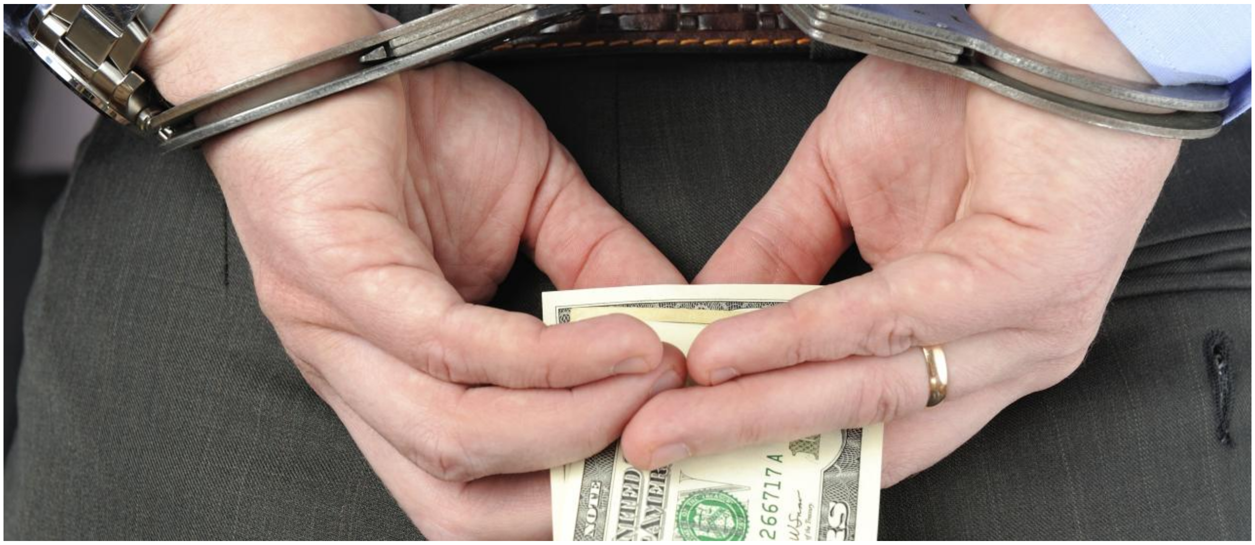
Tackling Unethical Banking: How Far Should Regulators Go?



By N. Craig Smith , INSEAD Chaired Professor of Ethics and Social Responsibility

How far should regulators go to weed out ethically challenged individuals in the banking sector?

When Jonathan Burrows was caught cheating the British rail system he expected a slap on the wrist or perhaps a large fine - and for a while it looked like that was all he would incur. Caught by a ticket inspector using an “0yster” card to tap out at London’s Cannon Street station, (paying a £7.20 London fare rather than the £21.50 ticket required for the journey from his home in East Sussex), the BlackRock Asset Management investment executive freely admitted he had used the trick on a number of occasions since moving to the country several years earlier. Despite a clamp-down on fare evasion he managed to avoid prosecution, settling with the rail company out of court, and away from public eyes, for £43,000; more than it would have cost him if he had been buying annual passes but easily covered by his

£1 million-plus annual salary.

Britain's worst train dodger

Unfortunately for Burrows, the railway workers union, outraged by the idea that the rich could buy silence while ordinary fare dodgers were "hauled into court and publicly ridiculed", notified the tabloid press. Burrows' face was soon plastered across the country's newspapers with headlines outing him as "Britain's worst fare dodger".

Much was made of the fact that he had a high-paying job in finance, an industry still trying to redeem itself in the wake of the global banking crisis. The U.K. Financial Conduct Authority launched an investigation and it was only then that Burrows notified his employers who suspended him assuring the public the allegations against their executive were "totally contrary to our values and principles."

Burrows resigned, but his ordeal was still far from over. In December 2014, at the conclusion of their investigation the FCA **banned** him from ever working in finance again. By knowingly evading the fare for his train journey, the regulator claimed he had demonstrated a lack of honesty and integrity that failed to meet its Fit and Proper Test for Approved Persons.

Burrows accepted the punishment admitting what he did was wrong, but in a statement to the press questioned whether there were more insidious activities the FCA should have been investigating. "I recognise that the FCA has on its plate more profound wrong-doings than mine in the financial services sector and I am sorry that my case has taken up its time at this critical juncture for the future of the city and its reputation."

So was Burrows right? Was the punishment disproportionate to the crime and should the FCA have been spending resources on what was in effect a misdemeanour conducted outside his work environment?

In making its ruling the FCA assumed that the values Burrows showed going to work were the same values he brought with him into the office. The question we might then ask is should people working in the financial services industry be expected to be squeaky clean, both personally and professionally? Or is it more a matter of how squeaky clean?

"If you ain't cheating, you ain't trying!"

The tide of public opinion certainly supports the view that tougher penalties are necessary to address the ongoing scandals and ethical challenges facing the banking sector. The recent spotlight on a group of rogue foreign exchange traders known as "The Cartel" or "The Mafia", provides a **glimpse** of the underhand way business gets done in the industry and the cowboy ethics of some of the sector's star players.

The group, who at one time or another worked for five or six mega-banks, colluded in closed chat rooms, sharing information on pending client movements to diddle exchange rates and manipulate markets at investors' expense. Transcripts of their conversation, released by the New York State Department of Financial Services (NYDFS) and the FCA in May 2015 as part of the settlement over their alleged activities, highlighted the use of "hard mark-ups", a term used to describe, in the words of one member (a Barclay's vice president in New York), "the worst price I can put where the customer's decision to trade with me or give me future business doesn't change". Gloating over his ability to dupe clients he went on to declare "... if you ain't cheating, you ain't trying."

As distasteful as their actions were, it is this attitude towards customers and the total lack of ethical considerations that is perhaps even more shocking. The transcripts, which covered almost daily conversations between 2008 and 2012, were peppered with congratulatory messages such as "We were epic at the fix!", "We f---ing killed it."

Who's accountable and who pays?

These offences didn't take place in a vacuum. Since the global banking crisis of 2008 there have been ongoing incidents of serious professional misbehaviour, ethical lapses and compliance failures at financial institutions, resulting in a long list of large fines and penalties and, in a very few cases, employee dismissals and punishment. According **to CCP Research Foundation analysis** over £200 billion was paid out by banks in fines and settlements during the four year period to 2014. And still it continues. As these stories continue to emerge from the banking sector it is difficult to have much sympathy for the industry's claim that it is being unfairly attacked.

Much has been written about whether the root of this ethically challenged corporate culture lies not with **a 'few bad apples' but rather the 'barrel makers'.**

To be fair, banks have made attempts to address the situation - to a degree. In 2013 Barclays' CEO Antony Jenkins—dubbed "Saint Antony" in the City—introduced a Code of Conduct, loudly warning those who could not follow the rules that "Barclay's is not the place for you." However a subsequent interview defending the use of bigger bonuses to encourage bankers to make money and protect the Barclay's franchise, showed that even this reformist attitude had its limits. While Citibank has a compliance programme that far exceeds the industry standard, still the company remains plagued by **major ethical failures**.

Banks may point the finger at individuals and insist the problem is a few rogue players, but they continue to pay out huge settlements—**Barclays was fined US$2.4 billion for its Forex rigging, Citi US$2.3 billion**. Thus the misconduct continues, with the banks effectively shielding individual employees who seldom face criminal charges for their actions, while the banks pass the bill on to their shareholders.

Perhaps it will take a few more jail terms before the message gets through. What we do know, if this latest scandal is anything to go by, is that the ethically-challenged culture is still well and truly endemic in the industry. And, as long as banks continue to take the rap for individuals who play fast and loose, the attitude among certain elements of the industry that "anything is acceptable as long as it's making money" will continue, leaving banks, and ultimately shareholders, to pay the price.

An individual's integrity

To return to Mr Burrows and his question of whether the FCA was wasting resources investigating him for ethical practices out of work hours. Many people would agree with the FCA's stance, that bankers' actions outside the office reflect their integrity; the standards they live by and take with them to work each day.

There is a school of thought which holds that it is ethically-flawed individuals like Burrows, and the traders who believe "if you're not cheating you're not trying", who epitomise the culture of greed and the casual attitude to integrity that remains entrenched in banking today. The firing of Barclays CEO Antony Jenkins **this month**, apparently over shareholder concern at the bank's lacklustre financial performance, certainly does not bode well for efforts to effect long-term culture change at the bank – despite the billions of pounds in fines paid by Barclays for employee misconduct.

N. Craig Smith *is the INSEAD Chair in Ethics and Social Responsibility at INSEAD, the Programme Director of INSEAD's Healthcare Compliance Implementation Leadership Programme and a specialist professor at the* ***INSEAD Corporate Governance Initiative***

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About the author(s)

N. Craig Smith is the INSEAD Chaired Professor of Ethics and Social Responsibility. He is also Academic Director of the INSEAD Ethics and Social Responsibility Initiative (ESRI).