Ethics in Banking – The Way Forward

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Ethics in its simplest terms means our conduct, our moral values and righteous behaviour. Although, in practice, some of these values keep changing depending on the place, time and situation, the core values remain the same. The basics do not change. Ethics is the discipline that deals with what is good and bad or what is right and wrong. Ethical conduct has an important role to play in business. A business which is conducted ethically alone shall survive in the long run. And that is equally true in case of banking.

To quote the former Chairman of the Tata Group-Bharat Ratna[1] J. R. D. Tata, "No success or achievement in material terms is worthwhile unless it serves the needs or interests of the country and its people and is achieved by fair and honest means." Ethical conduct is therefore a means to an end.

In modern times, ethical conduct has unfortunately been side-lined because of the increasing importance being given to money. When you start eulogising business organisations or people on the basis of their profits/materialistic achievements without caring two hoots about the way they have made their money or the way they have achieved their status or the ways and means adopted by them to grow/go up the organisational ladder, the ethical standards in any society will go down drastically. In the context of the banking and financial services sector, indulgence in risky and unethical behaviour by innovations in the form of creative products or unwarranted actions or bending of rules and regulations is also becoming quite frequent. This is largely due to the need to show better performance in the fiercely competitive business environment, to retain one's position in the organisation, for personal financial gains or simply to go down in the annals of history as a great manager. And this is a world-wide phenomenon.

The Ethical Predicament

Bankers deal with public money. The growing competition within the industry, business complexities, economic upheavals, increasing economic disparities after liberalisation, policy changes, changes in lifestyle, and changes in expectations of shareholders, government and regulators have all put ethics to a test never seen before.

We have a general impression about ourselves that we are always right. And there is a general tendency to mould everything to suit our convenience especially when our own interests are involved.

Let us take the example of entitlements of employees to substantiate what we mean. All employees are entitled to reimbursement of various expenses, while on official duty. The upper cap on such payments generally depends on the seniority of the employee. The general practice in most of the organisations in this case at all levels is that the employees certify having incurred the expenditure and retain the unspent amount and the organisations too, accept their certification. And this happens irrespective of the fact whether the organisation is making profit or loss. There is no feeling at all of the practice being unethical because it is treated as the employee's right and is followed at all levels by one and all.

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[1]Bharat Ratna is the highest civilian award of Republic of India.

How many of us are capable of resisting temptations to make such quick buck? However, this may not be the case with organisations which permit expenses on actual basis with or without an upper ceiling.

The following case study will further elaborate our assertions:

A large Commercial Bank has a subsidiary, which is a joint venture with a Foreign Institution. The majority stake is with the Bank and the Bank appoints the CEO on deputation, who is paid salary as per Indian Standards. The Foreign Institution has the right to depute the Deputy CEO, who gets an Indian salary in addition to his Foreign salary. Since the subsidiary is a joint venture, 2-3 board and other meetings at foreign venues take place during the year. The CEO and the Deputy CEO attend all such meetings and in addition, certain other key employees are also invited to attend the meetings. The foreign visit of the CEO is approved by the Chairman of the Parent Bank in all the cases. The foreign visit rules permit allowance in US Dollars at a specified rate, which is meant for boarding, lodging, local conveyance and other incidental expenses. The subsidiary also has a requirement of submission of bills after the visit is concluded.

In case of certain meetings, the Joint Venture Partner also arranges for lodging, boarding and local travel expenses. In such cases, the Deputy CEO has been returning part/full allowance given to him in US Dollars. However, none of the other employees including the CEO do so.

Now the big question is – **Do we have an ethical issue in the organisation? Can the conduct of the CEO and other employees be justified?** We may call it 'the entitlement dilemma' and leave it for the readers to decide.

The Ethical Dilemma

In business, we often face situations, where we have to make choices, which involve ethical dilemmas. Should we agree or disagree? Should we say yes or say no? Should we swim with the tide or go against it?

Let us illustrate it further by taking the example of a Banking Conglomerate also having presence in the following sectors:

- Investment/Merchant Banking
- Asset Management
- Life Insurance
- General Insurance
- Factoring
- Primary Dealing

Every Year, before the new financial year starts, the Corporate Office of the Bank enters into a Memorandum of Understanding with the Subsidiaries which contains various parameters of business growth to be achieved during the year.

As Head of a big Corporate Branch of a bank, you have hefty targets for achieving growth in deposits and advances. You are approached by a financial intermediary who offers you its services for getting large amount of long-term funds from Government Companies/Agencies and for granting large advances to the proposals sourced by them. You come to know that this practice is prevalent in other banks as payment of commission for getting long-term deposits is involved, which is paid by the prospective borrowers. **What would you do?**

You are the head of a big Branch having potential for a lot of retail business and have been instructed to push your life insurance and general insurance products of your Bank's Subsidiaries. Since the Life/General Insurance Companies have started paying good commission to the bank as well as the employees selling their products, and other banks are also pushing their products in a similar manner, you are thinking of instructing your marketing staff to sell life/general insurance products to all new borrowers, who approach the branch for availing Housing Loans.

Should you go ahead?

As the CEO of the bank-sponsored Mutual Fund, you are approached by a big time distributor with a proposal for getting direct investment of long-term large size funds from their clients, which includes PSUs/Private Sector/HNIs. They want a share in the management fee earned by you because they are required to spend money for getting the business. As SEBI Guidelines do not allow giving any commission for direct business, you express your inability to do so. Your Marketing Head tells you that the Company can enter into a marketing arrangement with the financial intermediary and that such practices are prevalent in the industry. You understand that this type of arrangement is just a paper arrangement and indirectly this payment could be a bribe. But, since you have continuous pressure from your Chairman to increase your profitability/ranking and would like to stay in the good books of the Chairman as your promotion is due, you are inclined to agree to this arrangement and obtain the Board's approval for the same. **Is it ethical?**

Different persons will react differently in these situations. But the fact remains that you go ahead in these situations at the cost of compromising your ethical and moral values.

The Environmental Pressure

Of late, the top and middle level positions in the Indian Banks have been facing the problem of increasing stress and work pressure. In fact, banking is among the top ten sectors, which are high stress zones as per a study conducted by ASSOCHAM. Although, the Reserve Bank of India in their Financial Stability Report issued in December, 2017 noted that the stress in the banking sector remains elevated, but appears to be bottoming out, it might take a long time before complete normalcy is restored.

Key factors resulting in Stress:

- **Timelines and Performance Targets:**

  The Banking Sector has strict timelines for reporting and completion of work and there is a huge cost of non-compliance in many areas. Recoveries of NPAs are giving nightmares to bankers.

- **Work Pressures & Remuneration Issues:**

  The workload remains high throughout the year and there is lack of staff in several cases. The remuneration is not reviewed and revised in line with the market realities.

- **Working Conditions:**

  The workplaces, though improved, are not so good at places, especially at smaller places.

- **The Competition:**

  You have stiff competition all the time to attract depositors and good clients for extending loans.

The above factors have a direct bearing on an employee's conduct. An employee who is not paid well or who perceives himself as being exploited/ underpaid will be more prone to unethical behaviour. A distraught employee can be easily waylaid from the moral path. If your competitors are indulging in unethical practices for increasing their business, their rankings and profits; it is highly probable that under pressure to perform, you will also fall prey to the same game and start indulging in the same tactics.

Importance of Ethics in Corporate Governance

Ethics is of paramount importance in an organisation and must flow from the top. This is aptly described in an old Sanskrit verse, part of which reads, 'Yatha Raja, Tatha Praja' meaning "As is the king, so are the subjects". In other words, people follow the example of leaders. As such, there are no two opinions about the fact that ethics has to be an integral part of corporate governance and has to be followed by one and all.

In banking and financial sector, at apex level, the Board of Directors face the pressure of maintaining neutrality, objectivity and integrity in the wake of business development needs. The Board Members

have to set the highest standards of morality and ethical behaviour themselves, before they expect the employees down the line to be honest and conduct themselves according to the code of conduct for employees laid down by the Board. The tendency to meet the requirements by the regulators only on paper should be discouraged and a zero tolerance policy in this regard should be encouraged. This is important from the risk management angle as also from the point of view of building confidence and trust among the investors, customers and other stakeholders in the organisation and the banking and finance sector.

Of late there have been several cases of unethical practices involving action by various regulatory authorities. The cases fall under the following categories:

(a) **Manipulation of financial markets by banks colluding to misprice benchmark rates like LIBOR and EURIBOR:** Several prominent banks in US and Europe manipulated Libor and Euribor, which are important benchmark rates for inter-bank borrowing. It has also been reported that these manipulations simply involved rogue traders from some of the specified banks, who did it for personal gains, and most probably without the knowledge of their own employers.

(b) **Inadequate underwriting and improper sales practices in the sub-prime mortgage market:** The sub-prime crisis started with poor underwriting practices. The whole process of sub-prime mortgages was too complicated and involved conversion of a risky home loan into an asset-backed security forming part of a collateralized debt obligation that was rated and sold to investors. It caused a crisis that spread across the globe.

(c) **Material non-disclosures:** Deliberately hiding facts cannot be justified and can prove to be highly detrimental to the interests of an organisation. For instance, in 2009, the US Securities and Exchange Commission charged executives of misleading investors about the company's liquidity, including failing to disclose that the company was forced to sell the majority of its multi-billion dollar mortgage-backed securities portfolio in April 2007 to meet pressing liquidity demands. The executives were also charged with suppressing the warning signs of the mortgage crisis and its impact on American Home Mortgage's business to the detriment of investors and the broader market.

(d) **Violation of national and international regulations:** These violations could include

1. Non-adherence to tax laws, which could be unintentional as well as intentional;
2. Non-compliance with foreign exchange regulations;
3. Violation of general laws of the land as also specific banking laws;
4. Going against anti-terrorism rules; and
5. Illegal involvement with counterparties under economic sanctions.

(e) **Unethical and unlawful credit card practices:** A variety of unethical and illegal practices have been rampant in the credit card industry like

1. Unfair, deceptive, or abusive acts or practices.
2. A credit scoring system that treats card applicants differently on the basis of age.
3. Unlawful fees charged to the existing cardholders.
4. Violation of reporting requirements
5. Harassment of cardholders for collection of dues
6. Luring credit card customers with add-on products
7. Billing for services not provided

(f) **Manipulation of foreign exchange market by rigging foreign exchange rates:** In the recent past, several banks have been penalised for rigging the foreign exchange markets. Banks resorted to formation of cartels and shared sensitive information relating to orders from clients to manipulate exchange rates. Traders have also been charged with fraud.

(g) **Mis-selling of financial products to retail customers and investors:** Unsuspecting customers and investors who are not financially aware are often the target of mis-selling of financial products, which could happen because of personal motives and the pressure to perform and increase profits. This has typically happened in case of

1. Subprime mortgage-backed securities
2. Payment protection insurance plans
3. Mutual Fund Products
4. Credit Cards

(h) **Compliance breaches in terms of corruption, taxes etc.:** Corruption is a highly unethical and immoral act and cannot be justified on any grounds. This has created problems for banks by resulting in the increase in non-performing assets as also huge losses by way of penalties at the hand of the regulators. Similarly, evasion of taxes by suppressing information could also result in loss to a bank.

(i) **Regulatory non-compliances:** Non-compliance with the instructions issued and various guidelines laid down by the regulators could be deliberate as also unintentional. For example, in India, this may cover non-adherence to various guidelines on

1. Customer identification and Anti Money Laundering
2. Assessment of Non-Performing Assets
3. Delayed reporting of security breaches
4. Sanctioning and renewal of advances
5. Investment transactions

The Road Ahead

The cost of unethical conduct and its implications could be huge and would involve financial costs (including penalties, fines, settlements, damages and legal costs) as also non-financial costs (including reputational loss, damage to the confidence in the financial system etc.). This needs to be avoided with suitable control mechanisms and changes in thought process and behaviour. Improvements in corporate governance, review of compensation structures, regular review of code of conduct and dissemination of information on conduct rules/expected standards of behaviour will go a long way in improving ethical behaviour. A preventive approach rather than a deterrent one is desirable.

The road to success may appear to be long and there may not be any short-cuts, but as Mahatma Gandhi said, "It is difficult, but not impossible, to conduct strictly honest business". We can safely conclude that in the long-term, if you are honest, persistent, creative and hard-working, you are bound to succeed. The Banking & Finance Industry, therefore, needs to work ethically and must have a strong and robust ethical culture at all levels. Needless to add, the standards of corporate governance also need to imbibe the highest possible culture of honesty, integrity and ethics. This is the only way forward for the banking and finance industry in the times to come.