A STRONG ETHICAL CULTURE *in banking*

BANKS NEED TO CONTINUOUSLY STRENGTHEN THEIR ETHICAL CULTURE TO MANAGE TALENT RISK, THE RISK OF BANK FAILURE AND CONSEQUENTLY, THEIR ADVERSE FINANCIAL, ECONOMIC, AND SOCIAL IMPACTS ON THE GENERAL PUBLIC.

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Collapse

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The case for a strong ethical culture in banking is an intuitive one. The arguments, by now, are well-rehearsed. The main benefit to a bank of a strong ethical culture is the minimisation of risks to the organisation. If a bank engages in or permits unethical behaviour such as mis-selling of financial products, the charging of unjustified fees and outright fraud, it runs the risk of not only losing the business of dissatisfied customers, but also the imposition of increasingly substantial financial penalties, the withdrawal of its license to operate by regulators, and even criminal prosecution of key staff.

In addition, banks which do not adhere to high ethical standards may lose the ability to attract or retain the right talent. This trend is starting to happen in developed markets. Ask a class of MBA students in London if they want to join investment banking; very few hands go up these days. It can be both uncomfortable and demotivating for employees to work with an organisation with a dubious reputation. To exacerbate matters, history has repeatedly shown that a major scandal can destroy an entire organisation, resulting in thousands of employees losing their jobs. The collapse of Arthur Andersen and Barings Bank are cases in point. It is thus not surprising that in a September 2013 global survey of financial services executives conducted by the Economist Intelligence Unit (EIU), 96% of respondents expressed their preference to work for a firm with a decent reputation for ethical conduct.

DESTROY

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Finally, from the perspective of the general public, a bank collapse regardless of its cause(s) – unethical conduct, underestimation of credit risks, and so on – could result in severe financial, economic and social consequences. This is primarily due to the dominance of banking institutions in the financial services industry (FSI) (particularly in most Asian economies), as well as the global acceleration of the growth of the FSI relative to the broader economy and the increasing interconnectivity of the FSI across sectors and borders since the 1980s. The financial crises of the 1990s and 2000s dramatically illustrate this.

In contrast, a bank that is anchored in a strong ethical culture and thus consistently conducts its business with a high degree of professionalism, integrity, fairness, and objectivity has the potential to shine among its peers. Standing tall on the strong foundations of its reputation, the bank is then able to inspire trust among its stakeholders, including its customers, employees, shareholders and the general public. Such trust can even weather bad times when markets are unduly affected.

No time for complacency for Asian banks

Placing this continuous emphasis on ethics runs the risk that any seasoned banker will sound like a broken record. Yet, the news is replete with one major banking scandal after another. While it is the misconduct of banks and other financial institutions in developed markets such as the US and the UK that grab global headlines, Asian banks cannot be complacent. As Tan Sri Dr. Zeti Akhtar Aziz, Governor of Bank Negara Malaysia, mentioned in her speech at the launch of the Financial Services Professional Board (FSPB) in September 2014, banks and other financial institutions in the region should take this opportunity of relative calmness in the region to raise the bar of their professional and ethical standards in order to avoid major scandals and to secure their long-term sustainability.

So what can banks do to strengthen the ethical culture within their organisations? This question is being asked with increasing frequency by bank stakeholders the world over, not least because banks serve as a major financial intermediary for the general public. This core function of banking, that ranges from safeguarding savings and enabling payments to facilitating efficient allocation of capital to support economic growth, is both a heavy social responsibility and a privilege.

Unfortunately, there are neither quick answers nor simple solutions. Ethics are rooted in culture, which in turn is intrinsically shaped by human behaviour. As observed by Christine Lagarde, Managing Director of the International Monetary Fund (IMF) and Hector Sants, ex-Chief Executive of the former UK Financial Services Authority (FSA), grappling with issues surrounding changing human behaviour and ultimately culture, until recently, has been outside the comfort zone of stakeholders within the FSI ecosystem.

Thinking of an ethical culture as a package

In a January 2015 speech, Thomas Baxter, General Counsel of the Federal Reserve Bank of New York, likened ethical culture to that of a package. The culture that banks have is a derivative of what is put into the package and what is left out. The three main components for inclusion in the package are: first, having the right incentives for bankers, including compensation and career progression, second, having the right character at the top, and finally, having the right shared and well-understood values throughout the organisation. The three main things for exclusion from the package are: first, the treatment of customers as mere profit opportunities as opposed to people who are to be served, second, the notion of a bank as a pure money-making machine, and third, the adoption of 'short-termism' in incentive pay structures and the

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measurement of success.

Clearly, the drive for high ethical standards must start at and be driven at the top of each bank. The Boards and top management of banks must act in a manner that reflects the shared ethical values of their respective organisations, and ultimately that of a bank's public function as a financial intermediary. Given that the conduct of people in any organisation will be strongly influenced by incentives, the Boards and top management of banks must also ensure that the remuneration and incentive (R&I) policies of their organisations are aligned with ethical considerations. As Baxter put it, "If the only consideration with respect to compensation and promotion is how much money the individual made for the firm, then that communicates a message that is inconsistent with a strong ethical culture." This perhaps goes some way to explain why in the September 2013 EIU survey, over 53% respondents thought that it would be difficult to progress in their careers at their firm without being "flexible" on ethical standards, and only 37% believed that their firm's financial bottom line would improve as a result of higher ethical standards amongst employees.

INCONSISTENT

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Engaging industry

In this regard, two projects being undertaken by AIF may be of interest to readers of *Banking Insight*. First, the FSPB, of which AIF serves as secretariat, is currently developing a code of ethics that applies across the financial services industry (Code). The Code is being developed by a Working Group that comprises leaders from across the FSI (defined as banking, capital markets, insurance and Islamic finance) and individual subject matter experts, both domestic and international. It is hoped that institutions and individuals from across all sectors of the financial services industry will come together and support the initiative. Such collaboration would go a long way to create a sense of common purpose to raise the bar of professionalism, including ethics, across the entire industry.

Second, AIF recently commissioned an initial research on the consideration of professionalism (defined as competence and ethics) in the R&I policies of institutions in the FSI in Malaysia. One hundred and fifty participants from the FSI were invited to participate in the survey that was conducted as part of the research. The key highlight of the survey is that while the respondents do integrate professionalism into R&I policies – and they consider it important to do so – they find it more feasible to integrate competence into R&I policies than ethics. The main challenge in integrating ethics in R&I policies is in the identification of a robust set of metrics to measure the performance of this critical dimension among employees. We hope to engage FSI players in the coming months to strengthen our work in this area.

Conclusion

To sum up, it is vital that banks continuously strengthen the ethical culture within their organisations. Though such efforts may not succeed in stopping all bad behaviour, it may reduce the volume of such behaviour. This in turn would contribute towards minimising the risk of bank failure, and consequently, their adverse financial, economic and social impacts on the general public. Given the important and privileged role that banks and bankers play in society, this must surely be of paramount consideration in all their daily business decisions and actions. ✱

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