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Good morning, ladies and gentlemen,

It's a privilege for me to address you today, thank you very much to the leadership of BASA for the invitation.

I have been asked to talk about the role of regulation and enforcement in ensuring ethical conduct, and to offer a regulator's perspective on the importance of ethics in banking.

It's such a great topic I couldn't resist. The topic of ethics and ethical leadership is of great strategic relevance, not just for the banking sector, I think it's quite relevant for where we find ourselves as a nation, and where we need to go as a country in terms of our development trajectory. Indeed, it is also a central theme, for many of the vexed questions that the world is grappling with today. Whether one is talking about the major conflicts we have around the world, the levels of poverty, challenges around trade, human rights, climate change, technological advancement, etc. It is simply not possible to design or deliver any sustainable solution to these intricate challenges without first establishing where we stand as a society with respect to the question of ethics and values. So it is quite apt to be discussing this topic here.

I do think that over time as well, the place that ethics occupies in strategic conversations within the sector has changed – definitely for the better. Given the central role that banking plays in the economy, and the societal costs of bank failures, it becomes so much more important, for this sector to appreciate the impact of ethics in your day-to-day work. There are important lessons from economic history, and particularly the history of financial crises – which point to the fact that ethical shortcomings in the banking sector, result in significant economic costs and disruptions in terms of societal progress. In their seminal work on the impact of financial crises[1], Carmen Reinhart and Ken Rogoff estimate that it takes countries on average, 8 years to recover from financial crises, in terms of the time it takes to reach their pre-crisis income levels. That's a huge cost.

[1] This Time Is Different: Eight Centuries of Financial Folly, 2009

So, to make an obvious point, this is not just a question of strategic importance for the sector, it's an existential question for the financial system as a whole.

Background and context

If one thinks back to the 2008 global financial crisis – at the core of that crisis was excessive risk taking, poor judgment, conflicts of interest, opaque transaction disclosures, inappropriate incentives and dubious ethical underpinnings of certain business models. It was a big wake-up call, and an expensive example of what can happen when ethical considerations are sidelined in critical decision-making processes and are overridden by a narrow focus and rush for profits not properly anchored on an appreciation of what is good and right for the whole system.

Indeed, the world spent the better part of a decade, correcting for and recovering from those failings in order to make the financial system stronger, to prevent these failings from taking place in the first place and to better internalize the costs of bank failures when they do occur. In that crisis, the costs of failure were socialized because that's what government bailouts meant, and there was the too big to fail problem. We are now more confident that the current design of the system in terms of bank resolution frameworks, higher levels of bank capital, the introduction of deposit insurance, stronger conduct regulation and enforcement will all serve to lessen both the likelihood and the cost of the next financial crisis.

Drawing from these lessons, this morning I want to talk about the role of incentives in shaping ethical behavior, consider the role of governance and ethical leadership in ensuring good governance outcomes, reflect on some of the ethical challenges from emerging technologies, and look at the contribution of regulators in fostering an ethical culture in the banking sector.

Governance and the importance of ethical leadership

Like most things which are essential for the sustainability of a business, ethics require championing right from the top. Everything turns on leadership! Ethical leadership is crucial to help foster trust in and strengthen the integrity of the banking sector. When leaders fail to set a strong ethical example, it can lead to a culture where unethical behavior is not only tolerated but might also be implicitly encouraged. This is more than just setting the tone, it is walking the walk and staying the course.

Without strong ethical leadership, organisations risk damaging their reputation, losing revenue, and undermining the ability to attract and retain talent, threatening their very sustainability. The ripple effects of unethical leadership can be far-reaching as highlighted in the many examples of unethical behavior by leaders. It is critical for current and future leaders in the banking sector to prioritize ethical considerations in their decision-making processes. Leaders must be proactive in educating themselves and their teams about ethical issues, setting clear expectations for ethical behavior, and holding everyone accountable when those standards are not met.

Boards play a particularly crucial role here – in providing much needed independent oversight, rigorous and well-informed challenge to executive decisions in order to improve overall governance outcomes for the organisation. So Board composition is a critical element to get right in ensuring good ethical outcomes from a governance perspective.

There are many examples of the cost of inadequate and/or unethical governance, we have had our share of governance failings in the South African corporate sector including in the banking sector. It was a confluence of factors which led to the demise of VBS Mutual Bank ("VBS"), but at the core of it – were governance failures. It was leadership failing to meet the standard of ethical leadership required for an institution whose business it is to take deposits from the public and keep them safely. The result, billions of rands *stolen*, causing the bank to collapse and depositors, many of whom were vulnerable individuals and entities, losing some of their had earned savings. The scandal also highlighted the critical role of independent assurance providers in enhancing the moral capital of the sector and their failure in that case to contribute to a culture of integrity within the financial institution to prevent such a catastrophic failure.

Another popular South African example is the failure of Steinhoff, an outstanding illustration of the failure of the value chain of governance, where large scale multi-year fraud and financial misrepresentation was carried on by the most senior executives in the company completely undetected. Obviously not directly related to banking, but the example does carry profound implications for corporate governance and ethical standards across industries. It emphasises the importance of stringent internal controls, again the role of auditors, transparent financial reporting, and clearly a poor culture of ethical accountability which was absent within the organisation. It illustrated the far-reaching effects of corruption, fraud and misconduct, impacting not only investors and employees but also ordinary individuals, as evidenced by significant losses incurred by pension funds invested in Steinhoff, including the SA Government Employees Pension Fund.

The role of incentives

Let me turn to something fundamental in terms of how we should think about ethical behavior, which is the role of incentives in fostering appropriate or generally acceptable conduct. The banking sector is a microcosm of society. As such, the general behavior of the sector is in many ways a direct derivative of the society it serves and in which it operates. It is societal behavioral expectations, what society recognizes, celebrates and rewards, that eventually drive institutional behavior. These societal norms, then inform how institutions design and implement incentives which drive individual behavior in firms.

Correctly, and with this understanding, one of the key components of the G20 reform agenda responding to the global financial crisis was a focus on the design and implementation of compensation frameworks in the financial sector. This resulted in the publication of the FSB Principles for Sound Compensation Practices and their Implementation Standards (“the Principles & Standards). Essentially those reforms were targeted at ensuring that incentives in the financial sector (described to include the banking, insurance and asset management industries) strike a healthy balance between risk-taking, institutional sustainability and accountability especially at senior leadership level. The reforms included the introduction of requirements for deferrals of variable compensation, malus and clawbacks in order to encourage a longer-term view of risk and balance individual incentives with institutional sustainability. The Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO) were mandated to ensure prompt implementation of these standards.

Admittedly, many financial institutions in South Africa have adopted some of the key elements of these responsible compensation approaches as part of good governance practices, which is encouraging. To emphasise the point, the main ethical considerations behind the principles and standards is to ensure that the incentives driving the behavior of material risk takers in financial institutions are aligned with the long-term broader interests of the financial institutions and sometimes even broader societal interests such as sustainability and financial stability. This remains key in terms of what we need to get right if we are to build public trust and avoid what we saw elsewhere, as the unintentional incentivisation of misconduct / unethical behavior.

Unfortunately, we have more recent real-life examples of bad incentives driving unethical choices with disastrous consequences. The Wells Fargo debacle in the United States is one such example that sheds light on what can go wrong when a bank blindly pursues profits at the expense of ethics, by failing to appreciate the impact of its internal decision drivers on customer outcomes. Wells Fargo bank was caught creating millions of fake accounts without customer consent, and charging them bank account fees afterwards, all because they wanted to meet their sales targets. They had to pay billions of dollars to the US authorities for these unethical sales practices and the CEO had to resign. This scandal reminds us of the importance of establishing a corporate culture that prioritises ethical behavior, having the right kinds of incentives that anchor that culture, and a healthy appreciation of customer welfare over aggressive revenue targets, ensuring that the drive for profit does not compromise ethical standards, erode trust or harm customers.

Ethical challenges from emerging technologies

Coming to the ethical challenges in the banking sector emanating from advances in technology or emerging technologies, which are fundamentally changing the way banks operate and how banking services are provided to financial customers. There are countless potential benefits to banks and to banking customers from generative artificial intelligence (Gen AI). These span from leveraging machine learning and Gen AI for better efficiencies in terms of back-office processes, lowering costs, improvements in terms of regulatory compliance. However, integration of AI and other technological innovations and their deployment in business models of financial institutions not only bring about efficiency and convenience but also introduces new ethical dilemmas and challenges. With AI, for instance, there are concerns about unconscious bias, issues around data governance and privacy, the transparency of decision-making, questions about where accountability lies, explainability and so on. We now talk about Responsible AI, Responsible innovation, implicit in that is the admission that when not managed responsibly, these emerging technologies can also be harmful to society. When algorithms make decisions, who should explain the flaws and take responsibility for customer outcomes. Because you can't blame the machine after it's made you money, or can you? What we are emphasising is that human leadership, consumer education, transparency and accountability are so essential here, given the rapid coverage in terms of impact – the sector has to get this right and promptly if we are to build trust, in a more informed and ethical banking ecosystem.

That's how we want to approach our work with the sector on fintech, open finance, AI – all of these are re-shaping the financial services landscape, with a whole new set of ethical questions to consider. We appreciate that it is a business imperative, that the financial sector embrace the emergence of these new technologies, but with that, rise to address the ethical challenges and intensify efforts to be transparent, fair, and responsible, not only to maintain public trust but also to ensure financial stability and sustainability.

The role of regulators in promoting ethical leadership

Coming to the role of regulators in terms of fostering an ethical culture in the sector. In order to understand the role of regulators, one has to consider three aspects. The first is the regulatory framework – and here, we are working with the Prudential Authority to develop a joint conduct standard that aims to harmonize sectoral governance frameworks into a single, cross-cutting instrument that sets out governance-related requirements, with leadership and ethics being among the core themes to be addressed. So that there are coherent and consistent expectations.

The second element is on-going supervision – and ensuring that our strategic engagements with the sector raise the bar in terms of issues around ethics, reputation management, implications for financial customers and also implications for the sustainability of individual businesses and the stability of the sector. The third aspect of our focus is visible enforcement – which is a key strategic focus for us.

Now clearly with supervision, as we have said elsewhere, the approach is preemptive, proactive outcomes focused – in order to prevent ethical failings, detect things early and close the gaps. Whereas enforcement is to go in as a response to some of these failings in order to communicate the message that there are consequences and people should be held accountable. So that there is a credible deterrent to misconduct across the financial sector. This is important for building trust and confidence that this is a tightly and highly regulated sector. So those are the main elements in terms of the strategic approach.

Clearly relevant for this in our context, is the backdrop of being greylisted by the Financial Action Task Force (FATF). All of us need to demonstrate greater vigilance and take proactive measures to prevent the misuse of the financial system for corrupt and criminal purposes, in order to safeguard the integrity of the financial system. In our case as the FSCA and the PA, there is a specific recommendation on enforcement – in that we are expected to impose more dissuasive sanctions for breaches of AML/CFT regulations and we are making good progress in terms of this aspect and will continue to.

De-risking in banking

Some of the actions of the banks which have been particularly contentious in this area of AML/CFT recently pertain to the closure of bank accounts for reputational risk reasons. This is an issue that relates directly to the principles of ethics, fairness, and inclusion. Even for AML/CFT compliance purposes, the practice of widescale de-risking is considered an undesirable risk management approach. The guidelines issued by the Financial Intelligence Centre ("FIC") caution against excessive de-risking. They tell us that de-risking poses a threat to financial integrity in general and to the risk-based approach specifically, as it creates opacity in the affected persons' or entities' financial conduct and eliminates the possibility to treat Money Laundering/Terrorist Financing risks.

I think, therefore, that the challenge lies in balancing the legitimate need to prevent illicit activities with the moral obligation to ensure access to financial services. So, as banks, you need to ask yourselves if you are succeeding in striking this balance—is your risk management approach not overly stringent? Instead of managing the risk, are you not taking the easy way out?

Another ethical issue that is important to consider is the fairness to bank clients. While we understand that banks possess the legal right under contract law to terminate client relationships, questions have been raised as to whether the prevailing common law position is fair to customers, particularly in a context where access to banking is a gateway to broader economic participation? The lack of a bank account can severely limit an individual's or a business's ability to engage fully in the economy, affecting everything from receiving and making payments to accessing credit.

This takes me to the next issue around fairness and transparency, which relates to the processes and procedures that banks undertake for bank account closures. Are these processes fair and transparent? Answering this question requires a thoughtful examination of the procedures employed by banks when they decide to close accounts.

As the FSCA, our primary interest on this issue lies on ensuring that the process of bank accounts closures is fair and transparent. So, what do we envision when we talk about a fair and transparent process? In accordance with our Conduct Standard for banks, we mean fully engaging with customers and providing them with reasonable notice and clear reasons for the closure of their accounts. Banks should not simply cite reputational risk; reasons must be concrete and consistently applied to prevent what might appear as arbitrary account closures. Customers must also have the right to appeal or seek redress to ensure the process remains just and equitable. The mechanism for appeal and redress should be straightforward and accessible, enabling affected parties to challenge decisions they believe are unfounded or have been applied unfairly.

The issues I raised concerning de-risking are quite important and do require further reflection. I hope that during the course of the conference, you will address these issues and discuss solutions for how to deal with suspicious bank accounts from the perspective of Money Laundering/Terrorist Financing risks, while safeguarding customer rights and financial inclusion.

Conclusion

In conclusion, I understand that there are many Ethics Officers in the audience today. I want to encourage you to continue being the conscience of your financial institutions, asking the difficult questions / making decision-makers think twice – and maybe a bit uncomfortable at times, you owe them that much! Provide the ethical leadership that you know your organisations require – if ethical leadership is successful within the banking sector, then it can be exported to the broader society.

Let us each take responsibility for our part in promoting an environment where honesty, integrity, responsibility, and probity are not just aspirational, but become lived realities – and let’s be those examples. I wish you a fruitful discussion and a successful conference.