MACRO FORCES THAT SUPPORT BAD BEHAVIOR

Much regulatory attention since the Financial Crisis has focused on specific examples of wrong-doing, such as mis-selling or benchmark-fixing. But standing back and looking at the bigger picture shows that there are larger, macro circumstances that help to spread Conduct Risk, like a virus, across entire industry sectors.

CORPORATE LONGEVITY

In cognitive terms, the world appears different if you're an employee looking out from inside the offices of a long-lived financial organization. One effect you'd notice is that the political clock outside ticks at a much faster rate. Here's what that means in practice. Cognitive research has already taught us that small animals have faster body-clocks than large ones: To a hummingbird, beating his wings 80 times a second, the world seems to move along terribly slowly. In contrast, to an investment banker whose firm has been around for a century, or longer, it's no big deal simply to wait out the four- or five-year term of the current government.

Working for a long-lived megabrand bank distorts employees' perceptions of what's significant in the rest of the world. This bias can quickly morph into a belief that regulation doesn't matter because governments can be viewed like buses – if this one isn't heading the way we want, we'll just wait for the next one. In practice, this means biding time by gaming compliance efforts and beefing up lobbying teams to stall proposed rule changes.

DEEP POCKETS

This is a game that can be played by any organization that has more capital and disposable cash than any sovereign government that's trying to regulate it.

A well-established business sector has more resources than its regulator. Corruption will occur when the industry takes advantage of this, finding ways to out-maneuver the regulator, exploiting its superior resources of cash, intellect, data and knowhow. It's a common recipe for 'regulatory capture'.

ABSTRACTION

Business products or activities are abstractions if they are one or more of the following: complex, physically remote, virtual, subcontracted, or secondary-traded (derivative). Cognitive research during 2014 showed that the more abstract a transaction is, the less impression it makes on the consumer. So a chip-and-pin credit card transaction 'hurts' much less than handing over cash. It is harder to regulate and protect consumers, as well as market integrity, if the products concerned are abstract. That's why, for example, consumer-goods watchdogs enjoy more immediate public support than financial regulators.

UNCHALLENGED

Some commercial sectors get an easy ride, competitively. There may be few challengers, and only unfocused criticism from consumers, politicians, or other businesses. If a sector's critics really want to change it, they need to pick on a social harm that's plainly defined, not too abstract, and easy to see. Financial services clearly don't offer easy targets for protest – products and spheres of operation are often difficult for consumers to understand, and the impact of wrongdoing can be difficult to illustrate. A good example of this is the credit crunch – very few of the social movements sparked by this have survived economic recovery.

TERRITORY-INDEPENDENT

Some businesses have no need to be located anywhere in particular. Rather as with the longevity effect above, this encourages employees to reason that "because we don't need to be in this country, we don't need to worry about its laws". Not being dependent on any one country for infrastructure, organizations can shop around – often for the cheapest labor and the lightest supervision. An aggressive Board can play this game, regulatory arbitrage, and play it hard.

GRANULAR REGULATION

It's a truism that the more the detail, the more the loopholes, but there is a deeper structural factor here too. Governments and regulators often argue that forcing an industry to provide more detailed information will create more opportunities to reveal and prosecute misconduct. There is no good research evidence that this succeeds, and plenty of evidence that it achieves the exact opposite: the regulator succeeds only in accruing such a vast pile of management information that they will never find enough staff time to analyze it. There's also an obvious designed-in paradox: the regulator is reliant on the industry to produce the management information he needs to determine whether to mount an enforcement action.

Read more about conduct risk at:
http://accelus.thomsonreuters.com/resources-listing/all/whitepaper-experttalk

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