrity and to promote high standards of conduct throughout your organisation.

Principle 3 — to observe applicable law, regulations and professional conduct standards.

Principle 4 — when executing transactions observe the standards of market integrity, good practice and conduct required by, or expected of, participants in that market.

Principle 7: — to uphold the highest personal standards.

NEW HIRE – APPROVED PERSON

Being economical with the truth or selective in providing information at interview is incompatible with Approved Person status.

You work in the investment banking arm of a large group, which has recently recruited a number of staff, including those with Approved Person status.

You have just been informed by a contact in the private banking arm of your group that one of these newly recruited approved persons, was involved in an unsatisfactory incident several years previously.

You are told that, some five years earlier, your new employee (Green) who at the time ran a family investment trust, was a counterparty involved in an investigation by your private bank into what appeared to be off-market trades, which were always executed to the benefit of the counterparty.

The investigation was never satisfactorily concluded and a number of unanswered questions remain, primarily as a consequence of the counterparty not co-operating with the investigation on the grounds that a trust is not obliged to make disclosures.

Green failed to mention the above in any interview, or in the personal history form, which he completed on joining, but he is meeting all of the high financial expectations of him, when he was hired.

WHAT WOULD YOU DO?

This is a fundamental question of trust and integrity. The way in which any firm responds to this type of situation may be regarded as setting the tone for its general business approach. It is appropriate in this instance to quote the FSA who say:

"the culture of an organisation is a key mitigating tool for the proper management of conflicts of interest. Culture is a combination of both formal structures and procedures (such as HR policies on compensation, appraisals, discipline and training and IT support tools for this) and informal structures, including the values and ethics promoted by the organization, and staff behaviours - for example, what is considered generally acceptable behaviour by the staff in the firm."

Given what you now know about Green and the FSA's view of the importance of a firm's culture, consideration must be given to the implications of continuing his employment, without further enquiry. Considerations might be:

1. Is your executive happy to be associated with this person?
2. Are you prepared to support him?
3. What might be the impact on colleagues who become aware of past events?
4. Why did Green not divulge them himself?
5. Does Green meet the Fit and Proper test for Approved Persons?
6. Is Green really the type of person you want to employ given his apparent past behaviour?

OPTIMUM SOLUTION

In the circumstances surrounding your firm's past involvement with Green, it seems unlikely that he would have been found acceptable to senior management had they been aware of all of the facts. In an age when obtaining references beyond the straightforward confirmation of employment, is increasingly difficult, the information that candidates themselves are required to provide, must be beyond question.

Additionally, this case serves to highlight the tensions that may arise between the hiring department and HR department when recruiting and it is important that sound procedures are in place to provide the maximum degree of reassurance when recruiting. Hiring departments are likely to want to employ people they see as valuable to the business. It would be sensible to ensure that neither department is the final arbiter, against the wishes of the other.

As for a decision in this specific case, Green, having failed to declare what, by almost any standard, must be seen as material information, appears to be lacking in integrity and must be subject to further investigation. On the surface, Green does appear to have difficulty in meeting the Fit and Proper test for Approved Persons, which undermines the reason for employing him in the first place.

Accordingly, there appear good grounds for terminating his employment immediately.

QUICK READ SUMMARY

NEW HIRE - APPROVED PERSON

What is/would be unethical

As you have been advised that your new employee, Green, who was hired as an Approved Person, has been involved in questionable dealings with your firm, deciding not to investigate this information would be unethical.

Alternatively, assuming the worst and terminating Green's employment during his probationary period, without investigating with him the nature of the previous disagreement and his reasons for not raising it during interview is also unethical.

Key points summary

Approved Person status implies that the holder has the highest standards of integrity and is honest and trustworthy.

You are on notice that Green has been involved in a relationship with your firm, which might call into question whether he actually meets the requirements for this status.

Because he is on probation, you have the opportunity to terminate Green's employment forthwith, on the basis that he has failed to be open and honest during the recruitment process.

Adverse consequences

Failure to take any action could result in the bank employing someone who is believed to have been involved in activities which are at odds with your firm's reputation for honesty and integrity.

Optimum approach

The easiest course of action is to dismiss Green immediately, because you have probable cause to do so. However, what is arguable is whether to do so is any more ethical than the action (or inaction) for which Green is being dismissed. Consequently, the recommended course of action is to interview Green and raise with him your concerns as to why he failed to declare his previous contact with your firm, recognising that this may only be prolonging the inevitable.

However you can be satisfied that you have acted properly and fairly.

SII Code of Conduct impact

Principle 2 — to act with integrity.

Principle 3 — to observe applicable law, regulations and professional conduct standards.

Principle 5 — to manage any relevant conflicting standards of interest including making any disclosure of its existence.

COMPLIANCE CULTURE

A new director appears to be flouting FSA training and competence rules.

BACKGROUND

A new divisional director (Numan) is hired from overseas as head of your equities division. He will need to register with the FSA as an Approved Person so that he can be allowed to direct the division and advise clients.

When he joins, as the compliance officer you advise that, despite his considerable experience, he will need to pass the regulatory module of an appropriate UK qualification before he can start taking investment decisions. It is not considered feasible for him to be supervised given his seniority and experience.

Both the divisional managing director and Numan indicate that this will not be a problem and that, while studying for the exam, Numan will restrict himself to strategy and other non-trading activities.

Numan begins to study for the exam and, over the ensuing period, the performance of the equities division steadily improves.

You learn from an unattributable, but reliable source that, in fact, Numan is actually providing detailed direction to his department, including offering investment advice, for which he is not currently approved.

On raising these concerns with both Numan and his managing director, they reassure you that he is not providing any investment recommendations or advice. However, your source remains adamant that, despite the reassurances that you have received, Numan is indeed conducting regulated activities and performance within the equities division continues to improve.

Numan is scheduled to take the regulatory exam in the near future and is expected to pass, which will enable him to be judged as competent and thus registered for the appropriate controlled functions.

Given the above facts, what action would you take, if any, and what factors would you take into account?

Would your answer differ if you were aware that the FSA is due to visit and has indicated that they will look at your firm's T&C arrangements?

You may wish to consider the following factors:

1. You have no proof of Numan's alleged activities, only suspicions.
2. To pursue your suspicions further may cause serious friction with senior management.
3. Some members of the equities division are concerned that Numan is acting without proper regulatory authorisation.
4. The performance of the equities division is improving.
5. Numan will shortly take the appropriate examination, which he is anticipated to pass.
6. There may be a serious breach of FSA rules at a senior level
7. There may be a cover up.
8. You may receive an FSA visit, which will uncover this matter.

There are two problems here. One is seemingly prosaic but the other is clearly important.

The fact that it is likely that the equities director is breaching a rule which requires that an exam is passed, may be regarded by some people as being of only small significance. However, acting ethically will always require compliance with applicable regulations and laws, so the rule breach cannot be overlooked.

However, the more important issue is the probability that both the new director and his managing director have lied to you. This suggests a poor attitude to compliance and a low opinion of you as the compliance officer. The issue about the possible FSA visit is irrelevant. The key issue is the status of the compliance staff and the compliance function within the business. Secondly, there is an obligation upon firms and approved persons to escalate concerns and not to wait for discovery by the regulator. Consequently some action must be taken.

OPTIMUM SOLUTION

Although it would be possible to blow the whistle to the FSA and indeed there are protections for individuals who do so in accordance with the Public Interest Disclosure Act, this should be seen as a last resort. A more sensible first step would be to voice your concerns to the most senior level of the management team, possibly the chief executive or even one of the non-executive directors and to ask them to help. Another important step would be to write down the chronology of the case so that there is a record of the various conversations and actions.

Whilst, ultimately, it may not be possible for the relationship with the managing director and Numan to be moved on to a sounder footing, this should be tried first. You should also try to have the rule breach resolved as a matter of urgency.

The sad reality is that most whistleblowers tend not to be well treated, although there have been some recent exceptions to this. Nonetheless, it is suggested that the utmost effort is made to get the company to sort this problem out by recruiting the help of the senior management team. Compliance after all is an ethical concern not just for the compliance officer but for the whole business.

QUICK READ SUMMARY

COMPLIANCE CULTURE

What is/would be unethical

The new director and the managing director may have lied to you indicating a poor attitude to compliance which would be an ethical concern.

Key points summary

The new director has been advised he must pass the regulatory module exam before he can commence taking investment decisions.

You are advised that he may be ignoring this requirement.

On questioning him and management you are told that he is not providing advice.

You may have been lied to.

You have no definite proof, only suspicions.

Compliance does not appear to be taken sufficiently seriously by management.

Adverse consequences

If you do nothing there may be a regulatory breach.

No action by compliance may encourage further breaches.

Whistleblowers are not always well treated.

Optimum approach

Raise issue with appropriate senior management; repeat message if necessary.

Escalate to CEO or non-executive director in case of need.

Keep written records of the facts and chronology of case.

In extremis, consider whistle-blowing to the FSA.

SII Code of Conduct impact

Principle 2 — to act with integrity in fulfilling the responsibilities of your appointment.

Principle 3 — to observe applicable law, regulations and professional conduct standards.

Principle 7 — to attain and actively maintain a level of professional competence appropriate to your responsibilities.

INVESTMENT BANKING – CONFLICTS OF INTEREST

You are in a position in which you can see both sides of a Chinese wall and become aware of information on a deal which may have a negative impact upon one side of the transaction. What should you do?

BACKGROUND

You are the head of a division which covers a broad range of investment banking activities including an M&A business and a separately incorporated private equity (PE) operation.

You are aware that your M&A team are advising client X on the acquisition of ABC Ltd which is the subject of an auction process. You are also aware, through the conflict management escalation process that your PE colleagues are also participating in the auction process. The potential conflict has been managed on the basis of Chinese wall and independence policies and you have satisfied yourself on the reputational issues through disclosure.

You are aware of the current regulatory scrutiny in the area of conflicts of interest, as evidenced by letters recently disseminated by the FSA to CEOs of major investment banking operations. Indeed, you have participated in a training video in which you emphasised the ethical culture of the bank and reminded colleagues of the need for trust and integrity when dealing with clients, whose interests must always be of paramount importance.

The M&A director responsible for advising client X comes to see you to provide an update on the transaction and confirms that his client is through to the final round of the auction process, together with one other bidder, believed to be the affiliated PE operation. During the discussion you learn that, following a review of the information made available to all potential bidders in the data room, the M&A team conducted its own comprehensive due diligence exercise. This resulted in an assessment that the value of ABC Ltd is significantly less than generally believed. The M&A director idly wonders if this will affect the bid strategy of his PE colleagues.

Once the M&A director has left, your instinctive reaction is to pick up the phone to the head of the PE operation to ensure that the PE valuation is similar to the M&A assessment before finalising the PE bid and committing the group and its fund investors to an investment of several hundred million dollars.

You are aware of the bank's obligations to respect the confidentiality of client information, but are equally concerned about the financial impact on the bank if your PE colleagues proceed, without being privy to the information known by the M&A team.

In deciding upon the most appropriate course of action, it would be sensible to involve a senior member of your compliance department who will provide assistance in addressing your various responsibilities.

OPTIMUM SOLUTION

It is important that the interests of client X in the bidding process are not prejudiced by any actions you take, which means that what you have learned cannot be passed to PE colleagues. Given the size of the proposed transaction it would not be unusual for you, as division head, to satisfy yourself that comprehensive due diligence has been undertaken in respect of the PE transaction, but you must avoid the temptation to tip-off your PE colleagues in any way and must rely on the effectiveness of their PE due diligence and evaluation process.

You may also wish to consider the following points:

1. There may be occasions when it is not possible to manage conflicts on a disclosure basis, in which case, it is important to ensure that the material interest and independence provisions of the corporate finance engagement letters address the possibility of conflicts arising, inter alia, in an auction process.
2. The role of the division head should be assessed so that he or she is sufficiently divorced from the day-to-day activities of the M&A and PE operations to ensure that oversight responsibilities can be exercised above the Chinese walls in an independent senior management capacity.
3. If the additional due diligence exercise uncovered, for example, accounting irregularities, you would need to consider your responsibilities for reporting such issues (eg, to regulatory, legal and/or criminal authorities).

QUICK READ SUMMARY

INVESTMENT BANKING - CONFLICTS OF INTEREST

What is/would be unethical

You, as head of investment banking division, breach your Chinese wall arrangements by contacting the head of private equity to ensure that the PE valuation of the proposed acquisition, ABC, is similar to the M&A valuation. This would be to ignore the conflict of interest.

Key points summary

As head of investment banking you sit above the Chinese wall.

M&A are advising a client on an acquisition in an auction process.

Private equity are also participating in the auction process.

You learn from M&A that the value of ABC may be less than generally believed.

You consider suggesting that the head of PE checks their own valuation of ABC which might affect their auction bid strategy if the value turns out to be lower than presently believed.

Adverse consequences

Suggesting such action to the head of PE would breach your Chinese wall.

The FSA have made clear their interest in proper handling of conflicts of interest and failure to do so will result in regulatory action.

If PE bid in the auction on an unrealistic valuation, they, fund investors and your group may suffer adverse financial consequences.

Optimum approach

Pay proper regard to your Chinese wall arrangements and independence policy.

Ensure that any material interests and independence provisions are adequately addressed in corporate finance engagement letters which should indicate the possibility of conflicts of interest arising in an auction process.

The role of the investment division head should be structured so that it is sufficiently divorced from the day to day activities of M&A and PE.

If any irregularities in the valuation of ABC were uncovered, you should consider the possible need to report them to the appropriate regulatory or criminal authorities.

SII Code of Conduct impact

Principle 2 — to act with integrity in fulfilling the responsibilities of your appointment and seeking to avoid any acts, omissions or business practices which damage the reputation of your organisation.

Principle 5 — to manage fairly and effectively, and to the best of your ability, any relevant conflict of interest etc.

MIS-MARKETING

You are concerned that a product designed by your firm for distribution to retail customers via a third party is riskier than it appears, and the risks have not been fully considered.

BACKGROUND

You work within an investment bank in structured product design. Currently the bank is working on a product code named Lemming that will be labelled in the name of a major insurance group and sold and distributed through their sales force. Only in the small print will your bank's connection be disclosed.

The product will offer a highly attractive fixed rate of interest over the next five years, but there is the possibility of leveraged capital erosion should the stock market have fallen by more than 30% at the end of the five year term.

The insurance company is now planning a major sales campaign which will be directed towards retail investors who are currently dissatisfied with the low rates available on ordinary bank deposits. Ahead of the launch, the insurance company has asked you to review some of the promotional material to check its factual accuracy and you are concerned to note that the advertising suggests that the product is available to general retail investors.

Your marketing director has convinced the board on the benefits of this link and stressed the point that sales process and documentation are to be left entirely to the insurance company, although you are unaware of any internal discussion on the intrinsic merits or risks arising from this process. You believe that discussion has focused exclusively on the ability to generate revenue and foster strong links and establish a new distribution channel through the insurance company. The launch of this product is now close and will be a high profile event, being the first of a planned series.

You remain concerned that the potential risks are not being addressed at a senior level and that your marketing director's eagerness to launch the product has prevented adequate consideration being given to the reputational and financial risk to the bank, should the worst case scenario occur.

There are two distinct considerations in determining appropriate responses to this situation. The first is the impact upon your employer if the proposed course of action is implemented without further discussion and the second is what you might do about it.

On the face of it, the situation might be held to be quite straightforward, in that your bank has sold a product to another professional organisation on a principal to principal basis and that any subsequent promotion, distribution and sale is the sole responsibility of the intermediary. On a strict legal and regulatory interpretation, this is probably correct. However, in its promotion of Treating Customers Fairly (TCF), the FSA suggests that the responsibilities of product originators cannot be compartmentalised so easily and, increasingly, originators must have due regard for the likely end purchasers of their products.

Additionally, there must be a strong possibility, particularly against the background of TCF that, in the event of the retail product not living up to consumer expectations, aggrieved investors will, either singly, or en bloc seek financial redress against all parties associated with the construction and distribution of the product.

Under those circumstances, the cost to the originator's reputation, even if it is able to defend itself successfully against the retail purchasers' actions, is likely to include the spotlight of publicity being turned upon the organisation in a way that it would probably prefer to avoid. The old theatrical adage that all publicity is good publicity does not apply in the financial services industry.

OPTIMUM SOLUTION

Accordingly, a sensible first step for you to take, as the concerned member of staff, is to contact your compliance department to check whether they have been involved in the approval process for this new product. If they have and believe that the risks have been identified and communicated to the decision makers there appears to be little merit in seeking to reopen the matter. However, it would be sensible to place a note of your reservations on file, including the discussions that you had with Compliance.

If your compliance and or legal department have not been given the opportunity to review the proposed transaction, it would be sensible to bring it to their attention at a senior level as a matter of urgency. Although there may be a popular feeling that the role of these departments is to hinder all innovation, they should remain a key part of the risk assessment process and be given the opportunity to comment, even if they do not necessarily have the last word.

QUICK READ SUMMARY

MIS-MARKETING

What is/would be unethical?

To permit the production of this structured (leveraged) product for insurance company branding and distribution to private investors to proceed, without proper consideration of the risks. Should there be a significant stock market fall the impact upon both investors and your firm would result in substantial investor capital erosion.

Key points summary

Your investment bank is designing a highly leveraged, structured product to be distributed by an insurance company under its name via its sales force.

If the stock market falls by more than 30% after the five year term, there will be leveraged erosion of investors' capital.

You are asked to review the insurance company's marketing literature.

It is apparent that the product will be targeted at private investors.

There appears to have been no consideration within your company of the merits or risks of the approach whereby the sales process/documentation has been left entirely to the insurance company.

Adverse consequences

If the stock market falls by more than 30% at the end of the term, investors will see heavy capital erosion.

Aggrieved investors may seek redress from your company as well as from the insurer.

Your company could experience reputational damage as well as financial loss.

The FSA may investigate your company's role under TCF provisions.

Optimum approach

Check with your compliance department if they have been involved with the approval process of this product; were they content?

If not then suggest at senior level that they should urgently review the situation to focus on both regulatory obligations and potential risk to your organisation.

You might consider it appropriate to raise your concerns additionally with relevant senior management.

Keep a written record of your concerns and action that you have taken.

SII Code of Conduct impact

Principle 1 — to act honestly and fairly at all times when dealing with clients.

Principle 2 — to act with integrity,.......avoid any acts.......which damage the reputation of your organisation.

Principle 3 — to observe applicable.......professional conduct standards.

Principle 7 — ....rejecting short-term profits which may jeopardise your reputation and that of your employer, the Securities & Investment Institute and the industry.

POACHING STAFF

You have the opportunity to recruit a key member of staff from a company with whom you have a close business relationship, but is this a good idea?

BACKGROUND

Trawler is a small securities firm with a highly successful corporate finance team, which has been assembled over a number of years. The income from it represents a major share of the firm's profits.

Two years ago the board of Trawler felt that the firm needed to broaden the scope of its activities, and decided that the best way of doing this was by way of a formal alliance with another firm from which there would flow additional mutually beneficial opportunities.

Twelve months ago, Trawler concluded an alliance with Sceptre which, although slightly bigger than Trawler, has only a small corporate finance team. Sceptre has developed a reputation for recognising potentially successful businesses in bioscience, but has been less successful at helping them take the steps from developing business with potential, into actual success stories.

Consequently, Trawler's board felt that their team had the skills necessary to maximise this potential and, following discussions with Sceptre, an alliance was formed, whereby business opportunities would be shared between the firms, according to where the expertise lay. Although there was no form of merger or joint venture and each firm retained its own staff, the arrangement is covered by a memorandum of understanding.

You are the executive chairman of Sceptre. Last month one of the highly regarded members of your small team of corporate financiers left and you have been searching, via head hunters and network contacts, for a replacement.

You have recently become aware that an unnamed suitable senior replacement has been identified and approached. You understand that she can also bring one or two junior colleagues with her. Your director has now satisfactorily concluded negotiations and asked you to sign off the contract. He is particularly pleased at his coup but, just as you are about to sign off, you recognise the name of Gildenstern as that of a senior member of the corporate finance team at Trawler.

Given the alliance between Trawler and Sceptre but against a background of your firm's need to strengthen the team, how would you respond?

OPTIMUM SOLUTION

The dilemma you are faced with is whether and to what extent your decision should be based upon the immediate needs of your own firm, or whether you should take a more rounded view and consider the possible implications on your relationship with Trawler.

If you take the view that your firm's needs are paramount and approve Gildenstern's hiring, you will have to be prepared to deal with any consequences that may arise. Although you do not have a contractual agreement with Trawler, to take the view that your decision need take no account of the impact upon them, is likely to be viewed as a hostile act and a sign of bad faith. This may jeopardise not only your existing agreement, but any future co-operation and so the benefit of the hiring might be outweighed by the damage to Sceptre's reputation.

On the other hand, you might take the view that you will not take any action at all that might call into question Sceptre's commitment to the arrangement and so decline to authorise the requested hiring. Although this may be regarded as a highly principled approach, it does not help solve your firm's needs and, since you do not know why Gildenstern wishes to leave Trawler, you may decline an opportunity to hire someone who will be lost to the arrangement, if they are determined to leave anyway.

There is also a potential middle way, which is to suggest that your director contacts his opposite number at Trawler and says that you have been looking to hire a replacement in your corporate finance team and one of his members of staff has responded. You are intending to hire them, but are concerned that this should not be seen as a hostile act, since you did not poach the person, who had responded to a job advertisement.

However, this is quite a high risk option and you should consider what you would do if Trawler are insistent that Sceptre should not recruit Gildenstern, as it is unlikely that you would wish to be a part of an acrimonious legal dispute. You should also consider what might be the potential consequences for Gildenstern. Accordingly, it is probably only worth considering this option if you have agreed terms (although not entered into a contract) with Gildenstern and have her agreement that you can approach Trawler.

The key issue is your need for Gildenstern to accept that Sceptre's relationship with Trawler is more important than a single hiring and that should Trawler be unhappy with the proposal, then Sceptre would feel unable to offer the position to Gildenstern.

If Gildenstern is not able to accept that and thus will not allow you to discuss the proposal with Trawler, her response will effectively give you an answer to the dilemma.

Finally, there is the question of whether you should facilitate the hiring of the junior staff who have also been mentioned. Since Trawler is a small firm, it is improbable that they would be relaxed about losing several members of staff at the same time and since they did not form part of your initial recruitment objective, it would be unwise to pursue them as well. Additionally, Gildenstern could also face legal action from Trawler for inducing her colleagues to leave Trawler.

Although each of the above courses of action has a demonstrable drawback, the key issue is that Sceptre's relationship with Trawler is more important than one hiring and if this proposed hiring will jeopardise a valuable relationship, then the sensible course of action is to continue the search.

QUICK READ SUMMARY

POACHING STAFF

What is/would be unethical?

To go ahead and hire Gildenstern which would be likely to damage the valuable relationship between the two firms.

Key points summary

Trawler needs to broaden its activities by forming an alliance with Sceptre.

Sceptre is searching to fill a key position.

Headhunters find someone suitable who works at Trawler.

Do you place the needs of Sceptre above those of the alliance with Trawler?

The relationship of the two firms is more important than a single hire.

Adverse consequences

If you hire the Trawler employee you are likely to damage the Sceptre alliance.

You may damage Sceptre's reputation.

By not employing Gildenstern, you forego an ideal hire for Sceptre.

Gildenstern may leave Trawler anyway so that no-one benefits.

Optimum approach

Seek Gildenstern's permission to discuss the dilemma with Trawler.

Do not pursue the connected hiring of Gildenstern's junior staff.

SII Code of Conduct impact

Principle 2 — to act with integrity in fulfilling the responsibilities of your appointment etc.

Principle 5 — to manage fairly and effectively, and to the best of your ability, any relevant conflict of interest.

Principle 7 — to strive to uphold the highest personal standards, including rejecting short-term profits which may jeopardise your reputation and that of your employer.

REPUTATIONAL ISSUES

Your firm is invited to take part in a financing scheme which will significantly reduce the customer's tax liability. What aspects might you consider and how important are political considerations?

BACKGROUND

ZXGAZ is the recently privatised natural gas utility of the former Soviet Republic of Akhatan.

The company dominates its domestic market and also sells 40% of its production to the broader European market, particularly Germany. With the strength of demand for natural gas, last year was a bumper year for ZXGAZ. Profits for the business are forecast to be close to $8 billion.

Public disquiet about the huge profits of the company, coupled with Akhatan's large current account deficit have given rise to suggestions that corporation tax rates for the energy sector in Akhatan could be increased to 50%.

You work as a senior manager for Acme Investment Bank who advised on the IPO of ZXGAZ some years ago and your firm continues to provide a broad range of services to the company as well as to the Akhatan government, which plans further utility privatisations. As a result of the potential corporation tax increase the structured finance department of Acme has originated a proposal that will, as its principal attribute, reduce ZXGAZ's corporation tax liability. The structure involves a sophisticated leasing arrangement undertaken through a British Virgin Islands incorporated entity.

Initial discussion with ZXGAZ suggests that they are interested, but they have no previous experience of such a structure and the finance director has told Acme that he doesn't think that it will be necessary to mention this transaction in the company's accounts — possibly because they are concerned at the reaction of the Akhatan government.

The transaction, which will not be leveraged, will use a special purpose entity and will earn Acme a high fee. The proposed structure has not been subject to comment or scrutiny by any tax, accounting or regulatory agency but, as part of your approval process, you have received two legal opinions, one from a global and one from a local Akhatan practice. Both state, unequivocally, that the proposed transaction does not contravene any existing Akhatan tax laws.

Would you approve this trade, what further information might you seek and are there ways in which you might mitigate some of the risks?

SOME THINGS TO THINK ABOUT

The nature of this transaction requires the consideration of law, stakeholder relations and of course, ethics.

The first issue is that of tax avoidance which is the legal minimisation of tax liabilities and should be contrasted with tax evasion which is criminal. In the scenario, you are told that Acme have two legal opinions which indicate that the transaction is legal. However, you do not know the opinion of the Akhatan tax authorities and, although they might challenge this interpretation, at a narrowly legal level it seems that there is little to object to. However, you may wish to check that full disclosure of the relevant facts and reasons for the structure was made to the law firms, and their description of the facts on which their opinion is based reflects this.

ZXGAZ's SHAREHOLDERS

Any knowledge or even suspicion that ZXGAZ may conceal the transaction in its accounts, needs to be investigated by Acme as both Acme and individual employees may be vulnerable to fraud charges and to civil claims from ZXGAZ's shareholders if the share price collapses. You may make your own enquiries as to whether the transaction should be disclosed in ZXGAZ's accounts or try to persuade ZXGAZ to change its mind on the accounting treatment.

Tax driven transactions are, in many respects, the lifeblood of much of the financial engineering undertaken by banks for their clients and it would be simplistic and wrong to suggest that all such trades are unethical. However it is the case that in the current environment, trades which have as their principal purpose, a specific tax, accounting or regulatory outcome, are increasingly looked upon as being of questionable probity. Leases have often been used as tools to minimise tax in ways which are unrelated to the ongoing operations of the business so, at the very least, you should be trying to understand the nature of the proposed lease and considering whether it is defensible.

If you are uncertain as to whether the political and cultural climate is changing, you might consider the case of the bankers who undertook what they thought was an everyday transaction with Enron, in which they bought and sold back some barges off the Nigerian coast. The effect of the trade improved Enron's bottom line by some $10m and the surprised bankers all ended up in jail.

RED FLAGS

Regulatory agencies on both sides of the Atlantic have issued documents suggesting that firms introduce additional processes and procedures to evaluate the legal and particularly the reputational risks involved in various non-standard transactions. The FSA, together with the SEC and the Federal Reserve, have identified various red flags that, if present in a transaction, should mark it out for this heightened level of scrutiny. The proposed ZXGAZ transaction seems to exhibit at least four of the red flags that FSA MD Hector Sants set out in his Dear CEO letter to the industry in November 2005.

Below is an extract from that letter showing the relevant red flags:

- Transactions where a material objective is to achieve a particular accounting or financial disclosure treatment, including instances where the accounting treatment may be unclear or the proposed treatment may not reflect the economic substance of the transaction.
- Transactions designed to achieve a particular tax treatment, especially if there is insignificant economic substance apart from the tax treatment.
- Excessive or high profitability for the firm (relative to the risk), or non-transparent profits/fee structure for the firm.
- A transaction that could cause adverse publicity for the firm or damage client relationships.

There are other questions, which you may wish to consider such as:

- Is each step of the transaction on commercial terms and prices ?
- Is the money under the structure round tripping or the SPV thinly capitalised ?
- Are the obligations under the structure documents likely to be carried out in practice, eg, if it is an equipment lease, is the equipment clearly labelled as being leased, is the insurance in the name of the lessor, does the lessee know in which country the equipment is located?
- Sometimes the structure may call for individual employees to use their own names in the structure. Is it clear that the company will keep control and that there is no personal gain?
- At what level in ZXGAZ, as well as in Acme, will the decision be made?

Another useful test to employ when considering this trade is to contemplate who is helped and who is harmed by it. Here the beneficiaries are the shareholders of ZXGAZ and the loser is the exchequer of Akhatan. Put emotively, your transaction might well deny the Akhatan population a new hospital. How proud do you feel? Does your behaviour or the behaviour of Acme bear public scrutiny? Would you be happy for this transaction and your involvement in it to be publicised? Would you tell your mother? If you are squirming a bit and would be reluctant for the world to find out, that would indicate that an ethical boundary is being challenged.

STAKEHOLDER RELATIONS

Another consideration is the effect that the transaction might have on Acme's relationship with the Akhatan government. Facilitating ZXGAZ's tax avoidance might yield a lucrative fee but, perhaps, good relations with the government might bring even more remunerative possibilities. Even a cold economic evaluation of the proposed transaction might suggest that it is best declined.

OPTIMUM SOLUTION

You will need to analyse the structure using the factors set out earlier. Further research may reveal a regulatory or legal reason why Acme should not proceed. If there isn't, you will need to decide whether you still wish to proceed with this transaction. The final decision may boil down to a consideration of your values and those of your firm. If for example your company espouses values such as being a good citizen or being socially responsible is such a position reconcilable with tax avoidance of this nature? Just because it is legal doesn't make it right.

QUICK READ SUMMARY

REPUTATIONAL ISSUES

What is/would be unethical

As the introduction suggests, this is an area where much financial engineering takes place, which does not automatically make it questionable. However, there are instances of transactions which bend the rules to an unacceptable, albeit not illegal extent, which may well cause considerable internal discussion before participation is, or is not, agreed.

Accordingly, extensive due diligence needs to be undertaken on all aspects before proceeding. Although you may be able to gain satisfaction on the question of the legality of the proposal, the question remains as to whether the inherent political risks associated with a tax driven transaction might still make it unacceptable.

Key points summary

Check that all advice is received from reputable sources.

Check that the business is not in conflict with shareholders' views, or the company's stated business aims.

Recognise the potential for adverse comment from non-government organisations, the media and other observers.

Adverse consequences

Adverse publicity.

Loss of business resulting from regime change.

Loss of customers if the business is felt generally to be unacceptable to the majority.

Optimum approach

Ensure that all due diligence is followed and documented.

Ensure that any tax avoidance is not too close to any suggestion of tax evasion.

Ensure that your reputation committee or equivalent body sign off participation, having been made fully aware of all aspects of the transaction.

SII Code of Conduct impact

This transaction requires consideration against principles 2, 3, 4, and 7.

Principle 1 — to act honestly and fairly at all times when dealing with clients.

Principle 2 — to act with integrity.

Principle 3 — to observe applicable law, regulations and professional conduct standards.

Principle 4 — to observe the standards of market integrity, good practice and conduct.

Principle 7 — to reject short-term profits which may jeopardise your reputation.

CORPORATE HOSPITALITY

Corporate hospitality is frequently offered and accepted, but what is actually appropriate?

BACKGROUND

As an institutional prime broker relationship manager at Indigo Investment Bank plc, it is part of Penny's job to maintain good relationships with her institutional investor clients. She prides herself on her portfolio of clients, which has grown in importance over the years.

Occasionally she may take one out for a drink if she happens to be passing and, sometimes, she will treat them to lunch. She is very open about these meetings, and considers them an important part of her job.

Word has reached her that one of her clients, Mouse & Co, has been making noises about switching, or even withdrawing, their custom. Mouse & Co, a regulated firm, is a valuable client to Indigo and it would be a professional blow to Penny if she were to lose them. She calls Geoff, the investment manager of Mouse & Co, inviting him to lunch.

Over lunch, and a fine bottle of claret, Penny talks about Indigo's new initiatives and investments, but Geoff looks distracted and changes the subject to football and the forthcoming World Cup. "I was desperate to go, but I was too late, they'd already sold out to all those corporate buyers, who have cornered the market! Tickets are like gold-dust! But I assume that Indigo has a generous hospitality budget."

"I wish!" laughs Penny.

But over coffee, when she presses him to see if there is any truth in the rumour that Mouse & Co are thinking of withdrawing their funds, Geoff smiles broadly.

"I couldn't possibly comment. If that's what you've heard then there must be a reason behind it. Perhaps some people at Mouse feel that we could be better looked after elsewhere. But I'm sure you'll do everything in your power to make us happy!" And he changes the subject again to Sven Göran Erikson.

Penny leaves the lunch with the uncomfortable feeling that the best way to keep Geoff happy and Mouse as a client, is to get him to the World Cup finals She can't afford to lose a client, but should she really try to get tickets to the World Cup?

THE DILEMMA

On the face of it, Geoff is only playing a game that goes on all the time and, if it did not, there would be no corporate hospitality industry. Recent press reports that all the World Cup hospitality packages were sold within a short period of becoming available support this.

The key question for Penny is not so much whether she should try to obtain World Cup tickets, but whether it is appropriate to the situation and if Indigo's entertainment hospitality policy might accommodate it.

OPTIMUM APPROACH

On the facts presented, a problem exists in the relationship between the two firms, but what the cause may be and whether Geoff is in a position to do anything about it is not clear. Accordingly, Penny's first action should be to relay her concerns to her manager and to suggest that a formal meeting should be held between the two companies, with the specific aim of clarifying the situation and resolving any issues that arise.

If such a meeting is arranged and it transpires that Geoff is actually instrumental in determining the allocation of business and matters are satisfactorily resolved, then Penny might consider what sort of response, if any, is appropriate. Such a response is likely to be determined by the value of the business to Indigo and the parameters of Indigo's hospitality policy. It is most important that, if Indigo does, internally, consider offering World Cup tickets, the possibility of this is not conveyed to Geoff before any agreement is reached, so as to avoid any suggestion that they are being offered as an inducement.

In general, hospitality should be in proportion to the value of the relationship and the level of seniority of those involved. There should be a limit to the hospitality offered. However it is likely to be governed as much by the type of hospitality offered, as the direct monetary value. For example, tickets to various events may have a cachet not reflected in their face value.

A key consideration in most companies' hospitality policies is that it does not include tangible gifts of more than a token value and that where it is offered, a representative of the firm should be present at the event. Additionally, so that there is seen to be some sharing of cost, hospitality normally would not include paying for travel or accommodation at events, but, again, company policy is likely to be dictated by the value of the customer to the business. In any event, hospitality which can be construed as an inducement to use the services of the company should be prohibited.

A key component in any hospitality policy should be a register of gifts and entertainment offered and received, which must be completed by all staff and which should include all items above a relatively low threshold. It may include a requirement for clearance by compliance and/or senior departmental management.

Whilst this scenario has concentrated on how Penny might react, it is equally important that company policies also cover the solicitation of inducements, of whatever nature, by their staff. Geoff appears to be treading a very fine line between actively soliciting an inducement from Indigo and being able to claim that he is merely making conversation on a subject about which he is known to be passionate.

Many companies now have a recognised point of reference (ethics champions in some firms) who are often a part of the regulatory/compliance function but could also be part of internal audit, the company secretariat or corporate governance. This makes it easier for the people in Penny's situation to get independent advice, before deciding how to take the matter forward.

QUICK READ SUMMARY

CORPORATE HOSPITALITY

What is/would be unethical

For Geoff to actively solicit hospitality or other favours in return for placing business with, or not withdrawing it from, Indigo.

For Penny to offer hospitality without considering the purpose of it, the value of what might be gained in return and any corporate policy covering the situation.

Key points summary

Corporate hospitality/entertainment can be a contentious area, particularly if firms do not have clear guidelines covering both the offering and acceptance of entertainment and gifts.

Generally any hospitality deemed appropriate should be proportionate to the nature of the relationship and the seniority of those involved. Hospitality should not be offered without the donor being present and would not normally cover more than the event itself.

A register of gifts and hospitality should be kept covering all activity above a specified figure.

Adverse consequences

Lack of clear policy and guidance can result in inappropriate types and value of entertainment being offered and received, resulting in a lax culture developing. Inadequate control and understanding of the purpose and place of corporate hospitality makes the possibility of what is, in effect, bribery becoming acceptable.

Optimum approach

Indigo should have a robust gifts & entertainment policy.

Indigo management should explain this to contacts at Mouse.

Indigo should ensure that a decision on offering hospitality is taken at an appropriate level.

Both houses should ensure that all relevant staff are aware of the policy and that it is enforced.

SII Code of Conduct impact

Principle 1 — to act honestly and fairly.

Principle 2 — to act with integrity.

Principle 3 — to observe applicable professional conduct standards.

Principle 7 — to strive to uphold the highest personal standards.

TO WHISTLEBLOW OR NOT?

A conversation is overheard between staff, suggesting that flagrant breaches of procedure are the norm in their office. What would you do?

BACKGROUND

It had been a successful week for Katy. As a potential junior manager for a nationwide retail investment firm she had been chosen to attend the firm's national seminar week in anticipation of a forthcoming promotional opportunity for which she is short-listed.

The seminar was held in a luxury country house hotel whose clientele included the type of customer which the firm aimed to attract. On the last day after the end of the formal part of the seminar, Katy chose to take a drink onto the public terrace rather than remain in the reception room set aside for the firm, which was becoming noisy with the end of seminar spirit. She noticed two other employees, easily identifiable by their name badges and seminar bags emblazoned with the company logo on the terrace. Talking in a loud and animated way, they were probably not the best advert for the firm, but after all it was the end of a hard week.

Katy did not join them but sat within earshot; in fact it would have been difficult not to hear them. When their conversation came round to the complaints procedures workshop held earlier that day, she became fully aware of what they were saying and consciously began to listen. Their attitude was that the approved polices were all very well in theory, but the reality in their branch was very different. Their established practice was to use a range of stalling tactics and low offers of compensation unless the customer threatened to escalate the complaint and they reckoned that they were saving hundreds of pounds towards their targets by this approach.

Dismayed by what she heard, Katy quietly got up and walked away. However, the more she thought about it, the more concerned she became. On the one hand she had heard, in a public place, employees of the firm bragging about breaking the rules; on the other hand, with her promotion pending why should she risk making a fuss? After all who would know? She had no hard evidence, nor would she be able to get any. And anyway, who wants to be known for sneaking on their colleagues?

WHAT SHOULD KATY DO NEXT?

We all know that any evidence of breaches of rules and principles should be reported and that the decision rests with individuals to do so. However, firms have a joint responsibility to help their staff to recognise when they are being faced with a dilemma and then to help them to respond in an appropriate way.

Points to consider:

Does the firm have a documented reporting or whistleblowing procedure? If so is it well known?

Is management regarded as approachable? Does it have an active dialogue with staff, providing opportunities for situations to be brought to their attention?

Do the procedures offer alternative reporting routes to areas such as compliance or HR?

Does the firm have a track record of treating these issues effectively and in confidence, if reported?

If a firm is felt to be lacking in appropriate policies, or staff have no confidence in their effective application, there is always the nuclear option of making a report direct to the regulator. Clearly, it is in a firm's best interests to ensure that reports are made internally in the first instance but, if members of staff lack confidence to follow internal procedures, it suggests that the firm's culture and ethos may be deficient.

How would you react to a similar situation within you firm? Do you consider that a report would be treated fairly and in confidence and how easy would it be to make it?

If you are in a managerial position, how confident are you that your staff would feel free to talk to you and do you give them the opportunity?

As a manager do you have a documented procedure for escalating any reports you receive and, how can you monitor the effectiveness of the process?

WHAT KATY DID NEXT

The following Monday Katy returned to her branch to a backlog of work and a manager who was not available until at least Thursday, "unless it was very urgent". Was her concern very urgent? What should she do? Who else could she approach?

Fortunately for her, on Wednesday, when she was still wrestling with her dilemma, the branch compliance officer initiated a feedback meeting as part of the monitoring of regulatory training provided at the seminar. As a result of her face-to-face approach and open question technique Katy was provided with an opportunity to raise the issue that had been playing on her mind.

It transpired that the branch where the other two employees worked was not large enough to have a resident compliance officer but, alerted by Katy's compliance officer, the group compliance unit for that area made a visit and took a close look at the recent complaints files, obtained all the facts and organised remedial action which saved the firm from potential regulatory sanction, reputational damage and financial loss.

The moral is not only that an individual must do the right thing, but that this is only likely to happen if firms help their staff to identify such issues and then provide them with appropriate procedures and encouragement to follow them.

QUICK READ SUMMARY

TO WHISTLEBLOW OR NOT?

What is/would be unethical

The action of the staff in ignoring the published complaints procedure is unethical.

Discouraging staff from reporting rule breaches is unethical.

Ignoring rule breaches having been made aware of them is unethical.

Key points summary

An attendee at a training course is concerned that some of her colleagues are ignoring complaints procedures. She is unsure what action she should take and whether she will be listened to if she does report what she has heard. Her own manager does not appear to inspire confidence in this regard, but a seminar feedback interview provides her with the opportunity to discuss her concerns.

Adverse consequences

Internally, the consequences of taking no action are to undermine the firm's procedures and regard for them, in three areas: operations, compliance and human resources. Operationally, failure to follow procedures breeds a culture of carelessness, which can lead to financial loss and regulatory sanction for compliance failure.

An absence of reporting procedures for staff, or contempt for them, suggests a culture of general indifference, which can lead to operational loss and compliance failure.

In this instance, since the problem relates directly to customer complaints, there is a real danger of justified adverse publicity which could well result in far more being disclosed than just the complaint handling failures.

Optimum approach

Ensure that your firm has in place proper internal reporting procedures and encourage staff to follow them. Take the reports seriously, following up the matters being reported and advising the reporter of the outcome. Ensure that the process is confidential. Management should seek to be more approachable.

SII Code of Conduct impact

Principle 1 — to act honestly and fairly.

Principle 2 — to act with integrity in fulfilling the responsibilities of your appointment.

Principle 3 — to observe professional conduct standards.

Principle 7 — to strive to uphold the highest personal standards.

TOWARDS A CORPORATE ETHICAL CULTURE

By Simon Webley, Research Director, Institute of Business Ethics

The appointment of a chief ethics officer to a major international financial services company does not often make headlines in the Financial Times. But it did in April 2007. After fifty two years, Cantor Fitzgerald has appointed one of their senior managing directors to be full time in this new post, reporting directly to the chief executive officer. The company says that it wants to 'reaffirm its strong commitment to business ethics and integrity'.

Cantor Fitzgerald is not the only financial service company to realise that having a strong compliance department is not enough to ensure that its staff behaves ethically. It is perfectly possible to 'comply' and still fail to do the right thing. Unhappily, in far too many cases in the United Kingdom, the introduction of an ethics policy based on core values with an accompanying code, helpline etc. only occurs following an ethical or legal failure. In the Cantor Fitzgerald case, it was the company's materially false statements in a patent infringement case which, according to the court, had been 'submitted with intent to deceive'.

Of course, the appointment of an ethics officer is not sufficient to ensure that the way a firm does business is always based on values and principles. It takes a long time to build a corporate culture of trust and integrity. The majority of the larger publicly quoted companies now have explicit business ethics policies and an increasing number of private firms are recognising the need to provide guidance for staff on the standard of behaviour expected from them.

This chapter considers four questions concerning corporate ethics:

- What is meant by ethical culture?
- What would constitute an effective ethics policy?
- What are the issues that one would expect to see addressed?
- How do firms know that the policy is working?

Ethical culture

Culture can be described but not defined easily. Nor can it be manufactured in an organisation just by putting in a programme. Rather it is perceived by those who are employed or those who come into contact with the business. At its most basic, corporate culture expresses itself in behaviour and the way a business is run. Staff are sensitive to management styles; where the prevailing culture is one characterised by greed or arrogance, it is soon reflected in the way they behave. On the other hand, if it is one of trust, integrity and openness, staff generally will feel comfortable at work and be proud of the organisation. As a result, employee attrition rates are likely to be below the norm for the sector.

Culture is also expressed in attitudes. When faced with a business problem, a manager has to balance the legitimate requirements of attaining business objectives and the ethical requirements of honesty and integrity in the way this is achieved. The culture of an organisation will be affected internally and externally by both the way the issues are handled and how subsequent policy is implemented.

An international polling organisation, ISR, drawing on more than thirty years of internal survey work for companies throughout the world, has drawn up a list of some general aspects of corporate culture that can put companies at risk of significant ethical misconduct. This is reproduced in Box 1.

- Discussions on company values are viewed by employees as a public relations ploy rather than a true commitment.
- Acting with integrity is seen as an obstacle rather than a vehicle to success.
- Open debate, questioning of the status quo, and dissent are discouraged.
- Bad news is spun rather than confronted head-on, and there is a shoot the messenger mentality, particularly as one goes up the chain of command.
- People tend to hoard rather than share information of all kinds.
- The behaviour of high performing employees tends not to be questioned, the ends are emphasised (particularly the financial ends), and the means are largely ignored.
- There is an exclusive focus on short-term financial results, often matched with unrealistic performance expectations.
- The external environment, including customers, investors and the general public, are seen as something to be manipulated, rather than respected.

Source: *How to create an Ethical Organisational Culture*, ISR White Paper. www.isrinsite.com

Box 1: Aspects of corporate culture that indicate there is a risk of ethical misconduct

The effectiveness of a business ethics programme is about maintaining an attitude by all employees, from the directors to the receptionists that "how we do business" really matters. A company with this approach is likely to be characterised by, among other things, a culture of trustworthiness. If this is recognised as a desirable characteristic of the firm, then it will be important to cultivate it by being open and transparent throughout the organisation. Maintaining trust internally between staff and externally with business customers and partners, is a key element in sustained business success.

An effective ethics policy

Most firms already have either an implicit or explicit ethics policy. Typically it takes the form of a set of instructions covering issues like conflicts of interest, gifts and entertainment and the operation of Chinese walls. Some, often small, longstanding family owned organisations, rely on the 'tone from the top' or 'my word is my bond' to set an example about business practices. When a firm reaches the size when its payroll reaches about fifty or more, there is a need for the management to provide explicit guidance and support to its staff on how to decide what is 'the right thing to do'.

The internationalisation of financial markets and the growing complexity of systems within most financial service providers have led to the need to formalise the way that business is done. The ethics policy normally takes the form of a code of conduct, an ethics training programme, a helpline for obtaining advice or reporting malpractice, and identifies a senior person or people responsible for the implementation and effectiveness of the policy. They may be located in the legal or compliance department but reporting directly to the CEO, while others are found in the public affairs or HR functions.

An important feature of an effective policy is making sure at the start of any relationship that the core business and ethical values of the firm are made clear to staff, contractors, joint venture partners and others with whom it does business. One way to do this is in the preamble to the code of ethics (usually written by the chairman or CEO). For example, the Introduction to Lloyds TSB's Group Code of Business Conduct states:

"We aim to set an example in the conduct of our business. We demand honesty and integrity in everything we do, and will not do business if our standards are endangered. We greatly value our good reputation.

High ethical standards are of crucial importance to us, (and in the following statements) we set out our core values which we apply equally to all members of the Group."

There is a tendency in a highly regulated sector like financial services for senior management to rely on the compliance function to ensure that ethical standards of behaviour are maintained. An indication that this may be happening is the way a code of ethics/conduct/practice is written and presented. A code that emphasises regulation and compliance — important as they are — will tend to concentrate on what employees are not to do. This is why this type of policy is often expressed in the title: 'Code of Conduct'. In a culture dominated by compliance, the question asked by employees will be: "What am I allowed to do?" rather than "What is the right thing to do?" Trust is more easily generated when the emphasis of the policy is on the application of core values and the ethical behaviour flowing from them rather than on an exclusively rules-based approach.

The question frequently asked is whether there is a business case for having an ethics policy. Chart 1 sets out in diagrammatic form the perceived benefit to a firm of having such a policy.

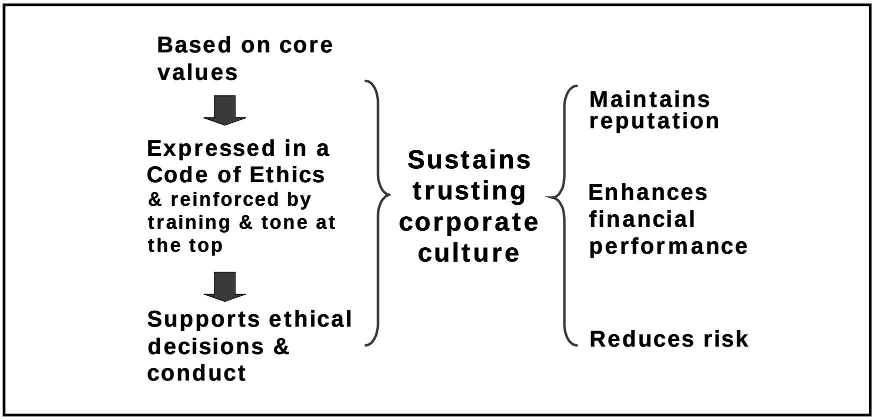

Chart 1: Benefits of a business ethics policy

The claim in chart 1 that an ethics policy and programme enhances long-term financial performance is based on UK research in 2001 and 2006[1].

[1] Ujogi K, Dando N, Moir L, *Does Business Ethics Pay? Revisited*, IBE, Forthcoming 2007

An effective ethics policy will also include ways for employees and others to raise questions in confidence concerning ethical behaviour, as well as the provision of regular reports to the board or its equivalent on the working of the policy. Regular reviews of the content of codes of ethics and their usefulness will also be necessary. But perhaps the most important ingredient in the policy is the example of top and senior management in living out the policy in their own day-to-day business life.

Issues that an effective ethics policy should address

An ethics policy as expressed in a code should set out concisely what is expected of staff and those with whom the firm has a business relationship. It should also make clear what the organisation sees as its obligations to its principal constituents (often called stakeholders). These can be described as those with whom the firm has a monetary relationship. Chart 2 sets out these relationships; they have a close and in some cases, a decisive association with the firm. This differentiates them from those of other interested parties (such as the media, competitors and special interest groups). While these can be influential to the business, they are not as crucial as the stakeholders.

STAKEHOLDER	FINANCIAL RELATIONSHIP
Shareholder	- Dividends and asset value growth
Provider of finance	- Interest repayments
Employee	- Wages, salary, pensions, bonus, other financial benefits
Customer	- Payments for goods and services (receipts)
Supplier	- Payments for goods and services (invoices)
Community	- Taxes and excise duties, licence fees

Chart 2: Financial relations between stakeholders and firm

Most day-to-day business ethics dilemmas arise within these relationships. Chart 3 sets out some typical statements concerning a firm's obligations to its stakeholders that are contained in codes of ethics.

Employees	We do not tolerate any sexual, physical or mental harassment or bullying of our employees. We strive for equal opportunities for all present and potential employees.
Customers	We do not accept or offer bribes or other inducements. We are honest and fair in our relationships with our customers.
Suppliers	We pay suppliers and subcontractors in accordance with the agreed terms and in a timely manner.
Community and Environment	
	Wherever we operate, we aim to be sensitive to the local community's cultural, social and economic needs. We endeavour to preserve and where possible enhance the environment in which we are located.
Shareholders and other Suppliers of Finance	
	We will protect the funds of our shareholders and others, manage risks and use the funds for the purposes for which they were provided.

Chart 3: Examples of ethical issues in relation to principal stakeholders

Although good practice in creating and operating policies to address these and other issues is available, each firm will need to work out on what topics it should provide guidance and how this is communicated and implemented and reinforced in their organisation. This book provides a number of examples of dilemmas experienced in the financial sector.

There are issues which are peculiar to the financial services sector. One that has moved from the sphere of discretion (ethics) to law (mandatory) is the use of privileged information for personal (or an organisational) gain. Known as insider trading it is sometimes called a victimless crime, but there are always potential or actual losers when an investment is made based on restricted information obtained in the course of business. Investigations into the causes of sharp share price movements before an official company announcement rarely uncover sources and only infrequently result in prosecutions. Consequently, the practice continues.

There will be other issues that arise that may be peculiar to a particular business. Business produces new dilemmas — often unexpectedly. If the firm has well embedded core values, then all involved will have a basis for their resolution.

How do you know the policy is working?

One of the paradoxes about business practices and behaviour is that reported lapses of an ethical or legal nature take place in both those firms with explicit policies and those that have none. There is clearly a gap between having ethical principles and codes and acting on them.

Tools are available to assure management that the policy is in place and working. Chart 4 sets out some of those that companies have found to be useful.

Results from ethics and other surveys — employees, suppliers, investors, customers.

Customers' ethical complaints — number, types, trends.

Results from ethics audits — internal and supplier.

Case data from ethics helplines.

Theft, fraud, financial malfeasance — number, types, costs, trend.

Lawsuits — number, types, costs, trends.

Enquiries from regulators.

Chart 4: Some business ethics effectiveness measures

Monitoring of incidents and reports will indicate how well the policy is or is not working. It will highlight where there are possible integrity risks and provide a guide to the areas that need more attention.

Less than half the organisations that say they have an overt ethics policy provide any training on it for their staff [2]. Providing such training for existing and new employees is a necessary part of making a programme effective. The introduction of ethics awareness questions in regular staff surveys and questions about the ethics policy in staff exit interviews have also been found to provide useful information in monitoring how a policy is working.

Some executive boards have sub-committees to which this information is given. The chairman is usually an outside director who brings independence to the role.

Conclusion

If an organisation is to generate trust and sustain a culture of integrity, its most senior management has to give a lead. They have to show by example that the way the firm does business matters. Many organisations now have an ethics policy; how well it works, especially in times of pressure, is the responsibility of the leadership team. As has been shown in this book, there are ways to make the policy 'live'. But it will only work if the ethical 'tone from the top' is clearly expressed and lived.

[2] Webley S and Le Jeune M, *Corporate Use of Codes of Ethics: 2004 Survey*, IBE, 2005

CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

Code of Conduct: Lord George Principles

Introduction

Professionals within the securities and investment industry owe important duties to their clients, the market, the industry and society at large. Where these duties are set out in law, or in regulation, the professional must always comply with the requirements in an open and transparent manner.

Members of the Chartered Institute for Securities & Investment (CISI) are required to meet the standards set out within the CISI's Principles. These Principles, which are also known as the Lord George Principles in recognition of the contribution made to standards of integrity by the late Lord George FSI(Hon), impose an obligation on members to act in a way beyond mere compliance and to support the underlying values of the Institute.

Material breach of the Code of Conduct would be incompatible with continuing membership of the CISI and may result in disciplinary action.

Members who find themselves in a position which might require them to act in a manner contrary to the Principles are encouraged to:

1. Discuss their concerns with their line manager.
2. Seek advice from their internal compliance department.
3. Approach their firm's non-executive directors or audit committee.
4. If unable to resolve their concerns, and having exhausted all internal avenues, contact the Chartered Institute for Securities & Investment for advice (email:principles@cisi.org).

The Principles

1. To act honestly and fairly at all times when dealing with clients, customers and counterparties and to be a good steward of their interests, taking into account the nature of the business relationship with each of them, the nature of the service to be provided to them and the individual mandates given by them.
2. To act with integrity in fulfilling the responsibilities of your appointment and to seek to avoid any acts, omissions or business practices which damage the reputation of your organisation or the financial services industry.
3. To observe applicable law, regulations and professional conduct standards when carrying out financial service activities, and to interpret and apply them to the best of your ability according to principles rooted in trust, honesty and integrity.
4. To observe the standards of market integrity, good practice and conduct required or expected of participants in markets when engaging in any form of market dealings.
5. To be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest.
6. To attain and actively manage a level of professional competence appropriate to your responsibilities, to commit to continuing learning to ensure the currency of your knowledge, skills and expertise and to promote the development of others.
7. To decline to act in any matter about which you are not competent unless you have access to such advice and assistance as will enable you to carry out the work in a professional manner.
8. To strive to uphold the highest personal and professional standards.

CISI Corporate Supporter demonstrates a firm's commitment to ensuring its staff are amongst the most professional and best trained in the industry. The following firms seek to uphold the highest standards of integrity and support the CISI Code of Conduct:

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