INSIGHTS FROM
CFA SOCIETY SINGAPORE

By Kurt Schacht

In financial services, we don't trust

Changing that mindset is more attainable when it is a collaborative effort where each player demonstrates continuous integrity in practice and culture

Firms, practitioners, consumers and regulators should work together to improve trust. Efforts towards this could include competency certifications, improving financial literacy and regulatory deterrence. ILLUSTRATION: PIXABAY.COM

ONE of the most alarming findings of our global survey on the impact of the coronavirus on the capital markets – and there were many – was the threat the coronavirus posed for ethical lapses in the investment management industry. Globally, 45 per cent of those surveyed felt financial hardships in the financial industry will result in unethical actions on the part of its professionals was likely or very likely. There were some regional differences, with the fear highest in North America, and the lowest in Latin America.

Unfortunately, this should come as no surprise. The financial services industry has put on an endless parade of scandals that have to lead to distrust of its institutions and practitioners. Taxpayer-funded bailouts, Bernie Madoff's Ponzi scheme, bogus credit ratings, Libor rate-rigging, money laundering, racial discrimination, the unauthorised sale of products, among many, many other missteps, are milestones of an ugly past.

With the Great Financial Crisis nearly a decade gone, things seemed to be settling down. But controversy has risen once again, this time whether financial services firms are receiving and meting out preferential treatment under the new Covid support programmes. At the moment, this looks bad, but as time goes on, this transgression will simply take its place in the long line of missteps, soon to be joined by other ethical lapses.

Perhaps the bigger question is: Will the financial services industry ever build durable trust? Many of our colleagues, members, and peers have resigned themselves to the belief that all of finance will get tarred with constant media stories about financial fraud and Wall Street privilege. Said differently, the bad apples are spoiling the entire barrel, leaving a hard-to-shake perception the entire industry is crooked.

This perception is reinforced by the annual Edelman public opinion survey on trust. Trust in the finance industry ranks dead last among the industries covered and it's been there for the last eight years running. While negative media exposure explains, maybe, some of the perceived challenges of financial services, the industry can't possibly be satisfied with permanent residency in the Hall of Shame for the ethically challenged. This ranking comes from the Edelman Trust Barometer 2020.

Our own CFA/Greenwich trust survey provides a glimmer of hope regarding trust perceptions. Investor respondents to that survey, who are generally more knowledgeable about financial services than general public opinion polls, see the finance industry holding steady for 2020 and in the middle of the pack among other industries in terms of trustworthiness. Finance comes in ahead of government and media but below professions like technology and medicine.

Durable trust

There is no magic bullet for building trust. But the finance industry must avoid using the "we never will be" excuse for inaction or to rationalise its abysmal trust ratings. Trust is not a restorative process, nor is it an end state. Trust is a process where industry constituents demonstrate continuous integrity in practice and culture. We offer three paths that can work in concert to demonstrate just that.

For firms and practitioners

Industry practitioners need to train, plan, communicate, and constantly display actions of integrity, not lip service. It may sound obvious, but firms get very complacent and self-satisfied that they have all the compliance bells and whistles in place, only to end up scrambling when an ethics crisis hits. We tend to think we are already ethical, it's the other guy that has the problems. Steps to take include a more proactive adoption of improved professional codes and standards. These bolster trust with regulators and customers. Putting the customer first and acting in a client's best interest are not just slogans but the process and cultural imperatives. This holds true for any provider of financial services. You must stay ahead of emerging ethical challenges as markets, products and technology change.

For retail and institutional consumers

This is a moment for consumers of financial services to be better educated, ditch untrustworthy providers, and use their bargaining power. Working through professional organisations like the Council of Institutional Investors and others, "lead-dog" asset owners must insist on trustworthy services. Many institutional investors don't and they put up with firms that have lousy compliance records, charge excessive fees and costs, and offer investment terms that do not protect the investor. They accept conflicts and unfair terms simply to get a deal allocation. Collective action by these investors demanding fairness is a movement whose time has come.

Importantly, retail investors too must up their game on financial literacy. For example, knowing that fiduciary investment advisers work for the client, versus brokers who are selling products for the brokerage firm is crucial to understanding relationship loyalties, revealing conflicts and reducing mis-selling by brokers.

Finally, collective client action to sack unethical firms is a must. Abandoning unethical firms *en masse* when their misdeeds are revealed will force ethical discipline. There is nothing like the outflow of AUM (assets under management) to get a firm refocused on the "process and culture imperative". And it will force the same at other firms.

For regulators

One of the most powerful drivers of trustworthy behaviour at financial firms is consequence-driven enforcement. This is increasingly important in the context of today's rapidly evolving products, markets, and financial technologies. Effective enforcement requires clear regulations, proper monitoring, and consistent application of sanctions. Improved use of technology is vital to proper surveillance and will guard against industry firms being three steps ahead of our regulatory overseers. Congress, regulators, and enforcement officials at all levels must help ensure public confidence and trust in the financial industry. In short, prompt enforcement based on effective regulations that penalise and deter wrongdoing is critical.

A durable trust in the financial industry requires effort and focus by several players. It is far more attainable when it is a collaborative effort where each player is doing their part to advance what we have identified as the process and culture imperatives. Courses in ethics training, competency certifications, financial literacy, financial firm culture, regulatory deterrence and professional codes and standards are all part of making the players' paths converge. We can fix this, or we can continue to dwell in the Hall of Shame.

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