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banking insight

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AN EXCLUSIVE INTERVIEW WITH TAN SRI AZMAN HASHIM
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REIMAGINING BANKS THROUGH ETHICS & PROBITY

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BREAKING BAD BEHAVIOUR: RESHAPING BANKING'S ETHOS

Recent findings indicate there's still some way to go in regaining public trust. Can recent strides to rein in misconduct help banks make the quantum leap?

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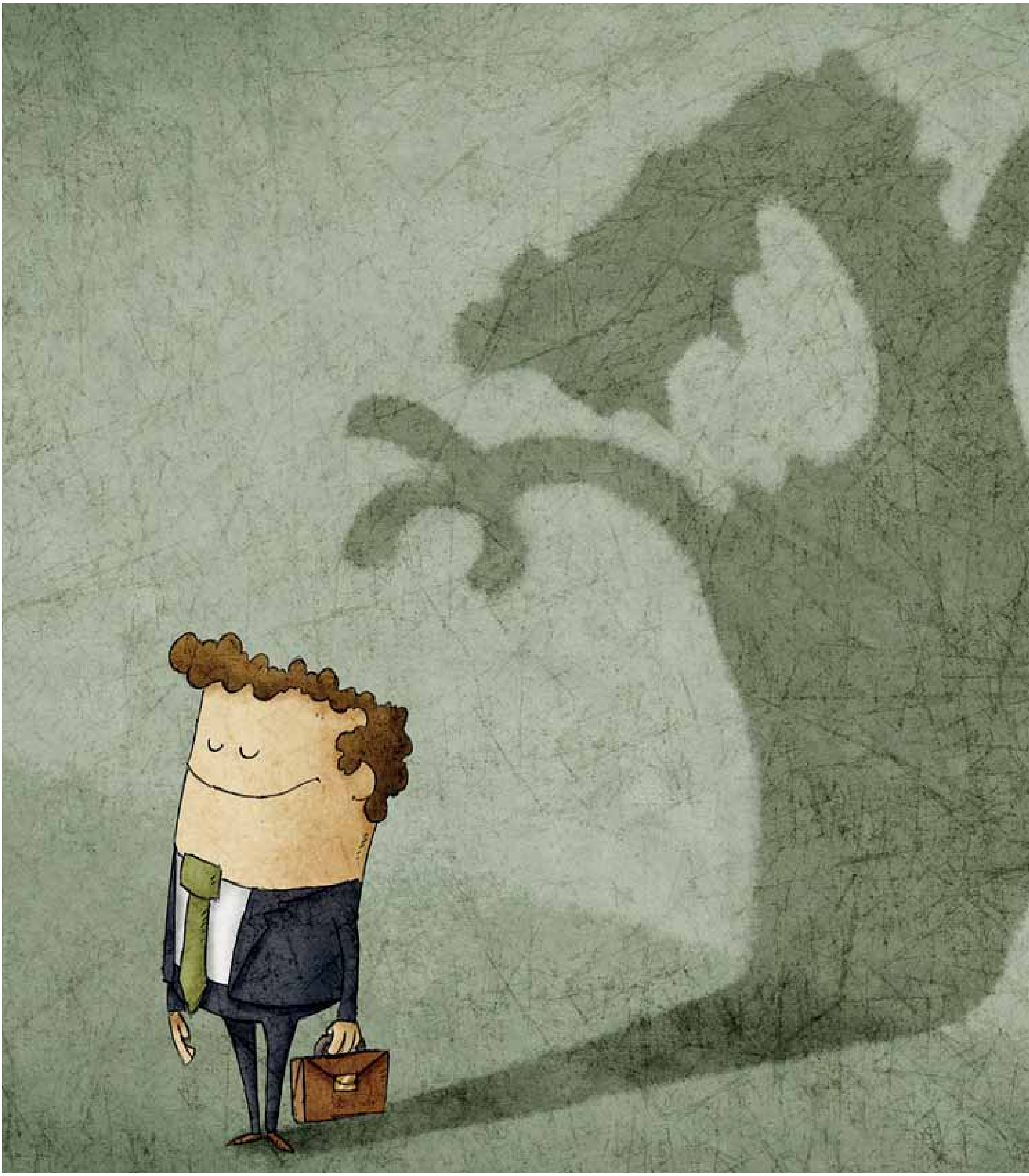


RECENT FINDINGS INDICATE THERE'S STILL SOME WAY TO GO IN REGAINING PUBLIC TRUST. CAN RECENT STRIDES TO REIN IN MISCONDUCT HELP BANKS MAKE THE QUANTUM LEAP?

BREAKING BAD BEHAVIOUR

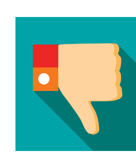
RESHAPING BANKING'S ETHOS

Banking's major failures of the past decade are largely attributed to lapses in ethical behaviour. Whether the result of a single rogue trader or rate-fixing cartels, the effects have been devastating and long lasting. Despite an eight-point rise in global trust in financial services over the past five years, Edelman's *2016 Trust Barometer* indicates banking is still the world's least trusted sector for the fifth year running.

This view is reinforced in light of recent incidents that banking and the corresponding ecosystem that supports it continues to be beset by lapses in transparency, accountability and governance.

Take for instance the Bank of England (BoE) Deputy Governor Charlotte Hogg's voluntary resignation in March 2017 after it was revealed to members of Parliament that she had failed to disclose that her brother was the director of group strategy at Barclays Bank. The 46-year-old apologised and the BoE's Treasury Select Committee report stated: "The Committee considers that her professional competence falls short of the very high standards required to fulfil the additional responsibilities of Deputy Governor for Markets and Banking."

Public uproar also erupted in March when loss-making Royal Bank of Scotland announced its remuneration and compensation packages to top



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management. The bailed-out bank, of which the government owns up to 73%, announced it would award £16 million in shares to nine executives despite reporting losses of £8 billion in FY2016, its ninth consecutive year of losses totalling £58 billion. The argument put forth by the current management team is that it should not be responsible for "legacy costs" and the approved bonuses reflect underlying profitability improvements in its operations.

There was also the tip-off that triggered official raids at Credit Suisse in five countries – the Netherlands, Germany, France, Britain and Australia – leading to scrutiny of thousands of accounts on alleged tax evasion and money laundering offences, at a time when Swiss banks have been aggressively trying to shed their reputation as a tax haven.

Then there was also scandal at professional service firms such as KPMG LLP's audit business in the US which ended with the firing of its top audit official Scott Marcello and four other partners over charges that they gave tips or advance word about which accounts its audit regulator, the Public Company Accounting Oversight Board, planned to scrutinise during annual inspections.

The question on everyone's mind is: Can banking truly reform?

'PREDILECTION TO CHEAT'

In April 2015, three economists at the University of Zurich published findings from their research on 'Business Culture and Dishonesty in the Banking Industry'. Recruiting 128 banking employees, each with about 11 years of experience in the sector (long enough to absorb the industry's norms), subjects were informed they would be rewarded USD20 each time the coin toss yielded the 'right' result, ushered into a private room, asked to flip a coin 10 times, and report the outcomes of each toss – heads or tails. In this first scenario, they reported the 'right' result 51.6% of the time – a statistically insignificant deviation from the norm of 50%.

However, the same group was then told to remember their profession as bankers, a social cue termed 'identity priming', and asked to repeat the experiment, after which 58.2% reported 'winning' tosses, an indication that over 25% had likely cheated in order to report wins. More worrying is the indication that this predilection to cheat is unique to the banking industry as repeated studies with non-bankers showed no deviation from the norm, pre- and post-identity priming.

"Our results," conclude the researchers, "thus suggest that the prevailing business culture in the banking industry weakens and undermines the honesty norm", a view that also concurs with many other studies by consulting firms that the prevalent practice of rewarding bad behaviour is deeply entrenched in the psyche of banking culture. As Alain Cohn, lead author of the research, summed up the phenomena in an interview with The Atlantic, "the apples are good, but the barrel is bad".

BoE Governor Mark Carney said in a February 2013 speech in Ontario: "Virtue cannot be regulated. Even the strongest supervision cannot guarantee good conduct. Essential will be the rediscovery of core values, and ultimately this is a question of personal responsibility. More than mastering

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options pricing, company valuation, or accounting, living the right values will be the most important challenge."

Instilling organisational culture to encourage employees to "live the right values" is a challenge that expresses itself repeatedly in all jurisdictions.

The answer for most institutions is to create a safe climate for employees to report incidences without punishment or retaliation. US-based non-profit Ethics Resource Center's *National Business Ethics Survey®*, the American benchmark on ethical behaviour at Fortune 500® companies, discovered companies that implemented effective ethics and compliance (E&C)-based programmes saw reporting rates soar to more than eight out of 10 staff reporting misconduct compared to three out of 10 staff in organisations with weak or non-existent E&C programmes. Other key findings include:

- 97% of observed misconduct is either reported or taken care of by employees themselves in firms with effective E&C programmes.
- The 'tone from the top' is essential in determining employees' confidence levels that alleged misconduct will be investigated. 71% report misdeeds when they believe top management is committed to ethics versus 56% otherwise.
- Only about one in 20 employees (approximately 5%) suffer from retaliation in firms with strong probity programmes compared to 50% retaliation rates otherwise.
- In turn, organisations with high reporting levels and low retaliation rates create a virtuous cycle, lowering the probability of misconduct and reinforcing a strong ethics culture.

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VALUES AS COMPETITIVE DIFFERENTIATOR

Post 2008, the UK experience, with one of the more mature regulators in the ethics sphere, is regularly adopted as the preferred industry benchmark in probity regulations. An analysis of the Financial Conduct Authority's (FCA) latest annual business plan outlining priorities and agenda for 2017/18 points to an increased focus on conduct management issues including the treatment of existing and vulnerable consumers, culture and governance, financial crime and cybersecurity as well as financial technology (fintech).

Accenture's research titled 'The Ethics and Conduct Challenge for US Banks: Learning from the UK Experience' identified five broad themes in banking conduct that will shape its landscape, not just in terms of regulation but also leveraging ethics as a competitive differentiator to rebuild the sector:

+ Cultural Change

Financial institutions (FI) are moving away from a poor ethics culture, defined as one that merely fulfils the letter of the law but not its spirit. The former is a result of incentives focused on short-term benefits and growth rather than prioritising longer-term customer or public benefits. Firms that show the most progressive and successful probity programmes and change in employee mindsets are distinguished by undertaking proactive and concrete measures such as an overhaul in fee and commission structures to a values-driven screening of potential new hires by human resource. In all aspects of operations, values should be the driving force and strategic differentiator.

+ Personal Accountability

The emphasis by regulators on individual accountability and the role of senior

CASE STUDY:
UK POLICIES TO RESHAPE WHISTLEBLOWING

The UK's Financial Conduct Authority (FCA) was one of the first regulatory authorities to acknowledge that lapses in ethical behaviour resulted in the mis-selling of credit default swaps, one of the triggers of the financial meltdown. Acknowledging the lack of an ethical work culture at FIs forced it to move aggressively to change employee behaviour in banks.

Recognising that bank employees may be reluctant to voice concerns about noticeable bad practice for fear of personal and professional repercussions, the FCA and the Prudential Regulation Authority (PRA) took active steps to strengthen whistleblowing legislation in order to encourage a 'speak up' culture at FIs. The wisdom behind this move corroborates research findings by other professional bodies such as the Association of Chartered Certified Accountants that cultivating a 'speak up' culture and strengthening whistleblowing policies can significantly increase the levels of trust within firms and consequentially reduce the risk of misconduct.

In 2013, a UK parliamentary commission recommended that banks put in place mechanisms to support their employees in whistleblowing. By October 2015, the FCA and PRA had introduced new rules requiring banks and insurers to introduce whistleblowing procedures internally. This included requiring that whistleblowing channels be open to all, firms' obligations to tell employees about such whistleblowing services, and introducing a Whistleblower's Champion at a senior level within organisations.

After a series of industry consultations, on 3 May 2017, the FCA issued a Policy Statement extending whistleblowing protections to foreign banks' UK branches beginning 7 September 2017.

The programme has thus far had a net positive effect in public perception according to consulting firm Navex Global's most recent *UK Financial Services Whistleblowing Regulation Survey* assessing the impact of FCA/PRA whistleblowing rules. Among its key findings:

- A significant number of respondents shared positive outcomes as a direct result of the whistleblower regulations. 21% reported **improved employee behaviour and organisational culture**; 12% experienced an increase in trust and awareness of whistleblowing programmes.
- Although 46% stated that there has been **minimal or no impact following the regulations,** there was a 3% increase in the volume of whistleblowing reports received since the regulation came into effect.
- Board level **involvement with a firm's whistleblowing programme** increased dramatically, from 24% prior to the regulation to 62% post.
- Compared to other sectors, staff at FIs are more likely to file a report with a regulator on the second attempt to raise a concern, another incentive for firms to **build trust internally** by instituting proactive whistleblowing systems so that employees are not tempted to resort to external sources for action, avoiding not just stiffer penalties but also reputational damage.

management is coming to the fore. For instance, a central database listing code of conduct violations by traders has been proposed by the Federal Reserve Bank of New York and the UK's move to impose certification under the Senior Managers Regime – which commenced on 7 March 2016 – have put the onus of doing right squarely on the shoulders of individuals by clearly mapping who does what in the firm.

+ Mis-selling Scandals

This is the prime source of legal as well as reputational risk. Existing business models, strategies and operating models can lead to instances of conflict of interest. Key areas of focus cited by the FCA and the US' Financial Industry Regulatory Authority, Inc., include misconduct when selling to seniors and vulnerable people, embedded product features such as hidden fees or overly complex bundling beyond layman understanding, and a lack of transparency in sales and distribution practices. In the UK, a mixture of regulation, staff re-education programmes to include ethical modules, and adoption of technological innovations to identify and support vulnerable groups has been effective in raising public trust as well as driving shareholder value. The next priority for institutions on this front is to establish early warning systems or procedures to detect bad behaviour.

+ Market Conduct

Globally, regulators are addressing information leakages and conflicts of interest including cross-market and cross-product manipulation. The UK is stepping up measures to train and professionalise banking as a pathway to increased personal accountability, and also investing in fintech such as blockchains and roboanalytics for forward-looking conduct risk identification methods e.g. analysing high volumes of transaction data, conducting probability analyses and detection of false positives.

+ Information and Social Media

Designating the right communication channel for product promotion and securitisation of personal data are primary concerns. Regulators are reviewing legislation/policies that will put customers first, including how information is presented on all platforms – from mobile devices to paper contracts – including real-life customer testing for at-risk groups such as senior citizens, ensuring that critical information on risk is truthfully and appropriately conveyed.

Asia can significantly benefit from these lessons learnt in crafting its own conduct agenda for the region, applying this throughout the spectrum of regulatory and compliance-related activities. The end game is the implementation of successful probity programmes that can help banks reposition themselves and get back on track to profitable growth.

'LIGHT TOUCH' NO MORE

The *New York Times'* 14 March 2017 feature, 'Focus on Bank Culture is an Odd Regulatory Strategy", described the shift and priority of central banks to codify and enforce a set of living values for banking as "no easy proposition'.

Aside from the most obvious and challenging task of operationalising ethics, this shift in banking supervision to reshape banking culture implies that the 'light touch' regulatory approach of yesteryears – characterised by 'box ticking' and standardised reporting – will now make way to emphasise judgement-based decision-making and how the sector will incorporate processes and procedures to challenge dominant or established ways of thinking and doing in banking.

This is a unique challenge. Institutionalising ethics requires both a reequipping of skill sets and revisioning of what it means to be a banker.

Far from being complacent, the global agenda to professionalise the industry charts new territory, according it due recognition par with other guild professionals of accountancy, medicine and law, and shaping the ethos of next-generation bankers. ✱

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