CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

ibe
Institute of Business Ethics

INTEGRITY AT WORK
IN FINANCIAL SERVICES

A practical guide
to trust and integrity dilemmas

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INTEGRITY AT WORK

IN FINANCIAL SERVICES

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INTRODUCTION

When I had the pleasure of writing the introduction to Volume 3 of *Integrity at Work in Financial Services* two years ago, I questioned whether the CISI's ability to keep publishing this series was an indication that standards in financial services were, if not declining, at least failing to improve, or whether it was more a question of media reporting.

At that time, I was optimistic that the worst had passed in terms of major corporate scandals, failing to anticipate LIBOR rate fixing, anti-money laundering failings and mis-selling of interest rate swaps: events which further undermined the reputation of the banks and seized the attention of the Government, leading to the establishment of the Parliamentary Commission on Banking Standards (PCBS).

However, other events involving the activities of global banks have raised the question of whether some are not just "too big to fail" but "too big to govern", leading to calls for the break-up of banks. The proposal within the UK to separate retail and commercial banks from the activities of their investment banking arms with an "electric fence" shows how far some banking activities and presumably the people carrying them out, have sunk in the opinions of the legislature.

But the purpose of this book is not to reinforce the impression that all financial services activities are steeped in impropriety, or imply that the many hundreds of thousands of honest people who work in the industry are inherently unethical. Rather, it is intended to support all of us in recognising situations where a little more thought may help us to choose between doing something which, upon reflection, we may realise is not in the best interest of all those involved and taking a course of action which would be accepted as "doing the right thing".

One of the significant outcomes of the PCBS was to question whether banking has the necessary attributes to regard itself as a profession. While many members of the CISI and other readers of this book may not regard themselves as bankers, we do all regard ourselves as professionals in terms of our standards of knowledge, skills and behaviour.

Consequently I welcome this book, which forms an important part of the CISI's activities to encourage and reinforce the standards and hence professionalism of our members.

Alan Yarrow, Chartered FCSI(Hon), Chairman,
Chartered Institute for Securities & Investment

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ACKNOWLEDGEMENTS

Thanks are due to all those who have provided the material on which the dilemmas in this book are based, together with the members of the Integrity & Ethics Committee who have reviewed the dilemmas and proposed responses.

We have offered a view on the correct course of action in the situations illustrated, but do not claim that ours is the only solution, or necessarily the best, since readers may chose a different approach, based upon their perception of the situation. However, whatever, or whichever course of action you decide to take, the fact that you have thought about the matter sufficiently to consider the issues more widely, contributes to the raising of standards.

FOREWORD

There was a time once when business leaders could just tell society 'trust me to do the right thing' and the general public would do so. Then, with increased regulation and pressures from investors, companies were asked to show, through their own reporting, that they were working to demonstrable ethical standards. But since the collapse of the financial markets, which many attributed to poor ethical behaviour, something more is required for society's trust in business to be restored.

We have entered a new era, the "prove to me" era. "Trust me" is no longer considered to be good enough and there is a growing demand for businesses, particularly in banking and financial services not only to say that they are ethical, but to prove that they have ethical values embedded throughout their organisation. Companies which aim high know the benefits of working ethically, but how can they ensure that an ethical culture pervades everything they do?

As John Griffiths Jones, Chairman of the Financial Conduct Authority said recently "tone from the top" will not be enough to regain trust. "What we next need to see is this translated into tone in the middle - or frankly, not just tone but action and observable behaviour, on the ground. In particular, acceptance of responsibility by everyone involved in the chain of command within these institutions, for actually getting it right, as opposed to just not getting it wrong".

The Institute of Business Ethics has long been asked if there is a way to prove a company's integrity. Now a new charter mark for businesses and organisations has been developed by the IBE and the CISI. The aim of the Investing in Integrity (IiI) charter mark is to provide an assurance of trustworthiness to clients, customers, investors and other stakeholders doing business with the organisation. Its aim is to help companies act with integrity by helping them know if their ethics programme is embedded throughout the organisation.

But how do you encourage ethical behaviour? IBE research has found that employees in organisations that provide ethics training are significantly less likely to say they have felt pressured to compromise ethical standards and are also significantly more likely to report misconduct of which they are aware.

The dilemmas and case studies within *Integrity at Work in Financial Services* provide tools for financial services professionals to do their jobs in an ethical way. These worked-through dilemmas will help understanding of the day-to-day issues faced in the workplace and how to deal with them with integrity.

Philippa Foster Back OBE, Director,
Institute of Business Ethics

ETHICS AND THE CITY 2013

By Jane Fuller

INTRODUCTION

When the CISI published the first volume of *Integrity at Work in Financial Services* in the spring of 2007, the financial crisis was embryonic – and yet unease at behaviour in the City was already rife. David Lascelles, a senior fellow and joint founder of the Centre for the Study of Financial Innovation, asked in the introductory essay whether it was even "possible for an industry which makes its profits by using other people's money to be viewed in a wholly virtuous light?"

Criticisms then included greed, short-termism, bonuses and the hard sell, yet the belief was that such public concern would go away eventually. In fact, the vilification mounted. Two years later, after taxpayer rescues of banks and a stock market dive, Lascelles wrote: "The City is in the doghouse." Recklessness and arrogance were added to the list of accusations and top bankers were hauled before parliamentary committees – a parade that has continued in 2013.

By August 2011, when the third edition of *Integrity at Work in Financial Services* was published, the great re-regulation was under way and the bills had started to mount for mis-selling, notably of payment protection insurance (PPI). The concept of ethics, which had little currency in 2007, was becoming a serious business.

It looked as though things could not get any worse, but they did. The Libor scandal – the rigging of a benchmark number – put a final nail in the coffin of the industry's reputation.

Now, the most optimistic thing one can say is that this essay is being written at the nadir of that reputation. Yet Anthony Salz, in his review of Barclays' business practices, warned that improvements instigated by new managements might uncover more "historic conduct" issues. The word "historic" is key. While it is difficult to control every individual in a workforce of one million, a measure of the required cultural change will be that there are no more mass ethical breaches.

To try to gauge the ethical state of the financial services industry, this essay is based on six questions put to ten experts (see the list of interviewees on page 9). The aim is to examine the specific issues and business practices that make it challenging to embed an ethical culture, so that doing the right thing becomes the norm.

Post-crisis commentary and the wave of new regulation seem to assume that banking is prone to be less ethical than other sectors. Is there any truth in this?

Opinions were split, but a majority answered either "no", or at least that neither banks nor their staff set out to be unethical. Those in the "no" camp pointed to the fact that ethical scandals have cropped up in other fields such as politics, the media and National Health Service hospitals.

One interviewee stated: "Most of society has a problem with ethics." This chimes with an observation made by Professor Christopher Megone, of Leeds University, an expert in applied ethics: "the loss of the capacity to discuss ethical issues as part of daily life is serious" *[Financial World, April 2012]*. Clearly, the case studies in *Integrity at Work in Financial Services* are designed to address that.

Yet the view that human failing is ubiquitous sets the ethical bar low, so it is not much comfort to hear that bankers are no worse than others. The perception of a lack of ethics in finance may indicate that the bar is set higher for this sector, as the custodian of our assets. People conduct financial transactions daily and those payments, loans and savings inevitably involve trust, so there is a sharper focus on standards in banking. Against the background of the crisis's impact on society, "people are massively sensitive to ethical problems".

Expectations are particularly high when the demand is for impartial advice. But is it an ethical breach if a customer is dealt with in good faith, but there was a failure to predict that a product designed for current circumstances would look unsuitable when those circumstances change?

The minority who believe the industry is prone to be more unethical cite greed and the opportunity to profit at others expense as the main reasons. "You are dealing with hard cash" – staff often know how much their transactions bring in and they expect to be rewarded accordingly. Financial illiteracy creates opportunities to behave in a way that is not in the customer's interest – "some of the normal disciplines do not apply".

There is no getting away from the pay issue in the discussion of ethics. One interviewee said he was "appalled" on entering banking at the scale of the rewards, even for relatively junior staff. Another described the different factors that motivate people at work – for example journalists like to be in the spotlight. Banking is likely to attract "people more motivated by making lots of money".

Again there is a perception issue. Because of the way some people in the industry are paid, there is a tendency to presuppose unethical behaviour.

If there are particular ethical problems in banking, or in financial services more generally, what causes them?

Two related issues produced the clear message that the combination of sales targets and bonuses, determined by hitting targets, creates pressure to cut corners and neglect the customer's interest. This is compounded by pressure for short-term performance in an industry where it often takes time to find out whether the product is appropriate. "If you have the wrong targets, people do the wrong things."

This does not just apply to people whose pay is dominated by the end-of-year bonus, where the "reward for crossing the line is hugely in favour of taking that risk". According to one interviewee, if staff feel that the bonus is the only part of their reward that they can influence, they will attach over-riding importance to the metrics used, even if it only adds 5-10% to their salary.

This emphasis on pay for performance created a culture of salesmanship and undermined service. According to one view, staff were actually uncomfortable with this and customers found it less pleasant to visit branches.

Another set of issues revolves around product complexity, including bundling and transparency. Several pointed out that PPI mis-selling was a by-product of cut-throat competition in the mortgage market, which drove interest on loans down towards unprofitable levels. The highly profitable insurance add-on mitigated that problem – until the mis-selling claims poured in. By the middle of this year, the UK's biggest banks had set aside about £14bn to cover compensation payments. It was a flawed business model that became unethical because of the way sales staff were incentivised by commissions, rather than customer need.

Complexity and a lack of transparency cause particular dangers if the customer is not only ignorant, but lacks understanding of what it is possible for a financial product to deliver. "Caveat emptor doesn't work very well."

Interestingly, there was more focus on retail financial services (which delivered PPI, after all) than on investment banking in answers to this question. "It's a myth that retail and commercial banking are less risky and/or less ethical than investment banking."

An issue that covers all aspects of the industry is short-termism. One interviewee described the way pressure had built up both to maximise revenues and to measure them frequently. That focus on short-term performance encouraged corner-cutting and so threatened ethical standards.

Are there some businesses, products or services within the industry that are more prone to unethical behaviour than others?

One problem area is where there is complexity and a failure to explain the product properly. Take the selling of interest rate hedges to small-business customers. The customer takes out a form of insurance against rising interest rates. If interest rates fall there is no benefit – and the bank will charge for ending the arrangement. In principle, this is "perfectly acceptable but perhaps not explained in sufficient detail to a small-business person".

Then there is the question of whether the salesperson in the retail branch understands the derivatives created on the wholesale side. "The real problem is a lack of competence, rather than the wrong type of product," as one put it. Skewed incentives also played a part – commission levels were higher for selling loans with ancillary products than without.

Cross-subsidy of one product by another is at the heart of this. The interest on the loan would have been higher without PPI or the hedge, or maybe no loan would have been made. This issue persists: free current accounts, for instance, supported by costly infrastructure. A common view in the industry is that "in an ideal world people would be charged for that". But this sense of injustice prompts the cross-selling of products that the customer did not originally seek, and sows the seeds of potential mis-selling.

The risk is heightened by the regulatory reaction to angry customers. More than one interviewee suggested that regulators have a tendency to act retrospectively. So we have arrived at a point where "if the product is not right, or the world changes, the consumer will get compensated. It is very hard to break out of that."

The ethical breach does not lie in the original intention. But a lack of transparency, or honesty, about the potential conflict of interest between customer service, sales targets and commissions can lead to both mistakes and mis-selling. "Wherever there are highly complex products, and/or products whose performance is hard – or takes a long time – to assess, there is heightened potential for mischief."

Away from retail, the issues are less complex: no one has defended the rigging of Libor by derivatives traders, where the misbehaviour of a few damaged the reputation of the whole. Some see proprietary trading as being more likely to harbour a culture of greed and to expose the customer to unwanted risk. The short-termism issue also arises in trading positions, where pressure to make rapid-fire profits can undermine standards.

Underlying it all is "the drive for extra earning in a low-yield environment" and that has not gone away. The danger lies in assuming that extra sales will automatically deliver sustainable profits. But this is questionable in a sector where there is a separation between the creation of product, pricing it and selling it. "You have an army selling as much as possible and they don't worry about profitability." He might have added "nor about the capital backing".

What are the most dangerous forms of ethical breaches from the point of view of:

a) the customer?

One summary ran like this: most dangerous is theft, and it is surprising how little of that there is in banking; then insolvency of the organisation where deposit insurance might fail – Cypriot banks, for instance; and finally, "over-enthusiastic selling where the product will never produce what is promised".

It is the last that attracts the most attention and the definition of ethical is being drawn broadly to cover all instances of treating customers unfairly. Unethical, but not illegal, issues include better deals for new customers than existing ones and introductory rates that drop like a stone. "People complain a lot about being lured in – sharp practice in lots of little ways," as one interviewee put it.

Another had particular fears that further legacy problems will emerge over the sale of unsuitable investments, without regard for the customer's risk appetite and with no follow-up reviews. This includes linking investment or pension products to mortgages.

This sale of certain investment products would actually work better as a continuing wealth management service, but that sets the bar high in terms of the type of customer who is profitable. Does the unmet need of customers have an ethical dimension? Service implies advice, which has a higher ethical and regulatory burden. A current concern is that the regulatory bar has been raised so high "that given the very small margins in some areas of advice, it's not worth doing the business".

It should be clear that a bank can behave ethically, but not be responsible for all the bad outcomes. But this can make it difficult to persuade the customer that he can rely on the culture and values of the bank.

A simple test would be to ask: "Is the product suitable and has it been adequately explained?" But the contextual question of how much responsibility the customer should take cannot be ignored. The answer tends to lead to differentiation between sophisticated and unsophisticated customers. "If the latter, there's a duty of care." But what if you get the distinction wrong? It is ethically simpler to give priority to the client's interests in all circumstances.

b) the board and management?

At board level, the extreme view is that non-executive directors cannot know everything that is going on in a large and complex organisation, where management can restrict the flow of information from their siloes. In milder form, the difficulty of monitoring such a wide range of transactions means the board may inadvertently allow more risk-taking than it thinks it has sanctioned.

Simply put, "the board needs to make sure the overall risk of the institution is under control". Reputational risk comes into it too, a theme that has grown stronger over the six years since the first edition of *Integrity at Work in Financial Services* was published. "The ethical breaches of greatest concern are those which damage the firm's reputation in a way that challenges the entity's licence to operate."

In the current sensitised climate, the public tendency is to see anything that harms a firm's reputation as an ethical issue. A sensible board response is to elevate reputational risk to principal risk status – it used to be more of a marketing or PR issue. Barclays, for instance, has created a Conduct, Reputational and Operational Risk Committee at board level, which aims to "look at everything we do against the test of reputational risk".

There is a consensus that the tone is set at the top, where a small number of people on the board and in senior management make the key decisions, "and the rest have to work within the framework".

A key challenge is how to embed values from top to bottom. The Libor scandal showed that a small number of people can severely damage not just the whole firm but the whole industry. One leader said that values have to be "forced down" through the organisation: through visible signs, staff meetings, monitoring officers and inclusion in staff assessments. The attention given to whistle-blowing procedures also comes in.

What must be avoided is that this becomes simply a compliance exercise. One former regulator said: "The danger is that ethical standards and compliance become detached from each other, which will quickly result in a downgrading of the ethics dimension."

To tackle ethical breaches in sales, another leader suggested three steps:

- Have a service gateway: no sales incentive is paid if staff don't pass through it – a reversal of the sales culture.
- Every savings product should be tested for appropriateness rather than just profitability.
- Tone from the top: spell out that "if you act inappropriately, in five years' time profits will be taken away and our reputation will be harmed. That's not good for shareholders or bank staff."

The trickiest area revolves around the concept of public duty, especially in retail and SME banking. How far does this duty run? One interviewee said intense political pressure to lend to small businesses seemed to stem from a belief that they are universally creditworthy. "It is part of the function of a bank to work out whether they are or not, and to charge the right compensation for the risk." It is also worth asking whether it is ethical to provide the means for a person or business to build up an unsustainable amount of debt.

c) the investor

The message is that it makes no sense, from a shareholder's point of view, if the bank has to pay back profits, with penalties, some time after the sales flow in. This is the concept of good profits, which build customer loyalty and brand value, rather than bad profits that damage both and risk regulatory sanctions. "We still have to make a profit, but we need to do it on a sustainable basis."

It could be argued, in the age of short-termism, that investors will ride the initial profits and get out before the day of reckoning. But the importance of the financial sector in indices and the commonness of tracking strategies mean that most investors will hold these shares. It is, in any case, a questionable assumption that investors are cleverer than boards and regulators when it comes to distinguishing good profits from bad.

It is also impossible for the majority of shareholders to get out at the top. So the case for creating sustainable value ought to gain traction with investors. The challenge is to restore trust with this constituency, as well as with customers.

One interviewee said: "None of the investors trust the balance sheets of banks." Questions persist over asset values on their reduced, but still large, balance sheets. Further write-downs, combined with increasing capital requirements, could mean more equity has to be issued. The ethical question is: have banks adopted an "honesty is the best policy" approach to asset values? If they have, the reputational issue is how to convince investors.

Remuneration comes into this: if shareholders, especially those receiving no dividends, still think too much of the reward goes to management, then trust will be harder to restore.

What remedies should the industry apply to any of the problems identified above?

If higher ethical standards are to mean anything, they must apply to the business's daily interactions with customers. There are many instances where no harm is intended, but neither the employee nor the customer can foresee whether the product will work as expected. Is it enough for the customer to suffer some detriment in order to class the employee's behaviour as unethical? The answer ought to be: not if the customer understood the product and was warned of potential disappointment.

One approach is to simplify the product to reduce the potential for misunderstanding. "At retail level, go back to providing basic, simple products that can be compared." There is considerable support for the recommendation from the Sergeant Review of Simple Financial Products that a badge should be developed to denote that a product has met standards of simplicity in its features, pricing and explanation. Such products can be sold without advice – that ethically fraught activity with a high regulatory burden.

But simplicity is not always possible. A simple outcome that involves a capital guarantee or a cap on interest rates, for instance, will have to be hedged by the provider, which incurs extra cost. "The more complex the product, the greater the need for a good explanation and a good audit trail to show the customer has understood." This activates an important source of discipline: the customer.

To carry out these more sophisticated tasks – where advice is often implicitly or explicitly given – staff need to be better trained. This means employers should support them through exams and continuing professional development. To raise the profile of ethics within its curriculum, the CISI has instituted an up-front integrity test for candidates.

Spreading professionalism through financial services will underpin a switch from a sales-led to a service-led culture. The Parliamentary Commission on Banking Standards (PCBS) was sceptical, however: "It is a long way from being an industry where professional duties to customers, and to the integrity of the profession as a whole, trump an individual's own behavioural incentives." With this gauntlet thrown down, the only sensible reaction is to try to prove the commission wrong.

Sir David Walker, Chairman of Barclays, has made the case for a banking standards board, which would provide guidance on how to help implement the principles set out by the Financial Conduct Authority (FCA). Banks would commit themselves to making sure that staff conform, which would entail professional training. Ideally it would also mean much wider membership of professional bodies, with the option of expulsion for breaches of conduct.

Barring someone from pursuing their profession is a legal minefield, because of human rights legislation, but the idea that such sanctions can be extended much further through the organisation than the PCBS envisaged is worth pursuing. Reform of both carrot and stick, from top to bottom, is necessary to back up behavioural change.

Apart from the industry, who should take responsibility for keeping financial services ethical?

Obviously, the regulator and policy-makers. The PCBS dwelt on the issue of individual responsibility at senior managerial level, but this will focus the minds of less than 10 per cent of the 450,000 people working for UK banks, the proportion currently on the approved persons list.

Enforcement has moved to the top of the regulators' agenda, and rule breaking is a lot easier to define than ethical breaches. "Regulators should focus on rules and enforcement. Pious hopes by the regulators about ethical behaviour are unlikely to be effective, and may even be counter-productive."

But as regulatory action is ratcheted up, is the enforcement net being cast too wide? Where does bad business judgment stop and ethical misbehaviour begin? If the economy turns out worse than politicians, the central bank and most commentators predicted, "what degree of foresight should I have been expected to have?"

It is easier to take it as read that a breach of the rules is an ethical breach, but it helps if the regulator is fair and predictable. Some are concerned about retrospective action. Complaints about PPI mounted over many years: "If it is considered by the regulator to be so egregious, why didn't they raise their hands at the time?"

Prompter action is now assured since the FCA is committed to more proactive supervision, including early scrutiny of new products. The danger from an ethical point of view is that the industry abdicates judgment to an intrusive regulator. The belief has to be that if a firm and its individual employees act in good faith in trying to serve customers' interests, they will not be prosecuted. Nor will they have to pay compensation, so it makes business sense too.

Matters are complicated where political pressure leads to commercial – and ethical – mistakes, such as the under-pricing and mis-selling of loans in the US sub-prime scandal. The more banks are ordered to behave like public utilities, but without provision for a reasonable profit margin, the more difficult it is for them to have a transparent and honest relationship with their customers. One interviewee talked of "a confusion in the minds of many, who put under the brand of good ethics what is really a demand that banks engage in what amounts to charity."

He went on to say "Making bad loans to good people is good politics but not a good business strategy." It should be acknowledged, however, that making bad loans is not ethical either because it is not in the customer's ultimate interest (nor the bank's, nor its owners').

You could go further than this and say that the interaction between a financial services provider and the customer should be a learning experience, including some tough love. “If the customer is constantly told it is not their fault, there is a lack of learning and a competitive market does not develop.”

CONCLUSION

How do you get the balance right between universal application of caveat emptor and the provider being responsible for all bad outcomes? Ethics plays a crucial role in this. In a negative sense, they provide protection against accusations of misconduct. In a positive sense, they form the basis for good profits, the ones that build customer loyalty. That, in turn, creates the sort of sustainable earnings that will pay dividends and please shareholders without risking regulatory sanction.

Ideally, we would not start from here. The industry would not have to reverse its combination of weak professional (and managerial) standards with high and sales-driven pay. Politicians would realise the contradictions in some of their demands and regulators would not impose counter-productive requirements. Customers would kick their addiction to instant gratification via debt and all would realise that the future is impossible to predict.

One approach is to “put on a white sheet” and avoid anything that could be unethical. But this is a counsel of despair. Sometimes ethics are easy: the principles underlying the case studies in this book are clear.

And, as Professor Megone points out, there is a virtuous cycle in promoting integrity: “It helps to develop trust within an organisation, and between the organisation and those outside it; it helps staff to look at what they’ re doing in the round, considering more carefully conflicts of interest, privacy, confidentiality and the public interest.” It can even make a bank a better place to work. Ultimately, virtue is its own reward.

Jane Fuller is Co-director of the Centre for the Study of Financial Innovation and a former Financial Editor of the Financial Times

INTERVIEWEES

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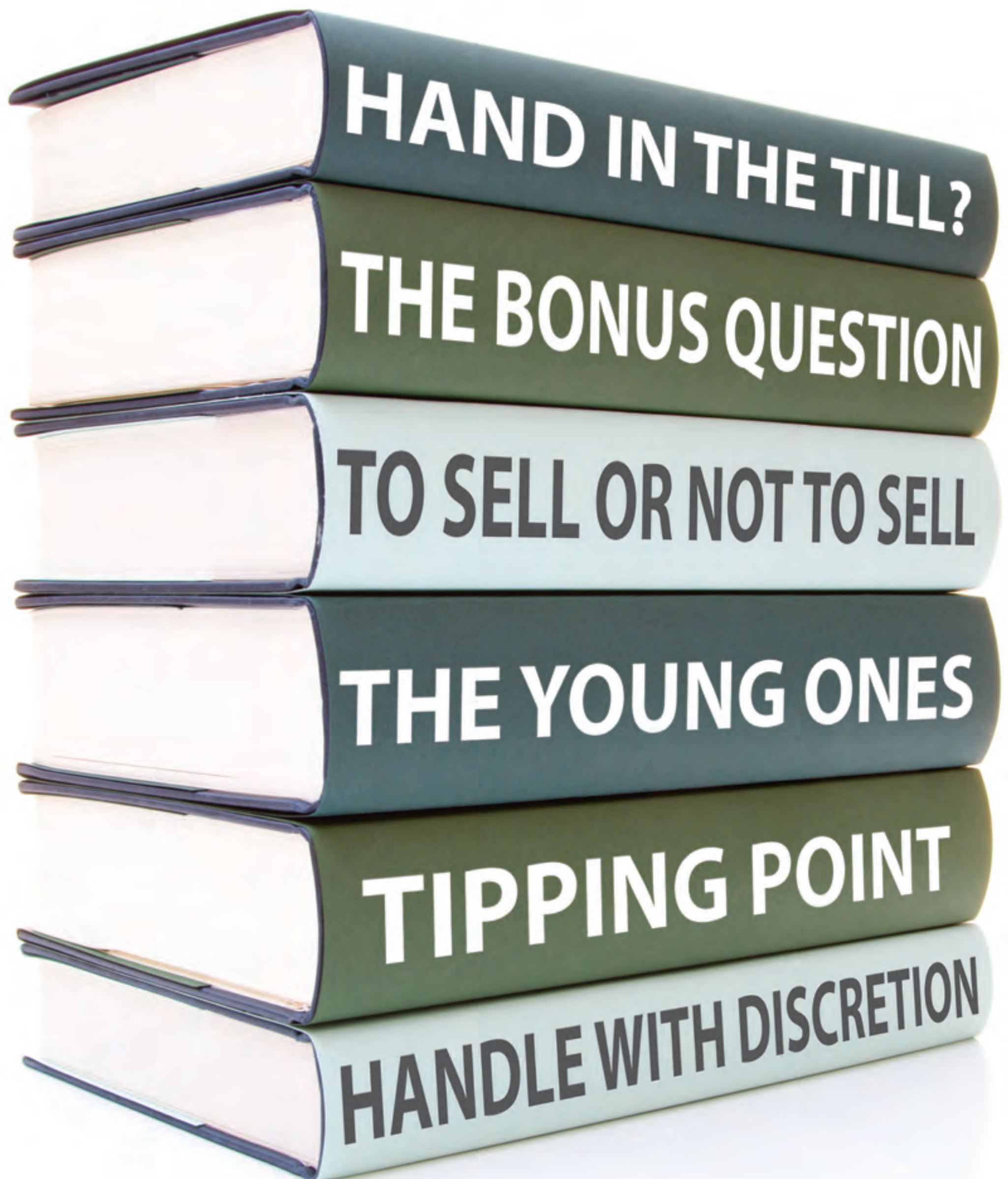
Sir David Walker FCSI(Hon)

Chairman, Barclays

CASE STUDIES
1-6



HAND IN THE TILL?

A trainee cashier suffers a shortfall in his till but the help provided by a colleague may have not been quite what it seemed.

BACKGROUND

Joe Frazier is a young trainee working in a quiet country branch of the bank a few miles from his home and has recently been assigned to be a cashier, where he is just getting the hang of his duties. There is little pressure on the staff and Joe is able to cope easily with the work load.

After some weeks of this quiet life, Joe is summoned by the branch accountant and told that there is a problem at Miltown branch, where many of the staff have caught a bug and they are very short of cashiers. Consequently Joe is asked to report to Miltown branch the following day for a brief attachment and warned that it is a busy branch which will really test his abilities.

When he arrives just in time at the unfamiliar Miltown office the next day, after a more difficult than expected journey caused by a road accident, he is directed to the senior cashier Eric, who seems less grateful for Joe's presence than he had expected and spends very little time briefing him on what to expect.

During an increasingly busy day, a queue of customers builds up and Joe works as quickly as he can until a gentleman announces loudly that he is a former manager of the branch and "that standards appear to have slipped since I retired" leaving Joe somewhat flustered, particularly when Eric the senior cashier comes up behind him and starts talking to the man.

It transpires that the customer is Mr. Macdonagh who retired from the bank about 10 years ago and is now the secretary of the local golf club, which keeps its account at Miltown. He comes into the branch regularly and pays in large numbers of cheques and cash and frequently is impatient with the cashier if he is not served with what he considers to be adequate speed and deference.

Joe is conscious of the other customers waiting behind Mr. Macdonagh and begins to check the deposit as quickly as he can, but he is unable to reconcile the amount of cash on his till with the figure on the credit slip and becomes increasingly anxious. Eric, noticing a potential incident, seizes the deposit from Joe's position, saying to Mr. Macdonagh: "I am sure that we can rely on our former manager to get things right." He stamps the golf club paying-in book with Joe's position stamp and gives the book back to Macdonagh, who thanks him grudgingly and leaves.

As things quieten down, Eric tells Joe to close his till and check the golf club deposit carefully to make sure that it is right, as the last thing they needed is Macdonagh complaining about them as he still has friends in the bank. Joe counts the cash several times but each time reaches the conclusion that there is a £100 shortfall in the cash deposit and he wonders what he should do.

Finally, he plucks up the courage to report the shortfall to Eric, who looks distinctly unhappy at what Joe tells him and says that as Joe stamped Macdonagh's deposit receipt, the simple answer is that they will have to report it on the end of the week return of overs and shorts in tills, which as luck would have it is being submitted that day. Eric tells Joe that he will help him complete the form explaining how the loss arose but that Joe will have to ask the accountant to countersign the form. Joe accepts what Eric says but feels that he is being made responsible for something that was not his fault and is particularly aggrieved that the accountant brusquely tells him that he must be more careful in future, if he is to get on.

Joe feels rather belittled by this treatment and when he returns to Miltown the next day, he is determined to be on his guard.

Fortunately the branch is a bit quieter and Eric is soon making noises about not needing Joe the next day when he sees Macdonagh enter the branch and head straight for Joe's till which fortuitously has no customers.

"Young man" he says, "I don't know what they teach you at school these days, but you seem unable to count any better than the people we employ at the golf club. They found £100 under the drawer of the till in the bar, which they said had been included in the club deposit, which you certified as being correct."

Pushing two £50 notes towards Joe, he pointedly said: "So who does this £100 belong to?"

At that point, Eric, who has been hovering once again, takes the money, saying to Macdonagh: "I'm awfully sorry that you had a problem yesterday. This young man found a discrepancy in his till at the end of the day and we had identified the likely source as your deposit and were going to phone you, so thank you very much for coming in." Macdonagh looks witheringly at him, turns round and stumps off, whereupon Eric, with the £100 in his hand, returns to his position as another customer approaches Joe.

THE DILEMMA

Shortly before the end of the day, Eric approaches Joe and thanks him for his hard work, saying that the busy days of the week are now past, a number of staff will be returning the next day and so Joe can return to his own branch, but in the meantime should take the opportunity to leave an hour early. Joe is quite relieved and grateful to have a head start on the commuter traffic, so he does not give another thought to the question of the £100 until he is on his way home, when he begins to mull over what happened and what if anything he should do. Joe feels that Eric made him look foolish both in the branch and with the controlling office, to whom his name will be reported. And what has become of the £100, which should have gone into his till, but seemed to have stuck to Eric's hand and why did Eric send him home early?

POSSIBLE OPTIONS

As he sits at a red light he muses on the possible courses of action open to him.

- Should he ring Eric the next day and check that he has done what he should, crediting Joe's till with £100, or will Eric feel that Joe is suggesting that he may have pocketed the money?
- Should he forget the matter and assume that it is just one of those things? He is not going back to Miltown and is unlikely to see Eric again, so there really is no need to do anything.
- Should he contact the bank's confidential helpline and report what happened? But anything he says will be pretty specific and so if they do anything it can easily be traced back to him.
- Should he discuss it with his own accountant, but what if he then rings the Miltown accountant and says that Joe is concerned about the £100; that will still make him look bad and may easily be seen as accusing Eric of pocketing the money.

RECOMMENDED OPTION

It is best for Joe to discuss this with his line manager in his own branch, to make his own role transparent and to raise any irregularities. This avoids any direct confrontation with Eric or the accountants, and Joe's line manager should be able to judge the best course of action.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

It is unethical for Eric to use Joe's own position stamp, thereby implicating him in the erroneous transaction. If Eric kept the £100 that belongs to the bank, that is straightforward theft.

KEY POINTS SUMMARY

A young trainee, Joe, is sent to another branch to help out, and is involved in an erroneous transaction by an experienced colleague in the branch, which is then reported as a loss of £100 in Joe's name.

Subsequent events result in the missing £100 being paid in to the bank the next day, but the colleague makes no effort to mitigate the impact of the loss report and may even be guilty of stealing the £100 himself.

ADVERSE CONSEQUENCES

If Joe does nothing, he has an undeserved stain on his record, but if he acts without thinking and reports his concerns, he could be unfairly implicating a colleague.

OPTIMUM APPROACH

The best approach is for the trainee to discuss his concerns with his line manager in his own branch, in order to clarify the situation and uncover any irregularities. In this way Joe is acting honestly and transparently.

CISI CODE OF CONDUCT IMPACT

Principle 1. To act honestly and fairly at all times when dealing with clients, customers and counterparties…

Principle 2. To act with integrity in fulfilling the responsibilities of your appointment…

Principle 3. To observe applicable law, regulations and professional conduct standards when carrying out financial services activities…

Principle 8. To strive to uphold the highest personal and professional standards.

THE BONUS QUESTION

Two employees receive a bonus but have different incentives for accelerating or delaying payment. Should you try to accommodate their wishes?

BACKGROUND

George is a production manager at Elixir, the UK subsidiary of an international electronics firm and he considers that he is fortunate to earn more than the national average salary. While his income is not yet subject to the 40% higher rate of tax, it is just on the margins. George's firm has an incentive scheme designed to reward staff who make valuable suggestions, which benefit the firm's performance and George, together with a young colleague Dean, made a suggestion which removed a production bottleneck and resulted in a measurable improvement in productivity.

As a result of this suggestion, George and Dean were each awarded a bonus of £5,000 but have been advised that, because of the timing of the announcement, there is some uncertainty whether the award can be processed in time to include it in the March payroll. Both men are delighted to receive the award and Dean, who is still struggling to pay for his Christmas holiday in Thailand, is very keen to ensure that payment is made in March. George, on the other hand, calculates that this bonus will push him over the tax threshold, so that £4,000 of it will be subject to tax at 40%, rather than at the 20% rate which will be applied to the rest of his income. Dean earns less than George, who assumes that none of Dean's bonus will be subject to more than 20% tax.

George feels very aggrieved that he might have to pay twice as much tax as Dean and wonders whether he can do anything about it, since it will make a big difference to what he and his wife can spend on the new kitchen they have long been planning. That evening he discusses the matter with his wife, who tells him that he must speak to whoever organises the company payroll and see that payment is not made until April.

The next morning, George tells Dean that he is going to see Nicola, his HR manager, who is responsible for organising the company payroll, to try to get the payments delayed until April, because it will save him nearly £1,000 in tax. Dean does not respond.

When George meets Nicola she congratulates him, saying that he will no doubt be pleased to learn that she is confident that she will be able to get the award payments included with the March salaries. George looks horrified and Nicola asks him what is wrong. "That will cost me £800" he replies and explains why, adding that he is sure that Nicola and Elixir will be sympathetic towards him. Nicola is taken aback at this, saying that she did not realise the situation and will have to think what can be done in the very little time left until the payroll is run.

George returns to work, leaving Nicola with a dilemma. In trying to accommodate Dean's need to receive his award payment as soon as possible, she is in danger not only of upsetting George, but actually costing him money and Nicola worries whether she will be able to satisfy both Dean and George.

Although Nicola has not said that she can do anything to help either George or Dean, she arranges to speak to Richard, the finance director, with whom she shares her dilemma. Richard says that he quite understands George's feelings, but income tax is something that everyone has to pay and the company avoids getting involved in any sort of manoeuvres that might attract unwelcome publicity. In any event, the award was made during the current year and will be included in the report and accounts for the year just ending. Accordingly, Elixir has no real justification for delaying the payment until the following year.

At the same time as George and Dean are awarded their bonus, the board of Elixir's parent considers the anticipated group results, which are particularly good. As a result a proposal is discussed to award Walter, Elixir's managing director, a bonus of £100,000. At the meeting where the decision is ratified, a member of the compensation committee suggests that it would be sensible to consider how to make the payment in a tax-efficient manner. If they delay payment until the following year, a lower tax rate will be in force, thus saving Walter some £5,000 in tax.

A member comments that they should be aware that any apparent delay to an award simply to permit Walter to benefit from a lower rate of tax might attract unwelcome publicity. The Chairman says that is a justifiable risk, but losing a key executive because you do not offer a sufficiently attractive compensation package is not. The committee do not demur at this, and agree that the "bonus" should be paid in the form of a retention payment, which could justifiably be made once the lower tax rate applies.

In due course the executive team of Elixir meet and the final results for the year are discussed, including the funding of the end-of-year bonus payments. Richard has been pondering what Nicola said to him about the impact on George's bonus of it being taxed at a higher rate and what, if anything, Elixir might or should do to help him. Accordingly, at the end of the meeting he raises the matter as a topic of general interest for consideration by the executive team, in the light of the public debate about the morality of deferral for tax purposes of bankers' bonuses, which reward people who are already highly paid, in the knowledge that a lower tax rate will apply in the following year.

Walter says that he does not see it as an issue; it is really no different to suggesting that someone should not be awarded a pay rise if it takes them into a higher tax bracket and that companies should try instead to find alternative means of rewarding their staff. That approach, he adds is what led to the rash of non- or low-tax items such as company cars and entertainment allowances which were paid until they were made unattractive by subsequent tax charges being imposed on them by the Inland Revenue.

As the other members of the team nod in apparent agreement with Walter, Richard, who is unaware of the pending award to the managing director, asks how that argument is different from the position of a highly paid individual who receives a sizeable bonus, payment of which is deferred to enable them to take advantage of the lower tax rate that it will attract the following year, when the top rate of tax will be reduced by 5%.

In fact, adds Richard, this is a perfect example of the well-off being treated differently from the lower paid employees. The impact of the 20% increase in tax paid by the lower-remunerated employee on his relatively small bonus is significantly greater than that of the 5% saving on the high-earner award, even if the actual monetary amount is much smaller. Accordingly, he says, there must be a strong argument that, in the interests of equity, companies should not differentiate in how they treat any discretionary awards, irrespective of the amount or the beneficiary.

Walter thanks Richard for his "interesting observations" and the meeting closes.

THE DILEMMA

The first quarter of the year often sees lurid headlines about the size and iniquity of "fat cat" bonuses. Following the announcement by the Chancellor of the Exchequer that he was reducing the top rate of income tax, with effect from 5 April 2013, these headlines were given an added twist as a result of proposals by a number of firms to defer payment of bonuses, so as to take advantage of the forthcoming lower tax rates for high earners.

But is this outrage based more on the size of the proposed bonuses and levels of income of the beneficiaries, rather than the principle itself?

POSSIBLE OPTIONS

- Since all parties cannot be satisfied, the firm should adhere to its existing policies, accepting that this may satisfy only a minority.
- Following the signal given by the board, it should delay the bonus payments for everyone.
- It should try and make specific allowance for individual employees.
- It should consult compliance as to the best course of action.

RECOMMENDED OPTION

The most honest and fair thing to do would be to impose the same standard on all employees. This is consistent with the first option. The second option potentially attracts unwelcome publicity, particularly since it appears to favour senior executives, thus reinforcing a perception of unfairness. The third option seems unwieldy and smacks of unfairness, and could attract attention from the Inland Revenue. The fourth option is likely to result in the same outcome as the first option.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

The potential lack of fairness, resulting from inconsistent treatment of employees, suggests an approach which is less than ethical, and which could impact the firm's reputation.

KEY POINTS SUMMARY

A couple of well-performing employees, George and Dean, are awarded bonuses, but differ in their preferences as to when these are paid. HR is trying to satisfy everybody.

At the same time, the MD also has the option to be paid his substantial bonus in the new tax year, when he will be taxed less.

ADVERSE CONSEQUENCES

If the firm is seen to be making distinctions among different levels of employee, that will be perceived as unethical.

OPTIMUM APPROACH

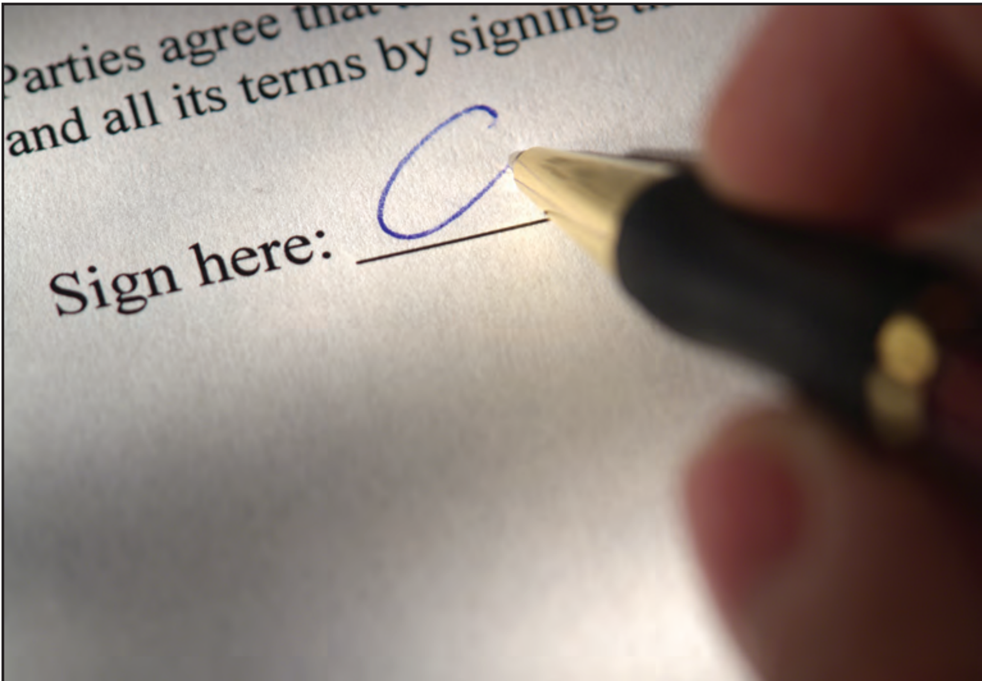
In order to preserve its integrity, both internally and externally, the firm should not veer from its established policy of paying bonuses in the tax year where they are reported.

CISI CODE OF CONDUCT IMPACT

Principle 1.	To act honestly and fairly at all times when dealing with clients, customers and counterparties…
Principle 2.	To act with integrity in fulfilling the responsibilities of your appointment…
Principle 5.	To be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest.

TO SELL OR NOT TO SELL

A loan to an expanding business is granted, subject to the customer buying interest rate protection, but the complexity of the product proposed causes some unease to the customer and his local bank manager.



BACKGROUND

Philip runs a successful small engineering company employing 40 people, making specialist components for the aircraft industry. He is keen to expand his business through the acquisition of GZB, a company in a similar line of business, whose current owner wishes to retire. Philip has reviewed the position with his accountant Sunil and they have determined that the proposed acquisition will enable Philip to take on more work, thereby providing valuable economies of scale. Although GZB was only occasionally profitable, a major attraction is that it owns the freehold property from which it operates, thus justifying the £3 million asking price.

Philip and Sunil draw up a business plan, which envisages an additional working capital requirement, and a term loan secured on the GZB property. Having completed the plan they make an appointment to see Alan, the manager of the bank, who has supported Philip to date.

Alan welcomes Philip and Sunil saying that the bank is always keen to support successful businesses and, if the business plan makes sense, it will be happy to provide the funding that Philip is seeking. He notes that Philip is looking for a term loan to support the purchase of GZB, to be secured against GZB's property and says that there may be some conditions, particularly hedging the interest rate risk on the term loan, as he knows the bank is promoting its interest rate protection products.

Alan is pleased by the approach, which will help him meet his new business target and if he convinces Philip of the merits of interest rate protection, he will receive extra credit. Philip and Sunil leave the bank satisfied that they have made a good case and that their application should be approved. They are not overly concerned by Alan's comments about hedging the interest payments, since it seems a sensible thing to do: interest rates have been lower than the historic norm for some time and the next moves are likely to be upwards.

A short time later Alan calls Philip and tells him that his funding application has been approved and, as anticipated, it is conditional upon the term loan interest payments being hedged. Alan adds that Kumar, a member of the bank's specialist swap team, will be visiting later that week and would like to discuss the various options with Philip, and a meeting is arranged.

Before the meeting, Alan and Kumar discuss the various forms of derivative products that are available and Alan admits his lack of detailed knowledge about swaps and their strengths and weaknesses. Kumar says that is not a problem, as he will do the talking, but Alan should bear in mind that the greater the structuring in a product, the more money the bank makes. So it's in everyone's interest that structures are not rejected, just because they might be a bit complicated.

At the meeting Philip and Sunil meet Alan and Kumar, who is introduced as the bank's swap specialist. Alan runs through the nature of the conditional approval relating to the interest rate protection, saying that it does not specify what form the protection should take and therefore it is up to Philip to decide.

Kumar sets out various product options, the attractions of which are determined principally by the interest rate environment and anticipated movements in rates over the next seven years, which is the term of the loan. They discuss the likely direction of interest rates and the fact that the bank's economics department is predicting a steady rise, until rates plateau about 3% higher than their present rate. Against that background the case for protection is obvious. However the form of the product is less so and they spend some time discussing the various options, starting with a straightforward swap, to enable Philip to fix the rate on the loan. Alan says to Philip that this seems a simple and straightforward option.

Kumar then explains that there are more complex products, such as collars and structured collars, which will limit interest rate movements within a specified range and can be tailored to suit specific circumstances, adding that he strongly believes that these would be ideal for Philip's expanding business, which would no doubt welcome a bit of flexibility.

Both Philip and Sunil are interested and Philip says that they will not rule out anything until they have discussed the matter a bit more. They are business men not financiers and want to make sure they do what is right for the business. They thank Kumar and Alan, adding that they will come back to the bank with a decision shortly.

When they have left, Alan asks Kumar what product he truly recommends as most appropriate to Philip's need, adding that if it was up to him, he would suggest a plain vanilla swap tied to the loan period. Kumar replies that he was not very happy that Alan had supported such a simple product, as he reckoned that, with a little gentle persuasion, Philip would agree to the structured hedge, which would go down much better with head office, for obvious reasons.

Alan says that as Kumar is the expert he will not argue with him but will wait and see what Philip wants to do and then respond accordingly, adding that he is beginning to feel a bit of a dinosaur these days!

The following day Philip calls and tells Alan that he wishes to go ahead with both the loan and the structured derivative which Kumar recommended, and asks for the necessary documentation to be prepared. He also asks for Kumar's phone number saying that he wants to make sure that he properly understands what he is signing up to.

A few days later, the documentation has been prepared and Alan has arranged for Philip to come and sign it at the bank. While he is waiting for Philip, he receives a telephone call from Derek, his regional manager, saying that with the imminent signing of Philip's loan and particularly the structured swap, which is a first for the region, Alan will be topping this month's league table for new business and he invites him to lunch at head office, which Alan enthusiastically accepts.

THE DILEMMA

Shortly after the phone call Alan welcomes Philip into his office. Prior to signing the documentation, Philip says that he is having a real struggle in understanding the mechanics of the structured product, despite further conversations and it is only because Kumar has assured him that the bank would not sell him anything that was not in his interests that he is prepared to go ahead.

On hearing this Alan is concerned that he may be a party to mis-selling and says to Philip that, before Philip signs, he will call Kumar himself and he asks Philip to excuse him for a moment while he does so. Kumar is clearly irritated by Alan's phone call, saying that he has explained everything several times and the client is happy. The fact that Alan, a self-confessed dinosaur, is uncertain is no reason to get cold feet at this time and he suggests that Alan must do whatever is necessary to reassure Philip and get the documentation signed.

Alan now feels torn in several directions and before returning to his office considers what is the best thing to do, mindful also of his earlier conversation with the regional manager.

POSSIBLE OPTIONS

Can he safely:

- encourage Philip to sign the documentation, reliant upon Kumar's reassurance that it is in Philip's interest; or
- say that Philip should not sign unless he is 100% comfortable with what he is doing; or
- tell Philip to sign the documentation because Alan will happily unwind the transactions if anything goes wrong; or
- simply leave it to Philip to make the choice?

RECOMMENDED OPTION

To remain honest and fair, Alan should advise Philip to sign only if he is 100% comfortable with the action, and understands the transaction fully. If the structured swap subsequently works against Philip, the bank could face a complaint or lawsuit from him, particularly if it appears that the structured swap added nothing meaningful to the client's needs and seems designed merely to boost the bank's revenues and league table standing. The bank's management ought to accept the integrity of this action, as even the swap expert has internally endorsed the plain vanilla option as reasonable.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

If the recommendation of the structured swap was made because it produces a better outcome for the bank than a plain vanilla swap, which would have met the customer's needs, then it is unethical to put the bank's benefit ahead of the customer's.

KEY POINTS SUMMARY

Philip is borrowing money from the bank to expand his business, and his bank agrees to make a secured loan, on the condition that the loan is hedged.

Philip agrees with this strategy, but is being sold a structured swap by the bank, which possibly exceeds his needs, as well as his understanding.

The bank's swaps expert accepts that a plain vanilla swap will also meet Philip's needs, yet persists in trying to sell a more elaborate (and expensive) structured swap.

The bank's manager is in a quandary as to what to tell Philip.

ADVERSE CONSEQUENCES

Should the structured swap prove to be an expensive millstone around Philip's neck, this could induce him to complain or litigate against the bank, on the grounds of its mis-selling a complex product that he did not understand. The bank will have lost a customer for life, and public reporting of this eventuality will damage the bank's reputation.

If Alan advises Philip not to accept the structured swap, he puts himself in a difficult situation with regional management and the swaps department.

OPTIMUM APPROACH

The bank and Alan should act in the best interests of the client, which may mean advising Philip to take the plain vanilla option, rather than the more lucrative structured swap, which he seems not fully to understand. Ultimately this will result in optimal long-term benefits to both bank and client.

CISI CODE OF CONDUCT IMPACT

Principle 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…

Principle 2. To act with integrity in fulfilling the responsibilities of your appointment…

Principle 4. To observe the standards of market integrity, good practice and conduct required or expected of participants in markets…

THE YOUNG ONES

A young employee in a bank is surprised to receive a "bonus" from his manager, paid in cash, when he knows that he does not yet qualify for the bank's formal bonus scheme.

BACKGROUND

Ray has completed nearly a year of his first job in a small branch of the bank, which he joined straight from school and is very happy to receive a good appraisal saying that he has performed well and shows great potential. Accordingly, he is not very surprised to be told by the assistant manager that the branch manager, Christine, wishes to see him at 4 o'clock.

Christine congratulates Ray on his performance and says that although, as a rule, staff are not able to participate in the bank's bonus scheme until they have completed 12 month's service, because Ray has performed very well she wishes to encourage him. Accordingly, she has made an exception in Ray's case and she hands him an envelope, saying that she hopes that Ray will be pleased, adding that, because of the special nature of the payment and the bank's rules on bonuses generally, he must ensure that he does not discuss it with anyone. Ray feels a little embarrassed to have been singled out, but pleased to have made a good impression.

Quickly Ray goes into the staff room, where he opens the envelope and is pleasantly surprised to find £100 in new notes, as well as a letter from Christine saying that the bonus is her personal recognition of Ray's hard work and good performance. Ray is a bit surprised at the comment, which leaves him unsure whether the bonus is from the bank or from Christine herself.

Although Christine has told Ray not to mention the award to anyone, which is the bank's normal rule regarding bonus payments, he feels unable to keep his apparent good fortune to himself and on the way home sends a text to his friend Dan, whom he met on the bank's induction course when he joined the bank, suggesting they meet later for a drink. Dan, who works in another branch but lives nearby, readily agrees.

When he gets home, Ray relays his good fortune to his mother, who says how pleased she is, adding that she hopes he will do something sensible with the money. Later that evening when Ray meets Dan he tells him that he has had a spot of good fortune and offers to buy him a drink; "not just the usual pint, but anything you like" says Ray extravagantly and Dan asks him to get the cocktail list.

When Ray returns with the drinks and sits down, Dan asks him what has prompted this unusual generosity and Ray says that he is not supposed to tell anyone, but that he has received a bonus. Dan expresses surprise saying that as they have not been in the bank for a year they do not qualify for the bank's bonus scheme and anyway, staff have been warned that bonus payments will be very limited, so Ray getting one must surely have been a mistake!

Ray responds by telling Dan that Christine has said that the bonus was personal and despite Christine's warning he shows Dan the letter. Dan reads it and says that he is very surprised and it looks as though Christine has given Ray the money out of her own pocket. He says he thinks that is rather odd and adds that he hopes Ray has not been asked to do anything unusual by Christine. Ray asks what Dan is implying, adding that he does not actually have much day-to-day contact with Christine.

Dan says that he thinks it is unusual to give people any sort of payment in cash, because it could imply all sorts of things but, even so, he is enjoying his drink bought with the proceeds of Ray's good fortune. Ray replies that he is sure that he has done nothing that he should not have done and suggests that they talk about something else and the conversation turns to more controversial matters, such as football.

At the end of the evening Ray and Dan go their separate ways, not having said any more about Ray's bonus, but Ray wakes in the early hours and has difficulty going back to sleep. He wonders whether he has done anything wrong in accepting the money or whether anything that he has done at work might have been at all suspect but he cannot think of anything.

THE DILEMMA

Ray wonders whether he should raise the matter with anyone in the branch, and if so who? Or should he perhaps phone the helpline number that he was given on his induction, but he is unsure to whom he will be talking and whether it will get back to Christine that he has called. That seems possibly to be worse than doing nothing. In the end, after tossing and turning some more, Ray falls asleep, with the matter unresolved.

POSSIBLE OPTIONS

In this case, Ray rightly has some suspicions of irregularity by Christine. Does Christine have an ulterior motive for awarding Ray the bonus in this way? It seems clear that the bonus payment was not made according to normal procedures.

Accordingly Ray has four main options:

- Call a staff helpline, with whom he can raise the matter.
- Notwithstanding that he has been told not to discuss it with anyone, Ray should report it to whoever is responsible for HR matters in the branch.
- Approach Christine directly to clarify the situation and return the bonus.
- Do nothing. He is very fortunate to have received a bonus in these difficult times.

Confronting Christine directly raises the stakes and could have potentially serious consequences for both Christine and Ray. It is still not clear what motivated Christine to take the action that she did.

If Ray reports the matter to HR, it could also have serious implications for them both, with Christine at particular risk of being fired. Nonetheless, the firm's bonus procedures appear not to have been followed and the situation needs to be resolved.

Although the call to a staff helpline may provide some useful advice, if it is anonymous, there could be the risk that the matter is reported by the staff helpline, which will have a similar result to the scenario of reporting it to HR.

In any case, an investigation is likely to determine that Christine has acted improperly, and so has Ray by accepting the money. This could damage their professional careers.

By doing nothing, Ray is implicating himself in a process that is neither open nor fair, and not overly honest.

RECOMMENDED OPTION

The best course of action is for Ray to report the situation to the staff helpline and get further advice. He should in any case return the money to Christine, citing his confusion, as a new employee, around the process and the secrecy of the transaction, and leaving the next steps, if any, up to Christine. While this may not improve his standing with Christine, he is acting with integrity in seeking to ensure that the bonus process is open and transparent, and leaving it to Christine to unwind a very sticky situation.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

Christine's action in covertly rewarding Ray for good performance, when he does not qualify for the bank's formal scheme, is at best foolish and at worst unethical. It places Ray in a very difficult position, as he is unlikely to challenge his manager's action at such an early stage in his career. It also raises the question of whether he will declare the payment to HMRC, which he should do.

KEY POINTS SUMMARY

Branch manager Christine takes it upon herself to make a cash payment in an envelope to Ray, a junior member of staff, who does not yet qualify for the firm's bonus scheme, because he has not been employed by the bank for 12 months.

She warns him not to mention it to anyone.

Ray accepts the money, and later mentions it to a colleague, who also works at the bank.

The colleague is surprised by the manner of the award, particularly since no bonuses were expected to be paid.

Given these reactions, Ray is confused as to what to do.

ADVERSE CONSEQUENCES

Confronting Christine may cause friction between Ray and Christine, but Ray will not look good if he accepts the bonus paid in this unusual manner. Further investigation by a close third party will benefit neither Christine nor Ray.

OPTIMUM APPROACH

Ray should contact the bank's helpline. The advantage of this course of action is that it is anonymous and does not require any face-to-face contact, which would probably be very difficult for a young person in Ray's situation. For this reason, this is more achievable and therefore more likely than for Ray to raise the matter directly with Christine.

CISI CODE OF CONDUCT IMPACT

Principle 1.	To act honestly and fairly at all times when dealing with clients, customers and counterparties…
Principle 2.	To act with integrity in fulfilling the responsibilities of your appointment…(Christine)
Principle 8.	To strive to uphold the highest personal and professional standards. (Christine)

TIPPING POINT

An investment manager enters an investment competition using his sister-in-law's name and wins, to the benefit of his wife's charity. But his entry was against the competition rules.

BACKGROUND

George is an experienced investment manager and for a number of years has worked for Verdant, a well-known firm of wealth managers, developing a reputation as an astute stock picker. Additionally George writes occasional articles for an investment periodical, as well as commenting in the broadcast media. In his own time, he is a supporter and active fund raiser for the Blue Moon charity, which supports disadvantaged children and of which his wife is a trustee.

As a regular reader of the financial press George could not fail to be enthusiastic when his favourite paper launches a competition, offering to make a substantial donation to a charity of the winner's choice. He determines to enter, before he notices that the competition is not open to professional fund managers.

The competition runs for a period of six months and requires entrants to construct a fantasy portfolio of 12 different shares; the winner will be the owner of the portfolio which shows the greatest increase in value over the term of the competition.

George is disappointed that he appears to be ruled out from entry until his wife suggests that she could ask her sister Mary to be the entrant and George could act as her adviser. Although this is stretching the rules a bit, because the only winner will be a charity, they feel that, surely, no one could complain.

After some discussion, Mary agrees, slightly reluctantly, that she will enter the competition and George constructs her portfolio. This contains a number of quite speculative investments where, if the companies' plans come off, they stand to do extremely well but, the chance of this happening is 50:50 at best.

Although Mary professes not to be interested in investment, when her portfolio gets off to a slow start she tells George jokingly that he appears to have chosen a few donkeys, rather than the thoroughbreds that she was expecting! But he tells her not to worry; it is their performance over the whole race that matters. Nevertheless he too is disappointed at their lack of movement and determines to see whether he can give them a helping hand.

George runs discretionary portfolios for a number of clients and has purchased some of the same stocks that he has "bought" for Mary for them. Accordingly, he begins to start recommending small cap stocks to clients with an appropriate risk appetite, as well as taking the opportunity in his media comments to mention the stocks held in Mary's portfolio, without making specific recommendations and making clear that he does not own any of these stocks himself.

This raising of their profile has the desired effect and trading in the stocks increases markedly, with a commensurate increase in price and the value of Mary's portfolio. The result of this is that, at the end of the competition period, Mary is declared the winner by a significant margin and the newspaper makes a donation of £25,000 to the Blue Moon charity. Both George and his wife are overjoyed, to think of what the charity will be able to achieve with this additional money.

An unintended consequence of George's action is that the value of his Verdant funds has increased significantly, leading to comments on his skill and a nomination for an industry award. However, as a result of this higher profile, a comparison is made in a financial periodical between the stocks in Mary's portfolio and those which George had mentioned publicly, leading to a not-so-subtle insinuation that there is a connection.

In due course, George is summoned to see his chief executive, who says that he has to ask him whether there is any truth in the speculation, particularly since he has had an informal approach from a friend at the regulator. George responds by saying that, although he admits that he designed Mary's portfolio, he is sure that numerous other participants had professional help, and at the end of the day, the only beneficiary was a charity and no one has suffered.

THE DILEMMA

As regards tipping shares in which he had an interest, George says that not only did he not have a personal interest in any of the shares, but all of his recommendations were genuine and soundly based and he stands behind those recommendations. Additionally, the newspaper seemed happy, as it increased its circulation, which was the object of the exercise and only paid out prize money that it had budgeted to pay and to a charity. So why should anyone complain?

POSSIBLE OPTIONS

The chief executive listens to George and considers that he has a number of potential courses of action;

- take no action - this is not a regulatory matter;
- ask George to resign - having repaid the money to the charity;
- sack George and report his action to the regulator;
- report George to the regulator and await its response before doing anything.

RECOMMENDED OPTION

Other people were disadvantaged by George's actions. The fact that he cannot recognise that, while also suggesting that his actions were no different to other entrants in the competition, as justification, suggests an ethical deficit in George's character. George should definitely be required to repay the money, and consideration should be given as to whether he should continue in employment, given the breach of trust he has made.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

George's participation in a competition specifically excluding fund managers is unethical, even more so with the veneer of his sister-in-law's name. His actions were neither fair nor transparent.

KEY POINTS SUMMARY

Fund manager George surreptitiously enters an investment contest in his sister-in-law's name, because professional investors are specifically excluded. He hopes to win the prize money for his wife's charity, which he does.

George's professional portfolio also benefits from the same investments, which draws the attention of the press and the regulator. George's employer is faced with a dilemma.

ADVERSE CONSEQUENCES

Other contest competitors were disadvantaged by George's participation, which was unethical in the first place. In addition he promotes stocks in the media that he has purchased for clients, representing that he does not own any of these investments himself. This argument is sophistry, since he will benefit, if his clients do so. Accordingly George is further bringing his firm into disrepute with the public and with the regulator by these actions. While his charity and professional clients have benefited, this has been at the expense of fairness and honesty.

OPTIMUM APPROACH

At the very least, George should be made to repay the prize money. He will probably have to make good to the charity out of his own pocket. His employer should also consider taking such further action as the regulator may demand, which may include asking him to resign.

CISI CODE OF CONDUCT IMPACT

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HANDLE WITH DISCRETION

An investment management firm buys the wrong stock for one of its funds, but the stock performs well and no customer is disadvantaged.

BACKGROUND

Graham is an experienced discretionary fund manager with Icicle Wealth Managers, a firm with a reputation for the highest standards of integrity, but whose reputation does not affect its industry-leading performance. Graham has a high profile and regularly appears in media lists of top performers in his sector.

At the weekly meeting of Icicle's investment committee, Graham discusses potential new investment in a number of established Far Eastern funds and recommends that Icicle should invest in Sampan Oriental Growth fund, for those of its clients with an appropriate risk appetite. Graham is confident that Sampan has an appropriate balance of risk when considering its declared aim of generating a return of 7% for Icicle's clients and although there are a number of people who question whether they can deliver this on a sustained basis, after some discussion, the committee accepts Graham's recommendation.

Following the meeting Graham gives instructions to his support team to effect the transactions to sell the firm's holdings in the Richter Reward fund and to purchase Sampan Oriental in its place and over the following days, as he tracks Sampan's progress, he is reassured that it seems to be performing well.

At the next quarterly review Graham is able to report that his recommendation to invest in the Sampan fund seems to be paying off and its performance is ahead of expectations, which will benefit Icicle's customers, cement his reputation as a leading investment manager and, if performance is sustained, should influence his bonus positively.

The week after the quarterly committee meeting, Graham is contacted by Lindsay, his head of fund accounting, who says that she is having trouble reconciling Icicle's investment in Simplon Investments, for which they can find no paperwork and asks whether Graham can shed any light on this. Graham responds that he assumes that Lindsay is actually referring to Icicle's holding of Sampan and this comment is greeted with a few seconds' silence before Lindsay says, "Graham, I think we have a problem."

In the discussion which follows, it becomes apparent that Graham's instruction to purchase Sampan Oriental resulted in a purchase of units of the Simplon fund and Graham is concerned at the ramifications of this, from both a risk and performance perspective. However he is relieved to learn that Simplon's performance, although not quite as strong as Sampan's, is positive and he will not have to report a loss to the committee.

Having been made aware of this problem, Graham wonders whether he actually needs to do anything, reasoning that these are discretionary funds and the erroneous investment has still produced a positive result. However, he decides that he should report it to the investment committee and an interim meeting is convened for the next morning.

The next day Graham explains to his colleagues what has happened but reassures them that Simplon generated a positive return, albeit not as good as Sampan over the same period, adding that since the investment was made on behalf of Icicle's discretionary clients, there is no need for them to be informed. At that point the committee chairman says that he does not feel that the decision is quite as straightforward as Graham had portrayed. Leaving aside the questions about how the situation arose, there is the issue of whether the firm does have an obligation to its customers to put them in the position that they would have been in, had Icicle actually invested in Sampan.

He adds that although this is not a transaction which was undertaken at the direction of the customers, who do not and will not know of all the discussions that took place within the firm before deciding upon investment strategies, the fact is that the intention was and the committee supported the decision, that Icicle would make an investment in Sampan, with a view to generating a certain level of income. The fact that the erroneous investment performed positively, while reassuring, is not the issue and neither is the fact that customers will not be aware that the return of the discretionary fund is not as high as it would have been had the Sampan purchase been made.

During the discussion that follows, Graham is asked to quantify the cost to the firm of paying into the fund an amount equivalent to the difference between the income received from Simplon and what would have been received from Sampan, as well as any cost of buying Sampan now. When he advises that it will cost Icicle £200,000, there is a sharp intake of breath. At this point, the chairman comments that all members of the committee should be given the chance to express a view.

THE DILEMMA

These views come down to a straightforward choice between, on the one hand, those who consider that, since this is an entirely discretionary fund, Icicle has no responsibility to compensate the customers whose funds were invested in Simplon and on the other, those committee members who accept that argument, except for the fact that a definite investment was agreed, the aim of which was to generate a certain level of return.

This latter group argue that once the committee decided that an investment in Sampan was the right thing to do, it became a corporate decision and the expectation was that it would be carried out and that is the key issue. A mistake has been made and, therefore, the right thing to do is to put the customer in the position in which they would have been, whether or not they were aware of the background.

POSSIBLE OPTIONS

Graham is supported in his view that Icicle does not need to take any action by another committee member and thus the chairman holds the casting vote. He sets out the four choices which he feels are to:

- Top up the customers' funds, without making them aware of what has happened.
- Compensate customers, giving them a full explanation of what has happened.
- Do nothing, since the customers are unaware of what has happened and Simplon is an acceptable alternative.
- Carry out an audit of operational procedures and report the position to the regulator, before coming to a decision.

RECOMMENDED OPTION

Having set out the possible courses of action, the chairman concludes that the proper thing to do in the interests of honesty and openness is to compensate the customers for any shortfall that there may have been in performance of the fund, and provide a full explanation of what has happened. This is the best way to preserve trust in the relationship, and to maintain Icicle's reputation for the highest standards of integrity.

In addition it will also be necessary to ensure that procedures are put in place to ensure that a similar error cannot occur in the future.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

It is unethical simply to keep the customers in the dark, as the investment is bound to come to light at some point, begging questions from clients.

KEY POINTS SUMMARY

Graham's fund management company makes the wrong investment in a discretionary fund, which has performed well, albeit somewhat below the originally intended fund.

This results in a situation where it will cost £200,000 to put everything as it was initially intended.

ADVERSE CONSEQUENCES

It will affect the reputation of both the firm and the fund manager Graham, if the firm does not adhere to the best standards of practice by being open and honest with clients about the firm's error.

Clients have also been disadvantaged by their funds being invested in a less well-performing fund than the investment committee originally intended.

OPTIMUM APPROACH

In order to do, and to be seen to do, the right thing, the firm has little choice but to compensate clients fully for the mistake and explain the situation to them. It would also be a good idea for the firm to audit its operational procedures, possibly followed by a report to the regulator.

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CASE STUDIES 7-12

COMPENSATION SCHEME

A firm's contribution to an industry compensation scheme is miscalculated and the mistake is not noticed. Should it keep quiet and benefit from the financial breathing space this gives?

BACKGROUND

Hugh is the chief executive officer (CEO) of Sargasso Stockbrokers, which provides discretionary management services in the UK to nearly 10,000 high-net-worth retail investors. Although earnings from Sargasso's various activities are growing, helped by last year's successful capital raising, in which a number of the senior executives (including Hugh) participated, the firm's costs seem always to grow at a faster pace. Hugh is concerned that the firm's required regulatory capital cushion is proving only just sufficient to cope with the extra business and frequently worries about how to balance the apparently conflicting capital requirements of the regulator with the dividend expectations of the shareholders.

However this challenging environment is affecting everyone in the sector and last year a competitor firm, Macadamia, became insolvent with liabilities to its UK customers of approximately £100 million, which it is unable to meet. It is the role of the regulatory compensation scheme to compensate investors who lost money from the activities of Macadamia and this is done is by imposing a special levy on the industry – including Sargasso.

Last spring, whilst Rosemary, Sargasso's head of compliance, was on annual leave, Sargasso, along with other firms in the sector, received a fee tariff request sent by the regulator on behalf of the compensation scheme. The purpose of the request was to seek information about firms' income from discretionary management activities, so that their individual contributions to the £100 million compensation claim, arising from the Macadamia insolvency, could be determined. Hugh was not made aware of this return, which was completed by a manager within the compliance department and declared Sargasso's annual eligible income from discretionary management activities as £4.2 million.

As a result of the return, Sargasso has recently received an invoice from the regulator for £86,000 as its contribution to the compensation scheme levy, based on the figures which were submitted to them. This amount far exceeds any regulatory fees or levies in previous years and Hugh is astounded by the invoice. Accordingly he asks Rosemary for an explanation and to check that it is correct.

In response, Rosemary tells Hugh that the figure reported to the regulator was calculated based upon an example but, because her manager used the wrong formula, the figure is significantly below the correct one. As a result, the true compensation figure may, in fact, be substantially higher, perhaps by as much as ten times.

Hugh is staggered that such an error could have been made and that the figure was returned to the regulator apparently without the knowledge of any senior executive. At the same time he wonders how Sargasso can cope with a cash demand of such an unexpectedly large amount, fuming that it is typical of the regulator to assume that everyone has a spare £1 million or so waiting for this type of event. He asks whether what he has now been told is actually any more accurate than the original figure supplied to the regulator.

After the initial shock wears off, Hugh asks Rosemary urgently to produce the data used to calculate the figure already reported to the regulator, compared with that which she has used to suggest the vastly higher contribution that she has just mentioned to him. Later that day Rosemary, accompanied by the finance director (FD), produces the figure and the FD confirms that the higher figure appears to be the right one.

THE DILEMMA

At this point Hugh wonders what he should do and asks Rosemary whether there is anything that she can think of to improve the situation. She suggests that, at this stage, as the regulator appears to have accepted Sargasso's earlier figures, a pragmatic solution is just to pay the invoice and then wait until challenged. At that point Sargasso can offer to review the figure submitted and pay up, as necessary. Although firms are required to make annual returns of their finances to the regulator, Rosemary says that she is unaware of how much liaison there is between the various departments involved and it is conceivable that it may be some time, if ever, before Sargasso's error is discovered. Even if it is discovered, it will have provided Sargasso with some useful breathing space, whilst they determine how to resolve the matter.

Hugh considers what Rosemary suggests, saying that he is quite attracted to this course of action and asks the FD for his opinion. The FD, possibly encouraged by Hugh's comment, says that he is sure that anyone else in a similar situation would do the same thing and, in any event, he does not consider this to be anything other than a way of temporarily dealing with what otherwise might be a serious cash flow problem for Sargasso, which is in no-one's interest. He adds that although he is aware that firms may have access to a special loan facility to meet levy demands of this nature, to seek to access it for nearly £1 million might shine a rather unwelcome light on Sargasso's finances. In any event, it will have a similar impact on Sargasso's capital position as paying the money themselves, which will cause further problems.

He adds that if they use the possible breathing space, as suggested by Rosemary, it will give Sargasso time to carry out a thorough review of its operations and, if as may prove necessary, raise further capital not only to support its increased operations, but also to resolve the issue of the true figure required for the levy on a correctly calculated basis. That must surely be desirable.

In response to the FD, Hugh says that although he understands the FD's point of view and accepts that if Sargasso does not have to pay the higher amount of the levy immediately, it will make life a bit easier in the short term, and so is superficially attractive, he believes that it will actually make life much more difficult all round in the longer term.

POSSIBLE OPTIONS

If Sargasso needs to raise further capital and invites people, including Hugh himself as an existing shareholder, to invest in the business, or even persuades customers to entrust it with their investments, the fact that Sargasso is either unable to calculate its own financial position correctly, or deliberately withheld information, can undermine their reputation, with an equally drastic outcome. It might be better for Sargasso to seek to control the process, by reporting the revised (and now presumably correct) figure to the regulator. It can explain the impact that the unexpected levy demand was having on their capital position but add that steps are being taken to remediate the position in a controlled manner, with the support (hopefully) of the board and shareholders. At the same time, Hugh can brief the board and seek their support in a positive and open manner, rather than keeping the true situation from them until he has no option other than to go to them as an emergency.

Hugh concludes by saying that he feels that, for all the discomfort that it may cause, this is definitely a case where it is vital for the firm to demonstrate their values by being open and honest about the situation, rather than taking the superficially attractive option of keeping quiet and hoping matters will turn out satisfactorily.

Hugh again considers his possible courses of action:

- respond to the regulator as originally requested, based on the original calculation, and hope that this is accepted;
- report the revised figure to the regulator, explaining the negative impact of this on the capital position, in an effort to have the regulator revisit the assessment;
- refer the matter to the compliance department and seek their advice;
- do nothing.

RECOMMENDED OPTION

It is in the interests of the firm to deal openly and transparently with the regulator, by reporting what it believes to be the properly calculated figure and to explain the impact of this on the firm's capital position. Trying to sweep it under the rug and hoping the regulator doesn't notice is not a sensible option.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

Trying to bamboozle the regulator is not a good long-term option. Hugh is right about being open and honest about the situation with all stakeholders.

KEY POINTS SUMMARY

A stockbroker receives a levy notice from the regulator, which is calculated to be at least £86,000, but is probably considerably more.

Even the smaller amount will have an adverse effect on the stockbroker's capital cushion, which needs to be bolstered, so the CEO must decide how to respond.

ADVERSE CONSEQUENCES

If the regulator discovers that Sargasso has not been honest about the extent of its miscalculation, this will tarnish the firm's reputation and may be detrimental in any capital raising.

OPTIMUM APPROACH

The best course of action, as advocated by Hugh, is to be open and transparent with the board and the regulator about the situation. This reflects the firm's culture of integrity and avoids problems down the line.

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HIDDEN AGENDA

A proposed transfer of business raises questions about the integrity of the practice in choosing a new business partner.

BACKGROUND

Alex Flowers is the chief executive of Freesia Investment Management, a regulated firm which he started 10 years ago and which recently became a public company. Freesia outsources all of its processing, some of its operations and its corporate secretarial work to Cyclamen, which is also a regulated firm and public company but larger than Freesia and highly successful. The chief executive of Cyclamen is Naz, a university friend of Alex.

The arrangement runs satisfactorily for some years until Cyclamen, having grown significantly in scale, reviews its activities and decides that it will cease handling any business outsourced from other firms. Cyclamen's chief operating officer (COO), Duncan, advises Alex of this change of policy, saying that Cyclamen, to minimise disruption to Freesia, has made preliminary arrangements for Freesia's work to be transferred to Tulip. He sends a detailed proposal, prepared by Tulip, which complies with regulatory outsourcing rules and offers to set up a meeting with Tulip to discuss the latter's service provision.

Alex is unfamiliar with Tulip and, on investigation, discovers that it is a relatively new company, is considerably smaller than Freesia and is staffed largely by former Cyclamen employees. Accordingly he asks to meet Tulip's senior executives to seek reassurance that the firm has the capabilities to undertake the proposed work to Freesia's standards.

During the meeting Alex is told that Tulip is not a regulated firm, has a very modest capital base and that the chief executive is a friend and former colleague of Duncan, the COO of Cyclamen. As a result of further detailed questioning it eventually emerges that Duncan has negotiated that Cyclamen will receive a fee from Tulip if Freesia agrees to the transfer of business to it. Alex is surprised to learn this and on further reflection feels uncomfortable with the proposed transfer of Freesia's business from Cyclamen to Tulip.

Accordingly, Alex arranges a high-level meeting with Naz to make him aware of his concerns. Alex tells Naz that, from an operational perspective, he is unenthusiastic about the proposed transfer and these reservations are strengthened by the fact that Tulip will be making a payment to Cyclamen in recognition of this, which he found out only by accident.

Naz explains that given the scale of his business, he was not personally aware of the details of this transfer, although he did of course know of the intention to cease outsourcing. He is, however, well aware that Duncan knows the people at Tulip and is sure that he has confidence in their abilities. Otherwise he would not have agreed to the direction of business to them. As for the fee to be paid, Cyclamen is in fact incurring significant costs in arranging the seamless transfer of business and he feels that in, these circumstances, the financial arrangement between Tulip and Cyclamen can be justified. However, given his old friend's disquiet he will ask his head of internal audit to look into the background to Duncan's proposal and report personally to him.

A week or so later, Naz calls Alex to advise him of the contents of the auditor's report.

The principal findings are:

- It is felt to be perfectly legitimate to attempt to obtain a transfer fee from Tulip in the event that Freesia moves their business to that company. The auditor is satisfied that Tulip is competent, albeit that the firm operates with less capital than would be needed were it a regulated firm.
- The auditor feels that Duncan has not adequately handled the conflict of interest inherent in making the transfer recommendation. The simplest way to do this is to make the fee transparent through disclosure. Alex should not have had to ask about this – it should have been made apparent at the outset.

THE DILEMMA

Naz is clearly uncomfortable about what has occurred, saying that he must apologise for Duncan's actions, although he feels certain that they were undertaken with the best of intentions. Naz explains that since the loss of the work undertaken for Freesia will have a significant impact on Duncan's cost centre and his ability to retain staff, he was been trying to protect them. The payment of the fee by Tulip will enable Duncan to employ two of his existing part-time staff for a further year. However, Duncan has not given adequate consideration to the conflicts involved and clearly has not met the standards which Cyclamen expects of its staff.

POSSIBLE OPTIONS

Alex thanks Naz for his explanation, saying that he appreciates what Naz has told him. He then adds that, as an old friend, he feels able to be frank with Naz and says that he does not feel that Naz is really dealing with the situation and suggests that Naz consider responding to the following thoughts that Alex has had on what occurred.

- What Duncan intended is clearly wrong and he should be fired.
- What Duncan proposed is wrong since Freesia was not being offered a similar fee.
- The transfer process was clearly flawed and should be restarted on a completely transparent basis.
- He accepts Duncan's motivation was for the best and so he accepts Naz's explanation.

OPTIMUM SOLUTION

What we have here is a situation in which one party is clearly being disadvantaged and the proposed transaction certainly does not meet the test of being open, honest, transparent and fair. Consequently, an offer by Naz to reopen the proposed transfer via an open tender will meet that requirement, although that is not say that the outcome will necessarily change.

It is worth bearing in mind that the proposed fee to be paid to Cyclamen by Tulip for introducing the business, would, ultimately have been at the expense of Tulip's clients, in this case Freesia. Cyclamen's attempted justification that they are incurring expense in passing the business to Tulip is probably equally true of Freesia and Duncan seems to have adopted a very blinkered view of the impact of his actions. Whether this amounts to a sackable offence is debatable.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

It is unethical to seek to impose a solution on Freesia, which is purely to the benefit of Cyclamen, in particular not making Freesia aware that Cyclamen will receive a payment from Tulip.

KEY POINTS SUMMARY

Freesia outsources processing business to Cyclamen, which is now shedding itself of such business, intending to transfer it to Tulip, a much smaller company. Tulip will pay Cyclamen a fee for the transfer.

Freesia is not comfortable with the arrangement and urges Cyclamen to review it.

ADVERSE CONSEQUENCES

The lack of transparency in the process could affect Cyclamen's reputation. Despite auditor reassurances, Freesia has no experience of Tulip or their operational capabilities, and may run the risk of business interruptions if the work is beyond Tulip's capabilities.

OPTIMUM APPROACH

The most open and honest approach would be for the transfer process to be reinitiated on an entirely transparent basis.

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TOO CLOSE FOR COMFORT

When a husband works for the Ministry of Finance and his wife is finance director of a major company, political considerations may override normal commercial decisions.

BACKGROUND

Cesar and Miranda have been married for 20 years and each of them has pursued a successful career in their respective fields. Cesar is the senior civil servant in the Ministry of Finance of Campanula and is thus answerable directly to the Minister. Campanula is a small country which has suffered quite large swings in its economic fortunes over the years, dependent upon which party was in power and, at the last election, the current government campaigned on the need for high standards of integrity in government.

Miranda is the finance director of L. Gordo, a major trading company, which exports large quantities of the various raw materials, upon which Campanula depends as a significant source of foreign currency. Campanula is going through difficult times at the moment, due to poor world prices for its principal raw materials and Miranda is wondering how best to manage her company's currency flows, in view of the price and exchange rate uncertainties, which are also impacting quite heavily on L.Gordo's financial performance.

At the same time Cesar is working long hours at the ministry and, on the increasingly rare occasions when he and Miranda manage to spend time together, he complains increasingly about the unsustainability of the government's economic policies, saying that they will bankrupt the country. In response to Miranda's question about whether he actually means this, or is just speaking for dramatic effect, he simply shrugs and says that he cannot speak about anything specific.

At the weekly L.Gordo executive team meeting, Miranda says that, in view of the on-going economic uncertainties in Campanula, she considers that the firm's best interests will be served by selling forward their anticipated foreign currency receipts over the next 12 months, rather than the three months which is their usual policy. She supports this by saying that the certainty this will provide outweighs any possible price rises over that period, since world markets remain soft. The chief executive agrees and large transactions are entered into with a number of banks and are completed before the end of the day.

Late in the evening, Cesar telephones Miranda, saying that there is a crisis at the ministry and he is unlikely to be home soon and does not know exactly when he will be able to return. In the event Miranda does not see Cesar before she turns on the television as she gets up in the morning and hears an economic commentator saying that heavy trading in Campanula's currency is causing alarm in the government, and there are rumours of the introduction of currency controls, as a result.

When Miranda arrives at work, the chief executive congratulates her on her recommendation to the company and the timing of the action. Unfortunately, he adds, he has received a phone call from the Minister of Finance, suggesting that L.Gordo's actions are undermining the government and the fact that there is a high- level connection between the Ministry of Finance and L.Gordo, through Cesar and Miranda, leads to the obvious inference that what should be secure discussions within the ministry are being leaked. The minister has suggested that he expects L.Gordo to take appropriate action, which he is sure will be reflected in the next round of mineral extraction licences to be awarded.

The chief executive asks Miranda whether she had knowledge of any government plans when she made her recommendation about currency sales, to which she replies forcefully that she was very conscious to try to avoid any suggestion of impropriety and did not discuss anything specific with her husband. The chief executive tells her not to worry about it or the effect of the Minister's threats to L.Gordo, because he is sure that the Minister is only posturing.

THE DILEMMA

Miranda is pleased when, late that evening, Cesar finally returns home. However her pleasure is short-lived as he tells her that he has come under great pressure from the Minister to resign. He is looking for someone to blame for the apparent run on Campanula's currency, who is not a member of the government, so that the government cannot be criticised and their integrity attacked. The opposition party is openly accusing the government of being in the pocket of big business and even some of the usually supportive media are suggesting the same thing.

Miranda tells Cesar that her chief executive has also come under pressure from the Minister of Finance, to fire a senior executive at L.Gordo and that, as it was she who suggested the currency trades, she is the most obvious target. However the chief executive has said that he has no intention of bowing to populist pressure, notwithstanding that the Minister has suggested that a failure to take any action will imperil the possible award of valuable mineral extraction licences.

POSSIBLE OPTIONS

Cesar and Miranda discuss what they should do in response to these threats, with a view to helping to resolve the crisis, while preserving their own reputations for integrity. They talk late into the night and amongst the courses of action which they consider are that:

- Neither Cesar nor Miranda should resign, since they each have a clear conscience that they have not acted improperly.
- Miranda should resign because of the threat that if no-one leaves L. Gordo as a result of this turbulence, it may affect the award of mineral licences to the company which, in turn, will affect a large number of people, beyond simply Miranda herself.
- Cesar should resign because he cannot prove, beyond reasonable doubt, that he was not the source of the information which caused the currency gyrations and, as the leading civil servant in the Ministry of Finance, his reputation must be impeccable.
- Both of them should resign, leave the country and, based upon their skills and experience, obtain highly paid positions elsewhere.

RECOMMENDED OPTION

Cesar should resign in the interests of the country and his own reputation. His position must be seen to be above reproach and because his wife holds an influential position in one of the country's leading trading houses, a suspicion that he is leaking information will remain.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

If Cesar either directly, or by inference, has given information to Miranda on government finances, which is not in the public domain, this is unethical, particularly where integrity in government is being promulgated. If Miranda uses this information, either for her own use or that of her employer, this is also be unethical.

KEY POINTS SUMMARY

Cesar is a senior civil servant in Campanula, married to Miranda, who is finance director of a company involved in exporting from Campanula.

Cesar shares inside views with his wife of Campanula's turbulent economy, which is causing exchange rate volatility.

As a result of these discussions, Miranda determines to enter into hedging transactions against the volatility of Campanula's currency, which has implications in the market.

The government of Campanula is calling for scalps, within its ministry and at the company where Miranda works.

ADVERSE CONSEQUENCES

The run on the currency of Campanula has adverse consequences for the nation's economy, weakening its finances.

Cesar's openness with his wife is not appropriate for the position of trust which he holds, his party having been elected partly on pledges of government integrity.

Miranda's actions have also placed her in a difficult position, where she now risks losing her job, and harming the company where she works.

OPTIMUM APPROACH

The best approach is for Cesar to resign his position, allowing the government to retain its arguments about integrity. Miranda should also consider changing her job, given her guilt by association.

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Principle 5.	To be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest.

NON-EXECUTIVE DIRECTOR

A non-executive director produces a report on a firm's compliance procedures, recommending changes that the CEO considers unnecessary.

BACKGROUND

Bob is an experienced senior manager who has spent most of his working life in the securities industry, during which time he has been an approved person and held board-level positions in regulated firms for many years. He has always enjoyed good relationships with other industry practitioners, as well as having served on an FSA advisory panel regarding the Retail Distribution Review. Bob is now semi-retired and is a non-executive director with Optimist, a small wealth manager, where he has been asked to undertake an informal review of how they meet customer due diligence obligations, such as "know your customer" when taking on board a new client and subsequently monitoring their transactions.

Bob's initial findings are that Optimist's processes are not of the standard suggested by industry guidance and he reports his findings to the non-executive chairman of the audit committee and board chairman, Kevin.

Kevin is not surprised and explains that Bob's findings confirm his beliefs, which is why he asked for the review. Kevin mentions to Bob that he has discussed this matter informally at an industry dinner with a mutual colleague of theirs, Guy, who now works in the supervisory division of the regulator.

Bob is asked to present his findings to Adam, the chief executive, who angrily refutes the findings, saying that Optimist's processes are in line with all the firms that he has ever worked for and states he does not intend to waste resources on this, or worry his clients over trifling administrative matters.

Bob accepts that no customer appears to have been disadvantaged and he has no evidence of the firm being associated with financial crime, but says there is not sufficient management information to confirm the issue either way. Bob's report is then discussed at the audit committee where, in view of Adam's apparent hostility to Bob's report, Kevin thanks Bob for his "excellent work, which has provided much food for thought" adding that in due course it may be felt appropriate to look at some of the individual parts of the report.

As a result of this decision Bob tells Kevin that he feels that, since the main focus of his position on the board was the production of the report, he does not consider that it is in the interest of either party for him to remain on the board, and he tenders his resignation as a non-executive director of Optimist.

THE DILEMMA

A few days later, Bob receives an email from Guy saying that he understands that Bob has left Optimist and asks him if "he is aware of anything that he would like to disclose". Bob is somewhat surprised by this and wonders whether it would be ethical for him to respond at all, now that he has left Optimist.

POSSIBLE OPTIONS

Nevertheless, he considers various possibilities, and writes them down so that he can mull over how best to proceed. The four courses of action which he considers are:

- Ignore the email and do nothing.
- Respond saying that he will be happy to meet Guy to discuss anything specific that Guy may have in mind.
- Respond saying that he left Optimist as a result of a disagreement over policy.
- Respond saying that he has nothing specific to raise, but then to phone the whistleblowing line to report Optimist's poor standards regarding basic compliance issues.

RECOMMENDED OPTION

Bob knows the sender of the email and to ignore it is both rude and may well be taken as an indication that Bob has something to hide.

Offering to meet Guy is a sensible response, providing that Bruce makes Kevin aware of what he intends to do and what he may say. Kevin has previously spoken informally with Guy and ideally the email should be forwarded to him and he should be given the opportunity to accompany Bob if/when he meets Guy.

To respond saying that he left as a result of a disagreement may be taken as an indication that all is not well at Optimist and may well provoke further questions.

For Bob to tell Guy that he has nothing to tell him and then to phone the whistleblowing line would be extraordinarily pusillanimous of Bob. Either he should have the courage of his convictions and should share these with the regulator, in which case he should make known to Kevin what he is about to do, or he should keep them to himself/Optimist.

In this situation, the best option for Bob is to respond positively to Guy's request, but to inform Optimist of his plan. Bob should forward Guy's email to Kevin, who should accompany Bob to the meeting, if he wishes to.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

If Bob ignores Guy's email, having knowledge of Optimist's deficiencies, this is not ethical. The statement about disagreement over policy is not exactly true. Calling the whistleblowing line while informing Guy of nothing specific would be craven. Either he should have the courage of his convictions and share these with the regulator, in which case he should make known to Kevin what he is about to do, or he should keep them to himself/Optimist.

KEY POINTS SUMMARY

Bob is a non-executive director with small wealth manager Optimist.

Asked to do a study of Optimist's customer due diligence practices, Bob finds them not up to an adequate standard.

While this is not a surprise to Optimist's chairman, the chief executive strongly disagrees.

As a result, Bob leaves Optimist, but is contacted by a colleague at the regulator, asking if everything is all right at Optimist.

ADVERSE CONSEQUENCES

If Bob candidly reports what he knows to Guy, Optimist could be visited by the regulator, so it is in their best interests to co-operate with Bob in the discussion. It would be unethical of Bob to reveal any information to a third party, without Optimist's knowledge and agreement.

OPTIMUM APPROACH

The honest and open thing to do would be for Bob to respond affirmatively to Guy, having first discussed with Kevin what he is planning to do, so that Optimist has an opportunity to participate.

CISI CODE OF CONDUCT IMPACT

Principle 1. To act honestly and fairly at all time when dealing with clients, customers and counterparties…

Principle 2. To act with integrity in fulfilling the responsibilities of your appointment….

Principle 3. To observe applicable law, regulations and professional conduct standards when carrying out financial service activities…

A COSTLY SLIP UP

A small brokerage makes an expensive mistake and its principal client seeks to ameliorate the impact on the firm because of an old school friendship.

BACKGROUND

Daniel and Craig worked for Astrology Stockbrokers for a number of years before the firm was taken over by an Asian bank. The new structure which resulted from this left them feeling that their opportunities for further advancement were now limited and they decided that the time was ripe to strike out on their own. They felt that with their experience and customer contacts they would be able to build a successful business by setting up a small equity-broking operation, based on Daniel building client relations and Craig running the operations side of the business.

The new business, Litmus, makes a slow start and although it does a small amount of research, most of its broking is execution-only, except for one large self-managed fund client, Raptor. Freddie, an old school friend of Daniel, works for Raptor and is prepared to try to help him, by placing business with Daniel's firm. However, this means that Daniel is reliant on Freddie and Raptor for 75% of his business.

Approaching the Christmas holiday, Freddie calls Daniel to execute a large (multi-million pound) pairs trade in FTSE 100 stock , telling him to buy ABC plc stock and sell a similar amount of XYZ plc stock. They have an animated conversation for a few minutes, following which Daniel executes the transactions. At the end of the day, Daniel goes on his Christmas break feeling that at least the year ended with a decent piece of business.

When Freddie receives the contract notes he is horrified to see that what should have been a balanced transaction is anything but, with the proceeds of the sale of the XYZ stock being only 10% of the ABC purchase, due to selling the wrong share class in XYZ. He immediately phones Daniel, who is on leave, as a result of which he is put through to Craig. He tells Craig that to correct the problem will cost over £100,000 because of volatile price movements in ABC's stock, and asks him to try to confirm with Daniel what was actually said.

Craig says that Daniel has gone abroad, but he will listen to the tapes of the telephone conversation and tell Freddie what is revealed. Unfortunately, the tapes indicate that Daniel is at fault, with both the order and the confirmation being quite clear. When Craig tells Freddie this, Freddie feels sorry for Daniel and is very concerned that Litmus may disappear and with it the exceptional service that he has received from Daniel. After considerable thought he speaks to Craig and says that if Craig now completes the ABC purchase to the intended value out of Litmus funds, he will use his best efforts to direct a significantly larger proportion of his firm's business to Litmus, providing that he receives the market price as well as more specifically targeted research. The consequent commissions received from this extra volume of business will, over time, cover the £100,000 cost of putting the transaction right.

THE DILEMMA

Craig is concerned about the impact on Litmus of having to bear the size of loss that Freddie mentioned and says to Freddie that while he feels inclined to agree, he will have to discuss it with Daniel, if he can get hold of him on holiday. Litmus does not have insurance cover for such a mistake.

As soon as he is off the phone with Freddie, Craig calls Daniel and manages to contact him at his holiday home, relaying what has occurred and Freddie's suggested resolution. Daniel is very apologetic that he did not follow Freddie's instructions and, anxious that this might prove a fatal lapse, he encourages Craig to accept Freddie's offer, saying that it should provide a satisfactory outcome for both firms and Freddie's client.

POSSIBLE OPTIONS

With Craig's agreement obtained, Freddie then goes to see Carole, Raptor's compliance officer, who agrees that while his suggestion seems attractive, she wonders whether Freddie's clients, or any of Freddie's other colleagues at Raptor are aware of what has happened and what might be Freddie's ability actually to deliver his side of the bargain. Freddie assures her that the arrangement will not disadvantage the client, since Litmus is responsible for making good the correct share class in ABC, and that the normal disclosure of brokers' names and commission will be made to the client. However, Carole is quite uncomfortable at being put in the position of deciding whether or not to endorse an informal agreement. Nevertheless, she feels she should give some advice and so advises Freddie that:

- He can safely make his offer as his client is not being disadvantaged since it will pay the same commission anyway; or
- He should not make any offer to Litmus as the mistake was its fault and it must take responsibility for the cost of putting it right; or
- He should not make the offer because, although it is not a breach of the soft commission or payment for order flow or inducements rules, since Litmus will have to pay the loss anyway, and Raptor is not receiving any money, it is perhaps against their spirit; or
- He can make the offer, because while Freddie's other brokers may feel aggrieved, they have no rights to the extra business, and Freddie's client does not suffer.

RECOMMENDED OPTION

From a commercial perspective, there seems no valid reason why Raptor's management should allow an old personal friendship to influence business decisions of this nature. Therefore no offer should be made to Litmus, which has to take responsibility for putting things right.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

Raptor has an obligation to all its clients to conduct business in a fair and transparent way. This informal agreement violates the spirit of that principle.

KEY POINTS SUMMARY

A start-up broker mishandles a transaction for a client, resulting in a liability of £100,000. Since the client and broker are long-standing friends, the client offers to send further business to the broker in an effort to help it clear its losses. Is this the best basis for conducting this business?

ADVERSE CONSEQUENCES

Should the regulator or other clients hear of this informal arrangement, they will have grounds to object in that it is not based on fair and equal treatment of all. This could negatively affect the standing not only of the broker, but also of the client.

OPTIMUM APPROACH

In order to keep things totally honest, open and transparent, the client should continue its business on an arm's-length basis with the broker, as with all its brokers, so as not to be accused of favouritism or unfairness. This means that the broker will have to absorb its loss, for which it is responsible.

CISI CODE OF CONDUCT IMPACT

Principle 1.	To act honestly and fairly at all times when dealing with clients, customers and counterparties…
Principle 4.	To observe the standards of market integrity, good practice and conduct required or expected of participants in markets…
Principle 5.	To be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest.

PLATFORM

An investment firm buys an IT platform from a third party, which it then customises for its own use.

It offers a similar, but less powerful version to another firm, but before signing the contract hears that the original supplier has sold a similar version to a competitor.

BACKGROUND

Paul is a senior manager in Visible, a long-established firm of financial advisers which also offers investment management services and is seeking to position itsself as a leading wealth manager. As a part of this plan, Paul has been charged with reviewing all of the businesses, investment products and services offered by Visible with a view to introducing a new investment platform to provide a class-leading proposition to its clients.

Paul identifies several potential platform providers and after viewing the products of a number of IT firms and carrying out a competitive tender, the firm of Spectral, a long-established IT provider, is chosen as being the most able to identify with Visible's vision and provide what is envisaged.

Paul is very pleased that Spectral has been chosen and is confident that they will be able to deliver and good progress is made. Inevitably, a number of unforeseen difficulties arise, which result in some delay, added to which, as the project progresses, a number of additional features are required, which further delay the launch.

However the Visible platform is finally ready and launched to a largely positive reception from the investment community and customer response is very good. As a result of this experience, the Visible executives determine that their configuration of the Spectral platform represents a valuable asset that can be marketed to other users, providing that they do not represent a direct threat to Visible.

Paul is again charged with managing this exercise, because of his in-depth knowledge of what the Visible platform offers and the competitive advantages it is felt that it will bring to a user. Paul approaches a number of suitable potential users of the platform and, after discussions with a number of firms, receives a positive response from Grey Bank, a high-profile name, but one which does not provide direct competition to Visible.

Following a period of intense testing, Grey Bank determines that the Visible platform, which has been specifically customised to meet its requirements, is acceptable and Paul is waiting keenly for them to sign a formal agreement. This will be accompanied by a high-profile launch, with considerable fanfare, and Paul is quietly pleased at the prospect which he feels can only be highly positive for his career aspirations.

However, this satisfaction is short lived because at an industry meeting shortly before the scheduled signing day he bumps into representatives of Spectral, who tell him that on the back of their successful platform sale to Visible, Spectral has managed to conclude a very good deal with Indigo Bank.

Paul is somewhat taken aback on hearing this news, since Grey Bank and Indigo Bank are similar types of organisation and therefore will be appealing to the same types of customer. More significant is the fact that Visible has sold their platform to Grey Bank on the basis that it offers unique advantages.

THE DILEMMA

If Indigo can now offer a similar product, how will Grey Bank view its proposed agreement with Visible? Will it accuse Visible of misrepresentation, or more importantly for Paul, might Grey Bank decide not to sign the agreement, or at least delay signing? Paul wonders whether he or Visible has actually done anything wrong and whether he should make Grey Bank aware of the fact that the platform that they are offering to their customers is based on a product from Spectral and that, inevitably, there will be some operational aspects that they both share, albeit that they look quite different.

Paul is very conscious of the importance that Hugo, his director, attaches to this project which will earn them both great credit if it goes well, but Paul, as the project leader, will be the one in the spotlight if there are any problems. Consequently, before discussing the matter with Hugo, Paul examines Visible's agreement with Spectral to see whether it contains any language that says or suggests that Spectral cannot sell their platform to anyone else, without Visible's agreement and is concerned to note that it does not.

POSSIBLE OPTIONS

Paul then considers the various options which he can recommend to Hugo as the best way to proceed, which he feels are:

- That Hugo should immediately contact his opposite number at Grey Bank and tell him what Paul has learnt, but seek to reassure him by pointing out that the Indigo Bank product will not contain any of the enhancements made by Visible, nor any of the Grey Bank customisation, leaving it to Grey Bank to decide whether to proceed.
- Visible should carry on as planned, without saying anything about the Spectral sale to Indigo, since the Grey Bank product is similar only under the skin and so no direct comparison can be made. If Grey Bank subsequently complains, and they might not, Visible can deal with that when it happens.
- Paul should immediately contact Grey Bank and, without mentioning anything specific, encourage them to sign and launch their new platform as soon as possible, warning them that he has heard Indigo Bank is also about to launch a new platform which might steal Grey Bank's thunder.

RECOMMENDED OPTION

The fairest and most transparent approach is for Visible to alert Grey Bank to Spectral's sale of a platform to Indigo Bank, and leave the decision to Grey Bank. This should avoid any potential problems in the future.

QUICK READ SUMMARY

WHAT IS UNETHICAL?

If Visible does not alert its client Grey Bank to developments at Spectral, this could result in a backlash to them. It might also be argued that Spectral acted unethically by selling to Indigo a product very similar to that which it sold to Visible, although there was no contractual bar on them doing so.

KEY POINTS SUMMARY

An investment adviser (Visible) has contracted with an IT provider (Spectral) to buy a new platform, which Visible has modified and is selling on to a major client (Grey Bank).

Visible discovers that Spectral is supplying a very similar system to a competitor of Grey Bank.

ADVERSE CONSEQUENCES

The consequences to Visible and its client could be severe, if Visible does not take some sort of action in relation to Spectral's apparent conflict of interest.

OPTIMUM APPROACH

Visible should at the very least contact its client Grey Bank to inform it of possible conflicts in relation to Spectral's product, and let it decide how to proceed. This may mean losing Grey Bank's business, but it is the ethical thing to do.

CISI CODE OF CONDUCT IMPACT

Principle 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…

Principle 2. To act with integrity in fulfilling the responsibilities of your appointment…

Principle 5. To be alert to and manage fairly and effectively and to the best of your ability any relevant conflict of interest.

BEYOND COMPLIANCE: WINNING HEARTS AND MINDS

Simon Webley, Research Director, Institute of Business Ethics (IBE)

We are experiencing, not for the first time, what amounts to a double-dip recession. But we are also in a double-dip in the City's reputation.

The first occurred at the start of the 2008 banking crisis, which some blamed upon the perceived greed, which led to excessive risk-taking and the ultimate downfall of UK banking household names such as HBOS and Northern Rock. A second drop in the City's reputation occurred with the investigations into LIBOR fixing, money-laundering and the mis-selling of financial products.

And yet, many of the companies involved have codes of ethics that set out their commitment to do business ethically and guide staff in the right conduct. Staff are expected to abide by the company's stated values or face disciplinary procedures. The CISI, like many professional bodies, also has in place a Code of Conduct and expects members to apply these ethical principles in their day-to-day work.

When we shake our heads at the latest corporate scandal, and wonder "How could this have happened?", the answer is unlikely to be that the organisation or individual intended to cause integrity failure. Usually it is the result of gradual erosion in behaviour over time. However, despite the complexity behind such ethical failures, too often the response of the organisation is to initiate a quick-fix, tick-box compliance effort in the hope of guarding against further integrity risks.

Sadly, these compliance efforts often fail, because ethics is too frequently placed at the periphery of business decision-making, rather than at its heart: an adjunct to operational risk at best, to public or investor relations at worst. When organisations face a reputation hit, there is often much scrutiny of business systems and risk management; they would also be wise to take a look at their ethics programme to see why it failed. The complexity and long-term nature of building a strong, effective and resilient ethical culture can present a challenge, but the near and long-term returns could be that much more significant.

BEYOND COMPLIANCE

The IBE distinguishes between compliance as a control mechanism (consisting of a systematic design of policies, procedures and rules controlling the conduct of business) and business ethics as the application to business behaviour of ethical values, such as fairness, honesty, openness, integrity. Ethics is about how an organisation does its business, not what it does. Are employees treated with dignity and respect? Are customers treated fairly? Are suppliers paid on time? Is the company open to dialogue with its local communities? Does it acknowledge its responsibilities to wider society?

Increased focus by the media, regulators and governments on how companies undertake their business has made it critical that firms examine and encourage their ethical culture. Reputations are based, not only on a company's delivery of its products and services, but also on how it values its relationships with its stakeholders. Ethics play an essential role in embedding the value-system throughout the company and in facilitating how this is expressed, through the behaviour and culture at both the individual and the collective level.

A programme based upon ethical values reaches further than one relying solely on detailed and prescriptive rules. No amount of compliance-based rules will be sufficient, as rules can be open to interpretation and circumvention. In a purely compliance-based system, without espoused values, if something is not explicitly prohibited, it is allowed. In a principles-based system, if an action is not in accordance with the principles, it is not allowed.

Although there is a need for both ethics and compliance, emphasis on compliance and control frameworks alone can be counterproductive. It can erode trust which is required in any organisation to foster a culture of "doing the right thing". This in turn can foster a culture where the lowest common denominator of non-prohibited behaviour is all that is achieved, or worse, aspired to. Even though rules are designed to prevent unethical behaviour, they can provoke the opposite reaction, known as reactance theory. People resent threats to their freedom, and they can manifest that resistance by flouting the rules.[1]

If purely rules-based systems imply distrust of employees and treat them like potential criminals and fraudsters, this can become a self-fulfilling prophecy – the Golem effect. Giving employees the opportunity and tools to enhance their ethical acumen and do the right thing; trusting them to make choices in line with ethical values; respecting them when they speak up – these are values-led ways to produce a Pygmalion effect. If people are treated positively, this influences the way they act in a positive way.[2]

1 Kaptein, M (2012) Why Do Good People Sometimes Do Bad Things?: 52 Reflections on Ethics at Work Available at SSRN: http://ssrn.com/abstract=2117396 or http://dx.doi.org/10.2139/ssrn.2117396

2 Eden, D (1992) Leadership and Expectation: Pygmalion Effects and Other Self-fulfilling Prophecies Leadership Quarterly http://greatmanager.ucsf.edu/files/Leadership%26Expectations_PygmalionEffects.pdf

Of course, compliance-based control systems have their benefits. They are, above all, much more objective and measurable than those based on the subjective 'soft' issues of ethics and principles. It is easier (and cheaper) to measure the number of employees who have signed a document saying they have read a company's code of conduct than it is to roll-out face-to-face training sessions and workshops to ensure they have understood it.

To influence behaviour, the two approaches must be harmonised. If corporate culture is rotten, compliance controls will not work: culture and behaviour transcend processes and controls.

ETHICS IN DECISION-MAKING

IBE research shows that the majority of employees are aware of elements of their organisation's ethics programme[3]

- 73% say their organisation has written standards of ethical business conduct ie, a code;
- 69% say their organisation provides employees with a way to report misconduct anonymously;
- 58% say their organisation offers an advice or information helpline;
- 62% say their organisation provides training on standards of ethical conduct.

But somehow the holy grail of an ethical culture still eludes many companies. So how can it be achieved?

The aim must be to embed ethical principles for business conduct throughout an organisation. It will then form the basis of the culture, decision-making and behaviour. It can be a challenging process that requires sensitivity, patience and resources.

Making ethics an integral component across all aspects of business decision-making needs to be addressed as a long-term skills and systems issue. For instance, including the use of ethical decision trees in the governance of decision-making provides an opportunity for organisations to reflect more meaningfully on how the seeds of ethical failures develop. Encouraging staff to consider the ethical dimensions of their decisions will not only minimise ethical risk, but will also maximise the benefits of effective ethical culture.[4]

3 Basran S & Webley S (2012) Employee Views of Ethics at Work: 2012 British Survey Institute of Business Ethics www.ibe.org.uk

4 Barr D & Campbell C (2011) IBE Good Practice Guide: Ethics in Decision-making Institute of Business Ethics www.ibe.org.uk

However, no decision is made in a vacuum. There will be times when - no matter how well an ethics programme is embedded - taking an unbiased, objective and sufficiently informed decision will be very difficult. Individuals may often feel that they are doing the right thing (eg, saving money for a client or the company; meeting a deadline; hitting a target; falling in line with the way something has always been done) and only when removed from the situation are they able to see a very different interpretation. This is because personal and cultural contexts, consciously and unconsciously, have an impact on our judgment and reasoning, and, more importantly, our propensity to act on it. These can include bias from our own past experiences, ingrained beliefs, cultural norms and the economic and the physical environment, as well as common workplace factors limiting rational decision-taking, such as time pressure, complexity and authority.

Recognising that we are all susceptible to such influences challenges the way that some compliance-based training is designed. Ethical failures are not always because of "bad apples"; they can equally be the result of good people making poor choices or the pressures put upon them from other sources. The results of the IBE's 2012 *Ethics at Work Survey* underlines this. While the majority (84%) of British employees feel that honesty is practised in their organisation, they seem to be significantly more likely to experience certain types of pressure to behave unethically than in previous years. The most common of these include meeting unrealistic business objectives or targets (19%) and being asked to take short cuts (14%).[5]

SETTING THE TONE – REGAINING TRUST

How can the City - whose foundation is based upon the ultimate motto for trust "My word is my bond" - have come to be viewed with such distrust? And how can trust be regained?

The current lacuna of trust can be traced back to the influence – both positive and negative - of leadership.

In this regard, the importance of leadership should never be underestimated. The culture of an organisation is set by the "'tone at the top" whether that is senior management or team leaders. Leaders who talk about ethical issues, support staff and behave in an open and transparent way, send the message to all employees, and the wider world, that ethics is taken seriously. Leaders lead by example. Fine words are all very well, but these need to be properly broadcast and visibly supported by actions.

Any say/do gap of leadership impacts upon middle management. Top leadership generally espouses ethical behaviour, but often fails to ensure there are sufficient systems and controls in place to support that behaviour. The result is that middle management, tasked with delivering business goals and targets set by senior management, have little incentive, or inclination, to deliver it in an ethical manner. A spiral of unethical behaviour can start from this pressure at the top. Obedience to authority is ingrained in our culture and workplace. When someone in a position of authority asks an employee to do something unethical or illegal, they can find it difficult to say no. It's easier to justify bad behaviour, if you are the instrument of another's wishes.

5 Basran S & Webley S op cit

Chief executives must lead by example, stating openly in their codes of ethics that the ends do not justify the means, and backing this up with support for ethical behaviour; celebrating good conduct and vilifying poor behaviour. Senior management also needs to be trained to develop ethical sensitivity - an understanding of fairness, openness, transparency, integrity, responsibility to others and the ability to recognise conflicts of interest, as they appear.

Research by Muel Kaptein of Erasmus Research Institute of Management shows that, in organisations where the management sets a good example, significantly less unethical behaviour is seen in the rest of the organisation, than when the management sets a bad example. Thirty-two aspects of unethical behaviour were measured, including cheating consumers, squeezing out suppliers, deceiving shareholders, competing unfairly and violating human rights. Kaptein says:

"Ultimately, ethical leadership should show people that they are not the product of their environment, but are capable of creating an environment in which they can get the best out of themselves and others."[6]

PERSONAL RESPONSIBILITY

A way forward for companies is to generate an open culture, whereby employees are inspired to do their best for their organisation, with ethics placed at the heart of decision-making.

Giving employees personal responsibility is an important step towards achieving that. A healthy organisational culture is one where employees are inspired to do the right thing because it is the right thing to do, not because the compliance department says they should. Training is one way to enhance ethical decision-making, but the most powerful is to show active support of employees in making right decisions. This begins at the top, with the formulation of strategies and objectives which are achievable, together with the message that the ends do not justify the means. For an ethical organisation, the means are just as important as the result. How you do your business is as important as what you do. Trust is a two- way street. For an organisation to be trustworthy, it must first trust its employees to do the right thing.

An ethical culture is not easy to achieve; it is an emotional thing - a case of winning over hearts and minds. It needs communication and training, but, most of all, it requires action. Actions speak louder than words.

6 Kaptein M op cit

CISI
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 FCSI(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:

Aberdeen
ADM
APCIMS
AVIVA
BARCLAYS
Bedrock
BNP PARIBAS SECURITIES SERVICES
BNY MELLON
BREWIN DOLPHIN
Broadridge
BROWN SHIPLEY Private Banking
CANACCORD Genuity Wealth Management
CHARLES STANLEY
citi
Cognizant
CREDIT SUISSE
Daiwa Capital Markets
Deutsche Bank
deVere GROUP
EFG Private Bank
Emirates NBD
fund advisers sound advice, simply given
HSBC
Investec Wealth & Investment
J O HAMBRO
Julius Bär
KILLIK & Co
LLOYDS BANKING GROUP
Morgan Stanley
NATIONAL BANK OF ABU DHABI
NOMURA
Oriel SECURITIES
QUILTER CHEVIOT INVESTMENT MANAGEMENT
RATHBONES Established 1742
RBC
RBS The Royal Bank of Scotland Group
Schroders Private Banking
Smith & Williamson
SOCIETE GENERALE Private Banking Hambros
Standard Chartered Private Bank
Standard Life Wealth
Towry
UBS
WH Ireland

ACPI Investment
Alpari
Bank Leumi
Bank of London & the Middle East
BDO Investment Management
Beaufort Securities
Bestinvest
Black Tower
C.Hoare & Co.
Capital International Group
Cardale Asset Management
Cave & Sons Stockbrokers
Cavendish Asset Management
Cenkos Channel Islands
Chase Belgrave
CheckRisk
City Equities
Close Asset Management
Collins Sarri Stratham Investments
Credo Capital
Duncan Lawrie Asset Management
Gore Browne Investment Management
Grisons Peak
Hargreave Hale
Heartwood Wealth Management
Highfield Financial Management
Interactive Investor
James Brearley & Sons
Jefferies International
JM Finn & Co
Jupiter Unit Trust Managers
Kotak Mahindra (UK)
Lombard Odier Darier Hentsch UK
MIG Capital
Mirabaud Asset Management
Monument Securities
MPC Wealth Management
Multrees Investor Services
N W Brown
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