Celent: Stop gaming the system

By Editor Test *Thu, Nov 8, 2012*

Between 5% and 10% of the population of some developing countries may have gone back into poverty due to the economic effect of the 2007-2008 financial crisis in those countries, a Celent analyst wrote.

A new report from Celent, the global research firm, uses unusually blunt language in calling for more probity in financial services, saying that "the global economy is not set up simply for the financial industry to benefit from, and if necessary, sacrifice."

The October 31 report, *Malpractice in Capital Markets: Changing the Organizational Blueprint*, by Celent's Anshuman Jaswal, adds that, "If anything, it is the industry that is set up for the economy to meet its requirements and goals. The service-centered focus of the financial markets has to be restored. This is something that has been lost in the last few decades."
The report found that:

- **"The events leading to the financial crisis were not outlying occurrences."** It was believed that the global financial crisis was caused in part by the repeal of the Glass-Steagall Act and the resulting tendency on part of large financial conglomerates to engage in high levels of speculation using complex derivatives. But the Libor-rigging case and similar instances show that there have been ongoing instances of market manipulation in the last couple of decades and the events leading to the financial crisis were not outlying occurrences.
- **"The systemic occurrence of market manipulation have negated the earlier idea that… corruption was only at the large corporate level and did not affect the layperson as much."** The recent case filed in New York by a group of US homeowners against the Libor-fixing banks possibly illustrates how the systemic corruption actually affected people in all parts of the society and was not confined to just one part of the economy or one country.
- **"A siloed approach for encouraging ethical employee behavior" may be to blame.** If firms want to incentivize ethical behavior, they have to make it an essential part of employee induction and training and also remunerative practices. Trading firms should create proper safeguards to ensure employees know what the limits of risk-taking are.
- **Organizational malpractices shouldn't "compromise the very economies firms are a part of."** Financial market participants have been making efforts in this area, but these have focused on fire-fighting and preparing for upcoming regulatory requirements.
- **The argument for a zero tolerance policy has its roots in the grassroots support for action against financial institutions in the leading global economies,** especially in the US and Europe. The Occupy movement in the US and the Spanish Indignants movement show the general public's displeasure at the way the financial crisis came about and was dealt with.
- **"The global repercussions have been severe."** Even though the crisis unfolded in a select band of developed nations, 5% and 10% of the population of some developing countries may have gone back into poverty due to the economic effect of the crisis in those countries. Growth rates for China and

India have still not recovered and are following a lower trajectory.

- **The crisis undid the good work of the previous two decades in a number of the poorer countries around the world** and made the situation more difficult for citizens of the US and the nations in the European Union.

- **Further changes have been recommended,** including looking at the size of financial institutions worldwide. Accountability and transparency can suffer when an institution is very large. If banks and other large financial institutions were smaller, regulators could monitor them more efficiently. But this is not a simple trade-off and requires further research.

- **"The financial industry needs to change its psychological blueprint,"** and prevent overwhelming domination by certain groups of individuals, perhaps by hiring different types of individuals and reviewing the places or institutions they are hired from.

- **Firms have to put checks and balances in place to encourage and incentivize healthy practices.** Self-regulation by organizations must go beyond normal risk mitigation. The industry needs to understand the impact that malpractice and corruption have on not-so-obvious stakeholders and society at large.