Can You Still Hear the Canary?[1]

The Role of Compliance

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VP, Compliance Officer
Zurich Insurance Company Ltd (Canadian Branch)

* All opinions represented in this case are personal and belong solely to the author. Any such opinions do not necessarily represent the views of the author's employer or any other persons, institutions or organizations with whom the author may be associated.

Ethical Leadership Case Study Collection Case Number 019-001
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[1] In earlier days, legend has it that miners would bring a caged canary into the mines with them. As canaries can detect small concentrations of gas and react instinctively, miners knew the air levels in the mine were safe as long as the canary kept singing. The canary, when it stops singing, has become a signal of bad things coming.

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Introduction

Ithaka Nisyros is ATTRAM Bank's newly-promoted chief compliance officer. During her ten years with the bank working exclusively in compliance, she has worked hard to ensure it remains in the forefront of compliance governance. She is gratified that her commitment has been recognized with a promotion to the most senior role in the function. A mere six months into her new job, however, she begins to think that one has to be careful what one wishes for! An alarming rise in complaints from retail banking customers about alleged unethical behaviour highlights just how serious and potentially damaging is the disconnect between the espoused values of the bank and its sales culture. She reports to the general counsel and the Board Audit Committee. They pressure her for an immediate response to customer complaints and the resulting intervention from the banking regulator. If something is not done to stem the tide of compliance issues it will only be a matter of time before the bank's practices become a target on social media or the focus of an investigative journalist. Her bosses' sense of urgency is significantly elevated as the bank has just announced a large retail-banking acquisition, which, up to now, has received a positive response in the markets. If the issues of compliance within sales go viral, the markets will question ATTRAM's leadership and their ability to successfully manage the acquisition. Ithaka realizes that this is now a trial by fire and her future depends on how well she can devise and implement solutions.

ATTRAM Bank

ATTRAM is a global bank with retail, corporate and asset management operations in over 60 countries spanning five continents. The bank's reputation is based on strong values, and it puts ethical behaviour, trust, and customer satisfaction at the center of everything it does. The bank's executives never miss an opportunity to talk about the importance of doing business the right way and of putting customers' needs first. These commitments are deeply embedded in the corporate culture and reflected in the bank's Code of Conduct. All employees are required to attest to their adherence to those principles annually. Further, the bank has been a global leader for establishing ethics line reporting, enabling employees to report compliance irregularities anonymously well before the requirements of the Sarbanes-Oxley Act.

At the same time, ATTRAM Bank is known for its ambitious sales culture. The bank is ahead of its peers in terms of the sales technology it uses. Early on, it invested in digitalization and sophisticated data-management capabilities. The bank possesses a lot of sensitive customer data, and it is getting more sophisticated in leveraging that advantage. In support of global growth plans, and in light of the enhanced data capabilities, goals for cross-selling per account (for example, selling credit cards to mortgage clients) are set above the industry average in each operating country unit. However, there has never been a formal discussion of whether this is in line with the bank's risk appetite. In fact, the bank's credo for the last 100 years had been that selling is the essence of every business line.

Ithaka Nisyros's Experience

Most of Ithaka's tenure with ATTRAM Bank has focused on managing risk and updating compliance procedures in the corporate and asset-management businesses of the bank. This focus followed the international financial debacles caused by sub-prime real estate instruments in 2008. The collapse of Lehman Brothers and the troubles of other financial services institutions such as Wells Fargo taught other financial institutions crucial lessons about the importance of paying attention to the signals provided by an organization's risk-management and compliance processes. Ithaka had provided very central leadership in making constructive change in the aftermath of the sub-prime meltdown, which accounts for the respect the CEO and the board now accord her.

Ithaka had direct involvement with retail banking in an earlier part of her career, as a junior compliance officer with another financial-services organization. While that experience made her aware of key elements of the retail business, since then dramatic advances in technology have increased potential risks dramatically. Not only do retail employees have access to customer information in more ways than they ever have before, social media increases exponentially the threat that compliance shortcomings or data breaches in the bank can have if they go viral before being effectively addressed. Compliance, more than ever, needs to get out ahead of issues.

In her new position as the chief compliance officer for the bank, Ithaka has global responsibilities across all of the bank's business units. It has been a steep learning curve, one that has required her to develop a multi-centric view of risks, a holistic understanding of different compliance cultures, and an appreciation for the varying regulatory approaches across the globe. Just as coal miners once depended on canaries singing as a signal that toxic gases were not present, the bank has relied on its ethical code and compliance systems to avoid trouble.

But while Ithaka's entire career in compliance has given her considerable experience in that discipline, she is not really skilled in understanding the retail side's business imperatives. Although she is aware of the bank's strong desire to control operating budgets and to push hard with sales growth, her knowledge is second-hand, even anecdotal.

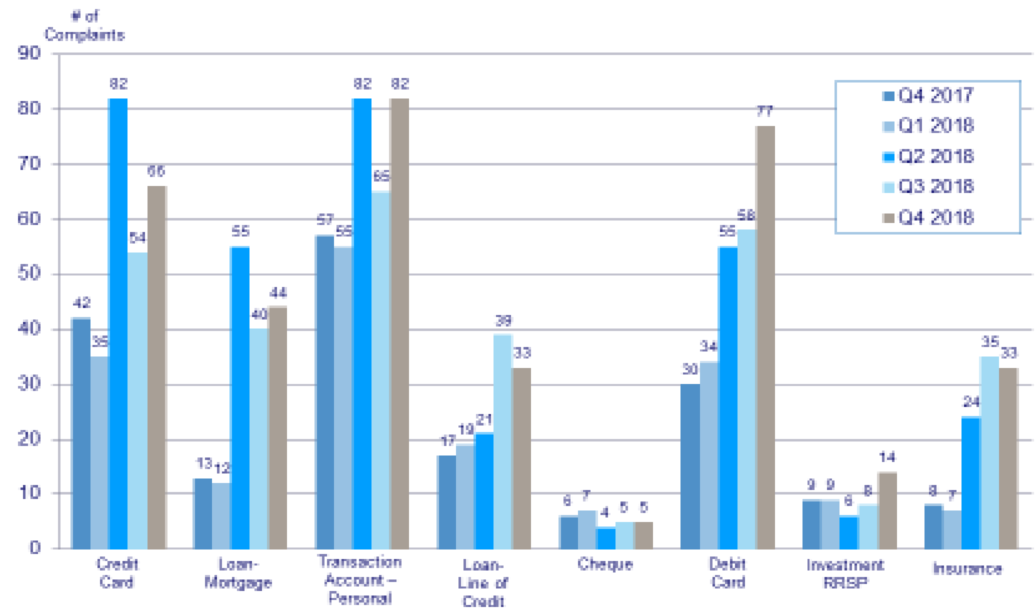
Ithaka's View of the ATTRAM Bank's Compliance Readiness

Now that Ithaka is in her new role, she is grateful that the CEO stands behind the bank's values and Code of Conduct. But there is always the potential for conflict in retail banking between the values-driven culture, on the one hand, and the aggressive sales culture, on the other. Last year, for instance, a departing employee reported directly to the CEO that parts of the sales teams in several jurisdictions are engaging in fraudulent activity. Moreover, compliance testing teams in several country units have continually reported irregularities in customer documentation. These issues have always been minimized. In the case of the complaint to the CEO made by the departing employee, for example, it was put down to sour grapes.

Based on her past, admittedly dated, retail banking experience, Ithaka's first response is that customer complaints in the retail banking business are one of the few compliance risks that are still largely a local matter. This view is confirmed by the bank's ombudsman, whom she trusts completely. The ombudsman initially declared that individual complaints appear to be "one-offs," a result of misconduct on the part of a small handful of employees. A recent onsite examination, by the regulator, of the complaints-handling framework was wrapped up without any negative findings. Follow-up activities, Ithaka therefore concludes, can safely be left with the HR Department and the sales managers affected.

But since last year, the ombudsman has noticed an increase in customer complaints about employees' tinkering with customer profiles without client consent, allowing for the escalation of cross-selling of credit card options, mortgages and insurance. Ithaka prepares Graph 1 to illustrate her findings.

GRAPH 1: CUSTOMER COMPLAINTS TRENDS



The chart shows that, in every area except the issuance of paper cheques, the number of complaints has significantly escalated in the last three quarters compared to the previous two quarters. This suggests a growing pattern of breaches of consumer accounts and an erosion of the company's Code of Conduct.

Ithaka Begins to Connect the Dots

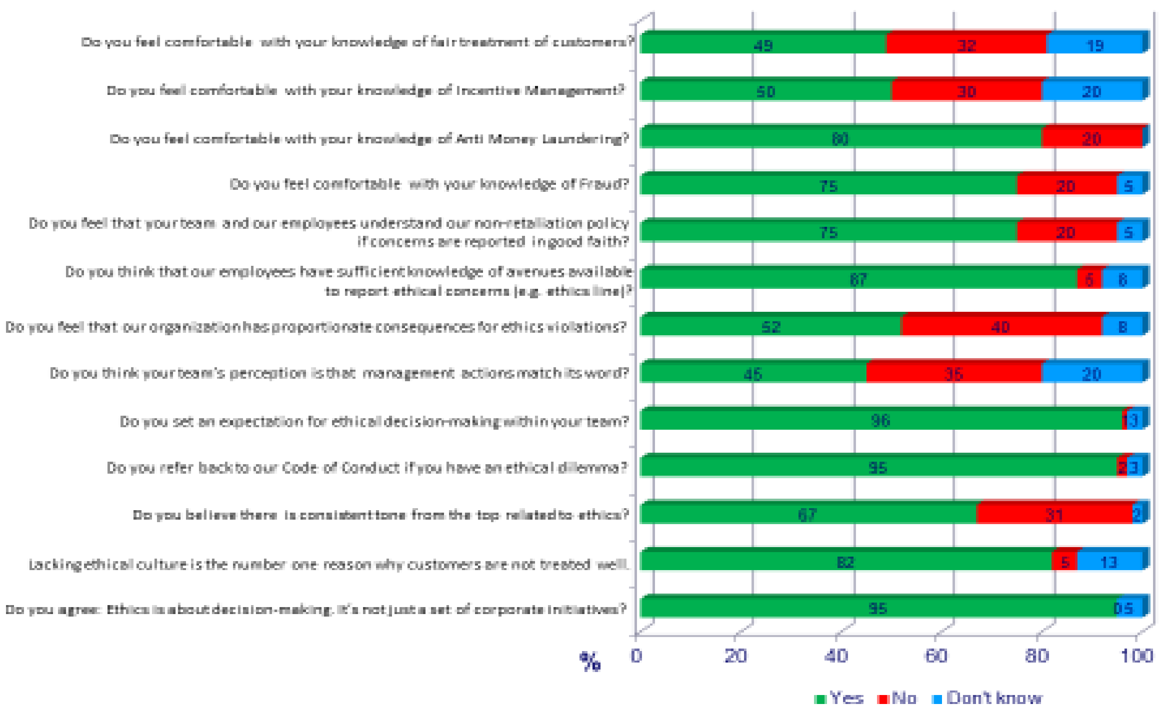
With a little detective work, Ithaka uncovers buried reports from several country units that begin to explain in more detail the specifics behind the rise in customer complaints. At the same time, she contacts the HR leaders in each of the country units facing a rise in customer complaints for an in-depth discussion about the sales cultures in their regions, the orientation of sales leaders, and any people issues that have come to light. Significantly, she discovers that several people dismissed for target failure allege that it is impossible to meet sales targets if one follows the Code of Conduct. The code is supposed to ensure that clients are fully informed and fully consent to all financial services and products provided. These dismissed employees also complain that sales leaders turn a blind eye to unethical sales tactics, explaining that, relative to the whole, few clients actually make official complaints. With this connection between customer and employee complaints, Ithaka is able to see that there is significant moral laxness in the organization. The data suggest that this is now a battle worth engaging in, on a global scale.

All this evidence underscores that the bank's local, regional and global compliance reporting and oversight are not what they need to be, particularly in light of the increase in customer data now available to each sales person. The compliance system is not metrics-driven, and is unable to do trend and root-cause analyses. Unless this changes, Ithaka must rely heavily on the willingness of her individual direct reports to share information, and they in turn need to be fully informed by other employees in other functions—a process bound to be cumbersome, incomplete, and, in the worst cases, fraught with mistrust and conflicts of interest. Is the canary about to stop singing?

Ithaka's Next Steps and the Bank's Reaction

In light of regulatory expectations locally and globally, as well as the reported increase in incidents related to sales integrity, Ithaka is well aware that there needs to be a better alignment of the sales culture with ethics. With a large consulting company's assistance, her predecessor had initiated a questionnaire targeting all managers globally. This was aimed at assessing the current status of managers' ethical awareness and creating a benchmark for the future. But in the wake of rigorous cost-cutting exercises at ATTRAM in the past year, Ithaka needed to cut back all consulting expenses, meaning the questionnaire results were never analyzed in depth, and the project resulted in no action being taken. Now, Ithaka spends several days analyzing thousands of responses on her own. She presents the high-level results to the Board Audit Committee, as shown in Graph 2. She is deflated when the Committee does not ask a single question following her presentation. They are pre-occupied with other matters and still convinced that local cultures can take care of the matter.

GRAPH 2: MANAGERS' ETHICAL AWARENESS



As there seems to be a limited appetite for a global initiative, Ithaka then focuses her control review on retail banking in Canada, thinking that success here might lead to a global commitment. At the Canadian unit, she requests an increase in general ethics training and updated sales manuals to reflect the bank's values and ethical decision-making framework. She also sends an informal email to local units requesting that they carry out an assessment of their existing sales controls and she suggests that the HR Department proceed with some modifications to the company's incentive-payment structures. The Global HR head is grateful for Ithaka's recommendations. Having received the global KPIs earlier that month showing a peak in HR interventions and involuntary employee departures in sales, the HR head feels that this is an area requiring his full attention.

Given the interest taken by the Global HR head, the members of the Board of Directors' Audit Committee do ask Ithaka a lot of questions, at the next board meeting, about her comfort level with the information available from regions and countries. She is pleased that the conversation has begun, but is far from convinced that there is a willingness to take action.

An Historic Week for the Hundred-Year-Old Bank

Ithaka quickly finds out that, in part at least, the lack of priority being given to the bank's compliance process is due to a pending acquisition occupying the board and senior executives. The prior week has been one of the most successful in the 100-year history of ATTRAM Bank. On Tuesday, a Latin American expansion plan accelerated with a formal offer by the bank to buy the Brazil-based Banco do AN, which operates in seven countries across Latin America. This transaction roughly triples ATTRAM Bank's market share in Latin America, and creates the strongest non-state owned bank in four core markets: Brazil, Chile, Peru and Uruguay.

The bank's strongest-ever annual results are announced the following day. When asked by investors about the continued success, ATTRAM Bank's CEO emphasizes the importance of the bank's response to evolving customer needs, and the benefits of its strong value-based brand, in particular for U.S. and European expansions. The stock market, the board is pleased to note, has reacted positively to these messages.

As she raises a glass in celebration with her colleagues, Ithaka cannot help but wonder why the bank does not see that the lack of a good compliance reporting system will inevitably create public issues for the bank, particularly now that there is more exposure in South America, an area notorious for its record of lagging behind Northern American compliance standards. Given the CEO's bold statements to the marketplace lauding the company's values, the possibility of customer complaints going viral escalates significantly, putting the company's leadership and their credibility on the line.

The Canary's Song Becomes Harder to Hear

As if to make her point, while Ithaka is reflecting on the work before her and her team, ATTRAM's general counsel arrives at her office, looking alarmed. He has just been notified of several ethics hotline reports alleging fraudulent internal activity related to customer accounts like those shown in Graph 3. As a result of regulators' ongoing scrutiny of sales practices and the heightened risk of onsite examinations, the general counsel is seeing red flags everywhere. The dangers to the bank are manifold. If sales compliance issues go viral, the market will be skeptical of the bank's leadership and capability in managing the Latin American acquisition. The general counsel issues a challenge to Ithaka: "What do you propose to do about it? I expect your answer ASAP!"

Graph 3: Ethics Hotline Examples

Reporter: Anonymous
Category: Business Integrity
Allegation: The reporter's team created email addresses to authenticate customer accounts

Reporter: Anonymous
Category: Business Integrity
Allegation: The reporter's direct manager advised the team to have inconsistent approaches for managing customer documentation

Reporter: Anonymous
Category: HR, Diversity and Workplace Respect
Allegation: The reporter's manager promoted an employee who was caught falsifying customer information

Questions

1. How did there end up being a disconnect between the values advertised by ATTRAM Bank and those practiced within the company?

2. What was the main reason why the training, frameworks, and controls in place were not sufficient to prevent these issues from arising?

3. Why did the magnitude of the situation not become clear earlier?

4. What is your assessment of Ithaka's responses over time? Could she have taken steps earlier to prevent this all from happening? What did she do well? What could she have done differently?

5. Why did the board and management seem to be out of the loop? What do you think about how shareholders should react?

6. How would you go about designing a sales culture that would be better aligned with the bank's advertised values?

7. What could the consequences of this situation be for ATTRAM Bank and for the individuals involved?

8. Who among the key stakeholders would have an interest in correcting the situation and who might not?

9. What recommendations should Ithaka now make to the board?