

## **Case study : Ethics and financial services**

### **Abstract**

A fictional case of a financial investment firm, based in offshore locations for the most part. It presents the structure and practices of the firm, with some expansion of these using anecdotes from the recent past. A range of ethical questions are introduced, relating to financial regulation, and employment practices. Readers are invited to take the perspective of an external consultant in evaluating and trying to change the ethical position of the firm.

### **Key terms:**

Financial ethics, whistleblowing, ethics and HR practices, money laundering, ethics of share options

### **Stelling Minnis**

In 1947 Alexander Stelling started a stockbroking business in the City of London. Over the following twenty-five years he built this up into a well-established and well-respected firm, with a strong client list. In 1972 he entered into a joint venture with two American entrepreneurs, setting up a small commercial bank. This encountered serious difficulties and was wound up in 1974, and eventually as a result Stelling's was taken over by the Minnis Group, stockbrokers operating originally in London and New York, but more latterly based in offshore locations such as Jersey, Cayman and the Isle of Man.

Alec Stelling carried on for another four years as a director before retiring. Minnis continued to hold the Stelling operation at arms length until 1980, when it merged the two businesses, and moved its main office to Jersey. In 1992 the Minnis Group itself was broken up. The old Stelling arm of the Group was divested and taken over as a management buy-out by a group of established employees. The company was re-named Stelling Minnis as a means of keeping a link with the history of the firm, and as a way of holding on to the established customer base.

Stelling Minnis has continued since then as a limited company, majority owned and run by eight of the original nine managers who

took over the firm in 1992 (and who slightly misleadingly prefer to be called the partners).

It has 177 staff - 124 financial advisors and sales staff, 45 clerical and administrative support, and the 8 partners. Of the employed staff, 18 have been with the company since the days of Alec Stelling, and only 12 have joined since 1992. There is a strong 'family' ethos amongst the longer serving staff, and a high degree of loyalty to the firm - even when there are differences with the partners.

The company is registered in Jersey and has its main HQ there, though there are also offices in Grand Cayman, Douglas Isle of Man, London and New York. Nowadays its clientele come from all around the world.

## Structure

There are three divisions -

Equities - Based at Head Office, but with an office in New York. 105 advisory/sales staff supported by 15 administrators, and headed up by 2 of the partners, provide advice on share transactions for a client base of personal investors, mostly these days from the developing economies and post-communist states.

Fund management - 3 of the partners, supported by 18 administrators, manage portfolios for a range of small to medium corporate clients, mostly UK, from the office in Douglas Isle of Man.

Custody and services - Based in Grand Cayman. Provides a range of services, including custody, company registration and company secretarial, management consultancy, tax, trade finance and venture capital. Run by the remaining three partners with the assistance of 19 advisors and 12 administrators. Customers come mainly from the UK and USA. One of the partners, a lawyer by training, deals with all aspects of complying with legislation and regulation of the various countries in which the company operates.

## Employment policies

All employees are treated as self employed - even though some of them may have worked for the firm since before its takeover by Minnis. The prime rationale for this is that it gives the firm much more flexibility than 'having to shoulder the responsibility for employees; this way each worker is empowered to take responsibility for themselves' as the Director of HR recently explained. Each employee is encouraged to take a small non-voting equity stake in the company (equivalent to about a month's salary) as a sign of goodwill. This is structured in such a way that ownership reverts to the partners upon the employee's resignation from the company. Individuals may also purchase voting shares on their own behalf, and some more senior staff have substantial holdings. Occasionally large bonuses to senior management are given as shares or share options.

There has been a concerted effort to operate fair recruitment practices in recent years, though inevitably the more relaxed approach of the past is still very much in evidence in the low overall proportion of senior women and members of non-white ethnic groups at almost all levels. There are no employees who are known to have disabilities.

Staff development needs are identified by managers as part of the review process, and are therefore very closely linked with business performance. Staff are encouraged to take responsibility for their own development, and are able to take advantage of a training voucher scheme, whereby they receive vouchers for a given level of cash to pay for training. If they choose to take more expensive development programmes, then they are expected to make up the difference themselves. Most staff have taken advantage of this policy to become specialists in an aspect of the work of their division.

There is a generous pay and benefits scheme (even by the standards of the financial services sector) which was set up in outline by Alec Stelling as long ago as 1958. Salaries are well above national averages. Sales staff have a high basic above which they can earn up to 20% from commissions. Additional performance bonuses are calculated on a combination of individual, team and company performance, so that although everyone partakes of the company's success, those who made most effort get the most reward. In good years the best sales staff have earned over 100% bonus, and even the most junior secretary has received up to 25% addition to their salary.

Performance is rigorously measured and monitored. All staff have six monthly reviews where achievement against targets is assessed and new targets for the coming period are set. The partners place great emphasis on setting well-designed objectives. They therefore spend a significant amount of time on this aspect of management. Nevertheless, failure to meet targets over three periods does lead to dismissal - a small but significant number of staff have been let go due to underperformance. One of these succeeded in obtaining a sizeable amount of compensation in the USA courts when they sued for breach of contract.

Work relationships are often very good - there have been several company marriages over the years. There are strong loyalties - especially in the Jersey office (a small number of staff relocated to Jersey from London when the firm moved there, requiring a special agreement from the government). Relations with the other main office, in Grand Cayman, have sometimes been strained. There is a small amount of travel between these two locations, occasioning comments such as "going on holiday?" to those who visit Cayman from St Helier.

Despite the jocularly, there is some evidence of real resentments. The Cayman employees, most of whom were originally UK based, are managed by those partners who are generally regarded as the most genial, and they also are perceived as having the most varied and interesting work, and enjoy a better employment package in terms of hours and holidays, as well as living in a much nicer climate).

### Commercial performance

The traditional equities side of the business has suffered some serious difficulties in the last three years, and has failed to yield an overall surplus since 1997. The Grand Cayman operation, involving a variety of business services, has by contrast gone from strength to strength, and now accounts for over 45% of the profit of the company. There have been several investigations into potential money laundering cases with Stelling Minnis account holders, but none has been taken as far as prosecution. The Bank of England, in 2001, did write to the CEO warning him that they were not sufficiently careful in vetting new clients at the opening of accounts (a typical point of vulnerability with respect to money laundering). There was also a US investigative report in a leading east coast newspaper, suggesting that some Stelling Minnis account holders had connections with terrorist groups. But

again a brief check by the relevant authorities indicated a lack of evidence to warrant further investigation.

The UK offshore operations continue to be successful. For example, the partners based in Jersey have chosen to plough back their share of the company profits into the company last year, and have stated publicly that they will do so again this year if necessary.

### Policies and practices

Alec Stelling devised his own code of practice in the 1950s, and a copy still hangs on the wall of the main offices. It talks about "...providing fair and informative advice, and seeking the best opportunities for every customer, large or small." It has been amended and more or less replaced over the years, but the spirit of the current employees' code is still very much in line with this extract.

There is a strong tradition of democracy and open discussion in the firm. Decisions are made by the partners after formal consultation with the staff. Formerly, policy proposals were formulated by the partners in Jersey after telephone fax or telex communication with their counterparts in Cayman and the other offices. Since 1997 videoconferencing facilities have been installed in every office, enabling the partners to have videoconferences at least once a week. Following these, partners will cascade proposals down to supervisors, who will in turn present these to staff. Feedback is the reverse of this process. In practice few proposals are rejected by the staff (who after all have very little formal power in the organization) but on a small number of occasions there has been significant amendment of a proposal in the light of staff responses. On one occasion there was a protracted dispute when the partners decided to vary the bonus scheme to reward high performers more for their individual efforts. Eventually, after an extended disagreement which led to several administrators threatening to join a union, a compromise solution was imposed on the employees - the two supposed ringleaders were dismissed.

There were two cases of whistleblowing in recent years. In one case an employee in the Isle of Man contacted the local regulating authority when he discovered that senior managers in the local office had used some of the pension fund money for a high risk speculative investment in robotics firms. Upon investigation, the senior managers argued that

they had hedged against any major loss by setting up complex off-setting financial products, and that the proceeds in any case went to the staff, in the form of payments per voting share. The regulator decided to take no action, but asked that this be specifically reported on annually. The whistleblower was interviewed by senior management, though no action was taken at the time. He was, it is true, made redundant for poor performance about six months later, though there was little that would directly connect that with the comments made at the time of the disclosure by one senior manager, that "whoever did this will be on their bike pretty soon". Upon applying to the Isle of Man government, and then under Human Rights legislation to the mainland UK government, he was informed by both legislatures that as he had benefitted from the advantages of self-employed status, he could not then try to revert to employed status in order to claim unfair dismissal.

The second case of whistleblowing concerned a young woman in the New York office, who claimed that the management in New York were using banking as a cover for a variety of less respectable services for high value clients, such as procuring prostitutes for visiting businessmen, supplying crack cocaine, and finding various methods of keeping assets away from the eyes of different tax authorities. This was splashed all over the leading New York newspapers on the 5<sup>th</sup> April 2003, though due to other leading news stories at the time (principally the war in Iraq) it was not followed up by any further journalistic enquiries. The New York Police Department visited the office and took away several boxes of materials. Several staff were interviewed, and there was one arrest made, though after a visit from the senior partner to a leading New York politician (believed to hold an account with Stelling Minnis) the individual was later released without charge. The whistleblower soon moved to Grand Cayman, promoted - to the surprise of several people - to a position of significant responsibility.

Discipline in general is short and sharp. One senior salesman was summarily dismissed after it was discovered that he had used client funds to carry out share dealings on his own behalf. His protest that two other sales staff had been let off with a warning the previous year was not accepted (though it was true). One partner was asked to sell his share of the company and leave in 2001 when it was reported in the FT that he had failed to pass on market sensitive information to clients until after he had completed his own share transactions.

The company received further bad publicity in the Caribbean press in

late 2003 when it was discovered that they had been refusing to appoint local people to jobs in Cayman, in favor of US and UK staff being seconded to assignments. Given that the workforce itself was largely non-Caribbean, the local press felt justified in describing Stelling Minnis as a 'closet neo-colonial backwater.' One of the partners, Claire Minnis-Bailey (a niece of Jonathan Minnis, who founded the Minnis Group) was interviewed on local TV and defended the company's position, saying "We provide a significant amount of work in spin-off industries, such as computing and office supplies, so we can hardly be said to avoid the local population" Nevertheless, the company has had significant difficulty in obtaining basic office supplies locally since then.

### The future

The company has set its development targets for the next three years:

- a) increase by 50% in fee totals the custody and services work
- b) develop the office in the City of London
- c) expand the fund management business by at least 35% in value
- d) re-focus and rationalize the equity trading aspect of the business, eliminating loss making elements, and producing a clear positive ROI across the whole division

### Questions

- 1 Identify the key stakeholders to the business of Stelling Minis. How much power does each group have? And how vulnerable will they be if the business suffers serious reverses?