

Compliance, Culture and Ethics in Banking after the Financial Crisis

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The concept of compliance (1)

- Why comply?
 - Reputation
 - Sense of moral duty
 - Fear of detection & punishment
 - How far to comply?
 - *Voluntary* compliance
 - *Enforcement-led* compliance
 - Rational calculators (probability of detection X sanction vs. cost of compliance)
 - Publicity and reputational effects
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Culture

- ❑ “the tacit understandings, habits, assumptions, routines and practices that constitute a repository of unarticulated source material from which more self-conscious thought and action emerges” (Vaughan 1998).
 - ❑ “Culture thus mediates between structure and agency, that is between formal compliance system and strategic action [by employees] ...” (Parker and Gilad 2011).
 - ❑ Dynamic and contingent.
 - ❑ *Firm* culture and *market* culture.
 - ❑ Can be understood also in a positive sense as *market discipline*.
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Ethics

Sources

- Fiduciary duties
- Regulatory rules (including principles e.g. TCF)
- Professional standards
- Codes of Ethics
- Individual moral standards

Integration into conduct/decision-making

- Personal autonomy/responsibility?
 - Product and process driven transactions
 - Proximity to customers
 - Complex hierarchy of sources (above)
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Integrating culture & ethics in the regulatory system: options

- Instrumental regulation (embed culture & ethics in rules)
 - A gap-filling role in the legal/regulatory framework
 - Fiduciary duty
 - Codes of Ethics
 - A compliance strategy (for firms)
 - *Voluntary compliance*
 - Role of reputational sanctions/market discipline
 - Beyond compliance?
 - Competitive advantage
 - CSR driven
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Culture, ethics and compliance

Involuntary
compliance

Culture and
ethics

*Voluntary
compliance*

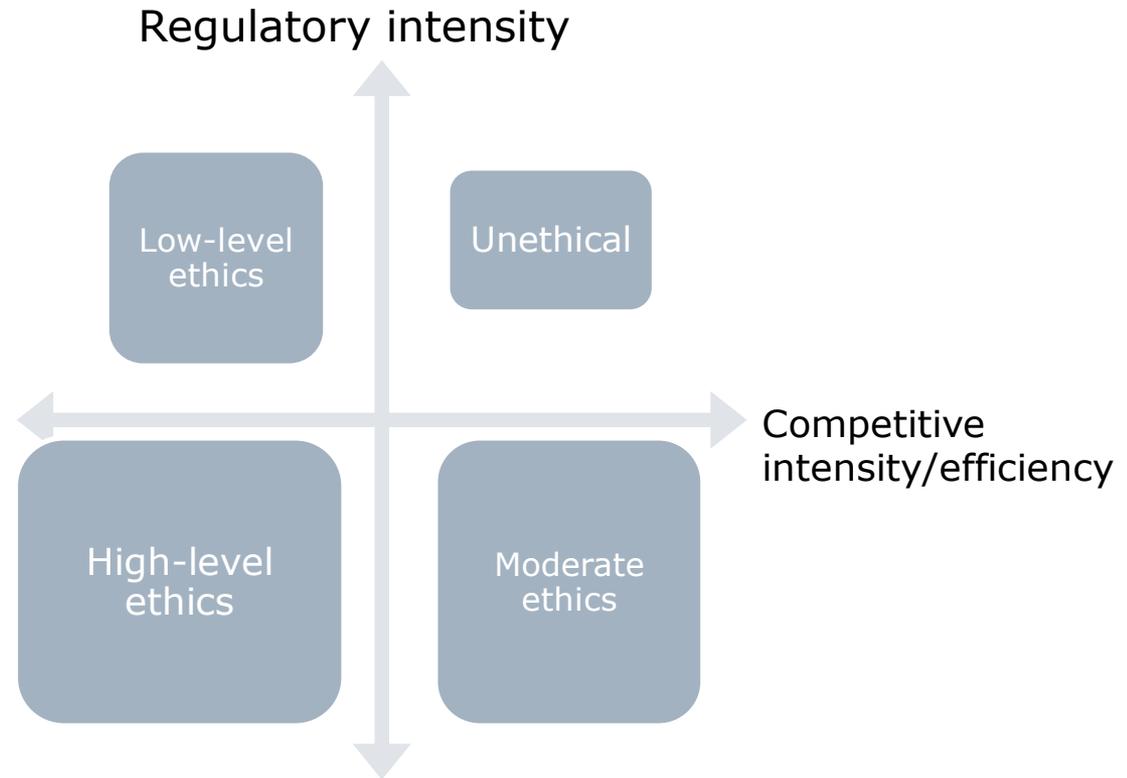
Enforcement (1) – the enforcement dilemma (Scholz 1984)

		REGULATOR'S ENFORCEMENT OPTIONS	
		Cooperation	Deterrence
FIRM'S COMPLIANCE STRATEGY	Comply	<i>Voluntary compliance</i>	Harassment
	Evade	Opportunism	Legalistic battles

Culture, ethics and competition

- If unethical conduct cuts costs or boosts rewards, others will follow/compete
 - A systemic dimension
 - Can unethical conduct be observed?
 - Regulator – difficult (beyond compliance)
 - Competitors - simpler
 - Increasing competition may induce an efficiency-driven downward spiral in ethical standards especially when:
 - Distance from ultimate investors exacerbates information asymmetry
 - Market transparency is poor
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Culture, ethics and competition (2) – a model



Conclusions

- We may be set on a path that does not promote culture & ethics:
 - Wrong integration options
 - Wrong balance of competition and regulation
 - Neither ethical codes nor embedding of culture and ethics in rules offer a solution
 - CSR, market discipline and reputational sanctions are better approaches
 - Investors/customers require greater choice between ethics and efficiency by reference to entity structure and governance (e.g. mutual ownership)
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