

WILL WE ALWAYS HAVE TO TALK ABOUT ETHICS?

The *Risk Universe* columnist **Annie Searle** takes a look at two recent studies on ethics in finance and asks if culture within the industry means it will always be an issue for firms



Annie Searle

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I've been looking at the banking and finance sector for a little more than 16 years and I have to say I don't think policy, ethical frameworks, codes of conduct or even regulation has had much of an impact on how employees behave. To satisfy regulators, both before and as a result of Dodd-Frank, firms have created risk units toward the top of the firm which are still frequently confused with internal audit groups rather than embedded in the lines of business. Risk management is perceived by the business as overhead: the cost of doing business, money that could very well have been spent on innovative new products and complex high-speed instruments that will make money out of the gate. Never before has the disparity between those who have and those who are disenfranchised been so great. Here in the US, banks are thriving and, at the same time, lobbying against further limits on their ability to speculate.

A *Risk Universe* article in July of 2012 summarised the contents of that year's Labaton Sucharow Financial Services Industry Survey, titled *Wall Street Fleet*

Street Main Street: Corporate Integrity at a Crossroads. The study looked at 500 professionals, half from the US and half from the UK. No other study I had read showed with such grim clarity how little impact the financial crisis and subsequent regulatory reforms had on banking behaviour for a statistically significant number of professionals. The report is worth reading still, since there is so much data there, but I find I go back to three pieces of information. First, a staggering number (25% from UK and 22% from the US) felt it was necessary to behave illegally or unethically to get ahead. Second, around 16% "said they would commit a crime, such as insider trading, if they could get away with it". The other significant issue in the 2012 survey was that fear of retaliation for reporting wrongdoing was still very high: "A startling 94% of all professionals surveyed said they would report misconduct if it could be done with a guarantee of anonymity,

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employment protection and a potential monetary reward".

In the 2012 report, Labaton Sucharow, a well-known firm for its prosecutorial work, concludes: "The best way to ensure the financial marketplace operates with greater transparency, fairness and accountability is to recognise the powerful troika – regulators, corporations and individuals – has the ability to establish and strengthen a culture of integrity that will create lasting change in the financial markets."

Three years later, Labaton Sucharow has released *The Street, The Bull and The Crisis: A Survey of the US & UK Financial Services Industry*. This time, 1,200 professionals in both countries

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were surveyed, representing "a broad spectrum of the industry, from young professionals to senior executives, investment bankers and investment managers, from San Francisco to Scotland". (2015 report). In this report, we're seeing jumps in statistics when those who make more than \$500,000 are reported. In the 2012 survey, 51% of those surveyed in the US were not aware of the SEC Whistleblower Program created by the Dodd-Frank Act, which offers financial compensation for reporting wrongdoing. Education seems to be proceeding at a slug-like pace, since 37% are still unaware of the programme even with this larger number surveyed. There's even more data to sort through this year and here I will highlight ones of particular interest to me. It's pretty clear executives making \$500,000 or more are pressured harder to

compromise on legal or ethical issues: 23% at the top, compared with 9% who earn less. That same executive group reports having first-hand understanding of wrongdoing at the rate of 34%, compared to 21% who make less. Please note that no matter how you read this report, the percentages are awful for both groups, as are the conclusions those who were surveyed have drawn: 32% believe compensation or bonus plans could cause employees to violate the law or

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compromise their ethics; 33% of them "feel the industry hasn't changed for the better since the financial crisis". There is significant variance also in the data from those who have been in the industry for many years and those who are relatively new to it. What is new in both cases is the proliferation of agreements – for 25% of those who earn \$500,000 or more and for 10% of others – that "would prohibit reporting illegal or unethical activities to the authorities". A significant number of employees (15%-21%) believe their leaders would look the other way if an activity or an individual was driving significant profit. And, in perhaps the most disheartening response of the new survey, 17% of all respondents "find it unlikely company leaders would report misconduct to law enforcement". When they look at regulators and law enforcement bodies in their respective countries, 39% find them ineffective; and that percentage rises to 49% when those who make \$500,000 or more are answering.

Individual and corporate integrity are fundamental components of effective risk management. Both studies indicate we have a very long way to go to change the culture inside banking. The C-suite is not making progress on the trust spectrum, or on communicating both values and acceptable behaviour to significantly reduce a firm's losses from fraud or other forms of ethical misconduct. How did we get to a place where doing the right thing (ethics) is perceived by professionals as unprofitable and as grounds for retaliation? So far the troika that Labaton Sucharow spoke about – corporations, regulators and individuals – has been unable to obtain the desired outcome(s). **TRU**