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DOES THE FINANCIAL SECTOR NEED AN ETHICS REBOOT?

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A plethora of examples of ethical lapses in the financial sector around the world demonstrate that regulation is not enough. There is a need to bring ethics back into financial discourse, culture, and practice.

Europe's largest bank, HSBC, was recently fined £ 10.5 million for mis-selling products to elderly customers and another £ 29.3 million in compensation to the particularly vulnerable among them. The bank's subsidiary was trusted by these elderly customers but it sold them unsuitable products breaching that trust. In Bangladesh, amongst the poorest of countries, micro-finance was actively peddled among poor villagers with teaser rates that eventually led to indebtedness on multiple counts and usurious rates of interest. Weekly payment schedules, naming, shaming and other pressure tactics led to many suicides, in the South Asian region as micro-finance spread like an epidemic during the last decade. These apparently good social entities that make huge profits now (up to 125% per annum in some countries in Latin America) have come to be described as the "new loan sharks". Nobel laureate Muhammad Yunus observed while addressing UN financial officials: "…we did not create micro credit to encourage new loan sharks". It is estimated the majority of micro credit in the world is being operated by ruthless banks with eyes on "big profits from tiny loans", as a title reads.

In April 2011, the Reserve Bank of India levied a penalty on 19 banks that include global majors, for selling derivative products inappropriately to trusting semi-literate clients. This decision was a result of prolonged struggle by small-scale knitwear and hosiery exporters in Tirupur, a town in Southern part of India. Many of them went bankrupt due to exotic foreign exchange derivatives they were lured into buying. These school drop-outs and cotton-farmers turned entrepreneurs were sold derivative products which contained mind spinning clauses such as, "The exporter buys (and the bank sells) USD Call / CHF Put at strike 1.2300 for USD4 million with Knock Out @ 1.2400; The exporter sells(and the bank sells) USD Call / CHF Call at strike 1.2300 for USD8 million with Knock Out @ 1.24, Knock in @1.12;" Double One touch option

TIDBITS:

INTERNATIONAL:

Φ Philip Armstrong, Head of Global Corporate Governance Forum, has been selected for the 2012 Marcos E. J. Bertin Quality in Governance Medal. Further, IFC's corporate governance unit manager Darrin Hartzler has been named one of the hundred most influential people in the board room and corporate governance community, by the National Association of Corporate Directors, as reported by the GCGF Bulletin.

Φ Through out America inc. there are fresh concerns on executive compensation and compensation to board directors, consequent to the regulations say-on-pay and the public ire at high compensations. There is tension in the bench-marking approach to compensation which is inherently flawed due to its upward bias. In the process, the relationship of compensation with performance is also getting disconnected. These dynamics are likely to impede recruitment of quality directors and are expected to be a difficult issue during the 2012 proxy season.

Φ The King-III report has created a new bench mark in South Africa since its release two years ago. Corporations are competitively progressing to meet the new standard especially in relation to managing and protecting the information assets.

Φ With a series of loan defaults and bad investment decisions coming to light in the with trigger 1.2270 and 1.2330 with pay off USD 50000 on maturity".

These individual episodes, indictments, penalties and scams around the world were never a worry for the mighty financial sector till recently, which remains towering in its influence across borders. But, the Wall Street protests following the North Atlantic and European crises have symbolized the growing mistrust of big banks in particular and the financial sector at large, especially in the developed world. It is at least providential, if not due to wise regulation as some would like to argue, that many important emerging market economies escaped this ignominy. The world-wide acclaim of the stinging judgement by Judge Jed Rakoff in October, 2011 – rejecting the proposed $285 million settlement between the SEC and Citigroup Inc. – is further evidence of the lost credibility of an important economic institution. The judgement underscored the cosy relations between the regulators and the big banks that some would call as misplaced regulatory forbearance, if not evident capture. The judgement concluded that the settlement appears to be a sop to the culprit in question with "small change"-sized levy without admitting to any guilt.

Despite some early attempts to disconnect the financial crises from the severe economic crisis that followed, many have realized that the economic, political and social turmoil across the world during 2008-2011 may have a common parent – the financial bubble that burst and exacerbated other tensions. The irresponsibility, greed and other human weaknesses that were stoked up, in the cause of free markets and in the hope that markets would discipline the participants, proved too expensive for the world. Entering the choppy waters of 2008, many began questioning the manner in which regulation was eased up in important economies during the last two decades - burning the fire walls between ordinary banks and investment banks, and creating a permissive environment for financial engineering that brought in much waffle. In most of the advanced economies, the sector that was meant to service the real sector began to grow for its own sake resulting in a massive jump in revenues and profits. Salaries of employees in this sector also overtook the real sector. Products out of financial innovations began gaining a life of their own leading to fictitious assets, prices and bonuses. So much so that Lord Adair Turner, Chairman of the Britain`s Financial Services Authority has reportedly commented that much of what happens in financial centres as "socially useless activity". Many now believe that the financial sector, which has been extracting rents from the real sector, should be seriously downsized.

Commenting on the financial leviathan in the USA, Bradford DeLong, says that there are no obvious benefits of either micro or macro level, to justify spending on extra 5.6% of GDP every year on finance and insurance, that has grown massively. He seems to conclude that the growth in finance is not necessarily due to a rising share of financial professionals that match people with risks with those who have the risk-bearing capacity. On the other hand, it could be due to unprofessional players matching risks with people who are clueless but have the money. This perspective is validated by the examples cited earlier and the penalties, even if eventually merely "small-change".

It is no wonder that the US Financial Crisis Inquiry Commission was informed by the Chairman of the Federal Reserve that while some financial innovations amplified risks, others facilitated unfair advantage rather than create a more efficient market. The public believes, at least since the 2008 crisis, that the financial sector has

GCC region, there is increased attention to corporate governance standards. For long, the Gulf region has been marked by family controls, relationship based subjective approaches, trust and informal authority based decisions. These functioned reasonably well in good times but the increased pressure on capital amidst global recession has brought to surface those "swimming naked". There is increased attention now to contracts, due diligence and corporate governance standards overall.

Φ Issues of corporate governance seem to have come to light in the inquiry set in motion at Cricket South Africa (CSA). An inquiry was ordered by the Minister of Sports into apparent financial irregularity that included huge bonus payment to the CEO and CFO that were kept secret from the remuneration committee.

Φ The banking regulator in Philippines has issued further corporate governance rules for banks to ensure sound banking practices and improve public confidence. It appears that the fresh circulars issued by the Central Bank would bring corporate governance standards closer to the OECD principles.

Φ The Corporate Governance Association of Turkey announced its awards based on the rating scores of Istanbul Stock Exchanges corporate governance index companies as of December 31st 2011. The Industrial Bank of Turkey scored the highest while the TAV Airports Holding came in second place.

Φ Tokyo Stock Exchange is expected to introduce new rules to strengthen corporate governance for listed companies in the coming months. Recent scandals such as Olympus corporation`s cover up may have prompted this move apart from the need to progress further in the standards. For instance, it is reported that only 35% of the listed companies on the first section of the Tokyo Stock Exchange have outside directors. The average is 1.8 for any given company.

Φ Australian Securities Exchange (ASX) has released a second edition of corporate governance principles and recommendations to facilitate compliance with the listing agreement.

Φ Corporate Governance has reportedly improved in the public listed companies of Malaysia over the last year. The score for the top 100 companies in the index was 66.9% - up by 1 percentage point. In respect of all 864 public listed companies the score increased from 55.6% in 2010 to 57.19%.

been rewired over the years to sin more than to add net value to the society. Such widespread dismal sentiment has affected the prospects of liberalization and planned reform in many emerging market economies.

In the UK and the USA the lack of sensitivity and the singular obsession for money was commented upon when bank chiefs paid themselves hefty salaries after symbolic restraint even as the financial entities were surviving on public financed bail-outs. Barclay's CEO, Bob Diamond, indeed asserted before the UK's Treasury Select Committee that the period of remorse and apology needs to be over and that business must go on as before. Leaders in the sector justified their salaries more on the basis of celebrities in soccer and Hollywood than teachers and nurses. Many refused to acknowledge the huge adverse impact on a generation of people and the social cost due to their greed and irresponsible actions that spawned the world-wide crises. It is no wonder that the Financial Crisis Inquiry Commission drew attention to the systemic breakdown in accountability and ethics – of an erosion of standards of responsibility and ethics stretching from the ground level right up to the corporate suites. This erosion in ethical standards was symbolised when only a fraction of management graduates from leading business schools (20 out of about 520 students in one case) were willing to sign the ethics pledge. Ironically, one Professor saw the bright side to this dismal situation saying that at least most of the students were honest enough to admit how they might carry themselves forward. Some consolation.

Such commitment to profits and career growth over ethics, such mindless remuneration that has no relationship with need or comparisons, such absence of sensitivity to growing social inequity and social costs of bail-outs is indeed appalling. The anger exhibited in social protests against the financial sector seem justified to many. Some wonder whether this sector has somehow conjured up conducive conditions for sociopaths to emerge as leaders – whether a behavioural distortion has been inadvertently injected into this sector during the last two decades. Lack of concern for others and absence of guilt are considered typical symptoms of sociopaths. Much evidence goes to show that some in this sector are nowhere near accepting the guilt but are working overtime to counter regulatory moves. They continue to socialize the cost of their irresponsibility and aggression irrespective of the implications to livelihoods of millions of the deprived.

It is possible that during the last two decades some people in this sector have developed insulation from ethical considerations. The remoteness of much of their work from the common people, the invisibility of services by nature, the futuristic nature of contracts and the opacity of transactions probably induces exclusivity. In the extreme, it could result in aloofness that may be seen in fighter bombers operating from great heights or those firing long range missiles. In the course of these two decades, some in this sector have subjected themselves rather innocuously, to an ethical bypass in the neuro-system.

It is apparent from the series of individual and institutional level episodes that the people involved in decision-making have probably kept a convenient frame of reference and the pay-off in mind than the standards inherent in their professions and the common perceptions of correctness. Thus, many examples show that professionally trained managers are prepared to compromise ethics to improve their performance rating, bonuses and corporate results. Regrettably, business schools and professional courses have emphasised the importance of competitive advantage and

Φ ISO has released new global records management standards, the ISO 30300: 2011 & ISO 30301: 2011, which offer a systematic approach to the creation and management of records that would strengthen corporate governance practice. These standards are expected to be compatible and complementary to management system standards such as those of quality management, environmental management and information security management.

Φ A report released by an international law firm (WSGR) reveals the patterns in corporate governance and disclosure practices of Venture backed firms in the US. They indicate significant efforts to improve the boards and their independence; the board committees; the board policies; stock plans; key metrics and non financial measures and the like. It validates other findings that companies preparing for an IPO keep corporate governance improvement as top priority.

Φ GMI has placed Japan 33rd among 38 countries in corporate governance rankings. Some believe that the risk management flows at TEPCO and cover up of loses at Olympus have led to a negative perception for the country. GMI rates it now behind Russia, China, Brazil and South Africa.

NATIONAL:

Φ SEBI has announced its plan to relax the equity market investment norms for insurance companies and mutual funds, waiving the six-month locking period while participating in preferential allotment of shares.

Φ ICSI's international jury selected Mr. Azim Premji for the Life-time Achievement Award 2011, which was conferred on him.

Φ The FII inflows have crossed the $2 billion mark in January 2012. This is reportedly the best month since November 2010 and against a $1 billion outflow in January 2011.

Φ IRDA has issued IPO regulation for Life insurance companies that have completed 10 years of operation which can increase the equity capital either through fresh issue or divestment of equity through public offer. They must get the approval of IRDA before applying to SEBI.

Φ The arrest of the directors and senior executives of the AMRI Hospital in Calcutta has brought to the center, the liabilities of success measured in financial terms. The media has indeed done its bit in its attention to the equity markets, the size of corporations and their wealth. For long, many business schools did not even assign credits for courses on ethics. There indeed appears no place for sessions on ethics in most of the executive development programmes. (A dip stick examination of about 100 executive development programmes with an average of 2500 sessions had only 10 sessions related to ethics.) International programmes on Corporate Governance for Directors deal with all else including sustainability issues, except ethical conduct and real-life dilemmas. These conditions of insulation from ethics and ethical considerations must be turned around quickly.

Professionals in the financial sector must bear in mind that most unethical actions are at the individual level and are of individual choice. Organisational expectations, group think, peer pressure may induce complacency and poor judgement in making choices. The first defence against ethical complacency is to build capacity among all to internalize ethical standards and know immediately when faced with a decision that includes an unethical choice. The next step would be the appreciation of the linkages between ethical conduct at work, quality of life, and their impact on the family.

A major correction is required to get the financial sector back to its role of serving the real economy and reaching out to all inclusively and ethically. To rebuild public confidence and reduce the massive trust-deficit, it is necessary to have a demonstrated, publicly announced and committed effort by a central think-tank or advocacy group. Such an effort may begin with a planned approach to installing an ethical compass in all employees and participants in the sector. Is The Seven Pillars Institute in the best position to initiate a policy dialogue on this and take it forward?

Please visit www.sevenpillarsinstitute.org (Kansas, USA) for access to"The Moral Cents – The Journal of Ethics and Finance for the full article including references.

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directors even if they are non-executive. The directors remain in custody and have been denied bail. There was a fire tragedy in this kolkata based corporate hospital in which 94 people died.

Φ The Corporate Affairs Minister has indicated the Government's plans to frame a national corporate governance policy.

Φ SEBI has imposed penalty on 17 entities for non-disclosures and fraudulent practices in dealing with the shares of Platinum Corporation.

Φ During the second half of the current fiscal year it is expected that 12 firms will announce major buy-backs through public announcements.

Φ SEBI has reportedly become active in penalizing non-compliance and legal transgressions in recent periods. Illustratively, it fined a former Independent Director at Ranbaxy and his wife for insider trading. SEBI has fined the promoters and executives of Jaiprakash associates for a similar offence. SEBI also pulled up the firm Anand Rathi as well as the compliance officer of Satyam on different counts.

Φ The OECD has prepared a report on related party transactions and minority shareholder rights covering thirty countries including India. India is one of the countries dealt with in-depth.

Φ SEBI sets up an international advisory board comprising of Prof. Viral Acharya, Ms. Jane Diplock, Prof. Mark Maletz, Prof. Maureen O`Hara, Prof. Arvind Panagariya and Dr. Andrew Sheng.

ACTIVITIES – 2011.

1. Address on ***Social Cost of Global Financial Crisis*** by Founder Trustee, organised by HMA - FACCI – ISTD – NIPM, Hyderabad, 25th February 2011.

2. Assistance by Founder Trustee as moderator for breakout session on India ***Asian Corporate Governance – The Future Steps*** at the ICGN's mid-year conference at Kaulalampur 28th Feb. to 2nd March 2011.

3. Presentations and discussions by Founder Trustee in the GCGF-DFRC project on ***Promoting on Policy Environment for Corporate Governance in the SADC Region***, Johannesburg, from 24th to 28th May 2011.

4. Assistance by Founder Trustee to the Royal Monetary Authority in ***Corporate Governance Training***, in a project supported by ADB, Thimpu, Bhutan, 30th May to 4th June 2011.

5. ACG – SCOPE's ***VII Programme on Corporate Governance*** for CEOs and Directors, Hyderabad 28th - 29th June 2011.

6. Address by Founder Trustee on ***Corporate Governance Practices in Emerging Market Economies: Trends and Implications*** at the first International Conference of CSIA, Shanghai, 22nd – 23rd September 2011.

7. Facilitation by the Founder Trustee in the DFRC–IOD, Zambia ***Programme on Corporate Governance relating to SOEs***, Lusaka, on 3rd to 5th October 2011.

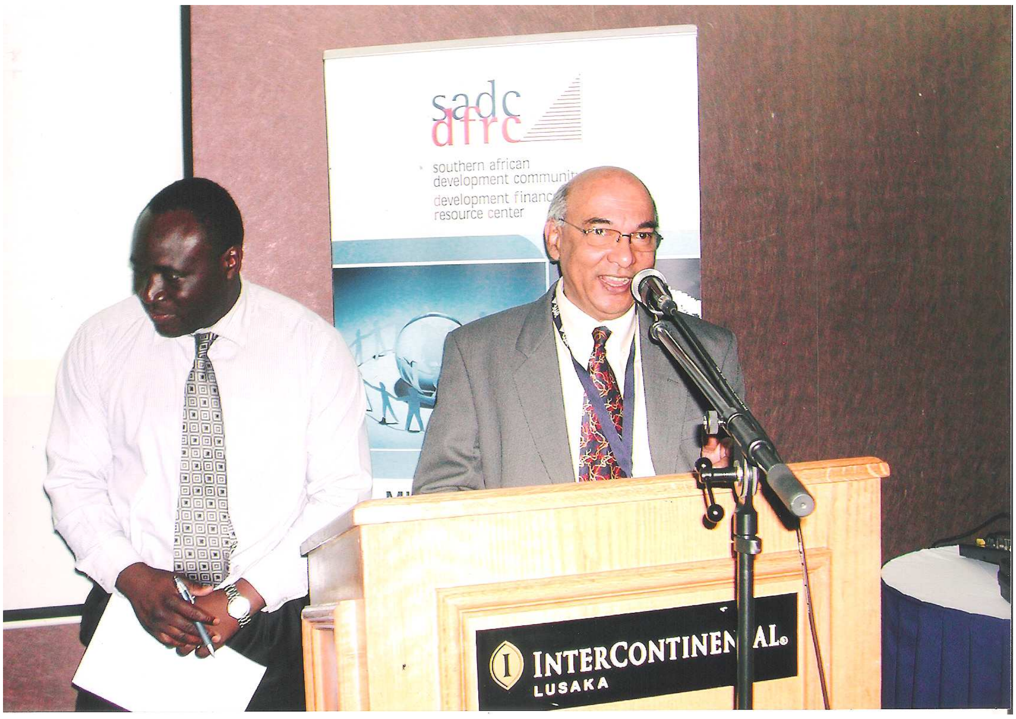
8. Participation by the Founder Trustee as member of the Jury for ***ICSI's Excellence in Corporate Governance Awards***, 12th November at New Delhi.

9 ACG – SCOPE's **VIII** ***Programme on Corporate Governance*** for CEOs and Directors, New Delhi, 14th to 15th December 2011.

10. Chairing / moderating the panel discussion on the eve of the Award Function of ICSI, on ***CSR & Diversity in Boards***, 23rd December 2011 at Hyderabad.

PHOTO GALLERY

Speakers at the session on "Non-western Corporate Governance Practices: The Emerging Model? At the 1st International Corporate Governance Conference of CSIA, Shanghai, 22nd September 2011.



Concluding session at the DFRC-IOD Zambia Programme on Corporate Governance for SOEs, Lusaka, 5th October 2011.

Inaugural session of the ACG–SCOPE VIII Programme on Corporate Governance for CPSE Boards, inaugurated by Mr. Ashok Chawla, Chairman, Competition Commission of India, along with Dr. Choubey, Director General, SCOPE, New Delhi, 14th December 2011.

Panel discussion on CSR / Board Diversity at the ICSI's Award ceremony function, 23rd December 2011.