

FAILURE OF BUSINESS ETHICS PART II

The day Dr Evil wounded a financial giant

Citigroup's efforts to instil an ethical culture were undermined by the trading controversy, write John Plender and Avinash Persaud

Of the world's top financial institutions none has done more than Citigroup under Chuck Prince's leadership to address ethical problems and attempt to instil an ethical culture. Citigroup has nonetheless been plagued by high-profile ethical lapses, underlining how difficult it can be to embed sound values in a diverse and complex international organisation.

The challenge when Chuck Prince became chief executive officer in 2003 was that Citigroup was under pressure from regulators and suffering severe reputational damage that threatened to tarnish its brand. It had been a prominent provider of finance, on- and off-balance sheet, to Enron, WorldCom, Adelphia and Parmalat, among others.

The bad publicity was not helped by some very maladroitness behaviour by bonus-hungry bankers. A prime example related to Citigroup's role in removing liabilities from the Parmalat balance sheet through a vehicle the bank's executives chose to call Buco Nero – Italian for Black Hole.

On Parmalat's bankruptcy some saw this as symptomatic of a cynical culture aimed at maximising short-term profits regardless of ethical considerations. The cost of settling the resulting lawsuits ran into several billions.

losses of €1m-€2m apiece. To prevent a repetition MTS restricted trading and many banks refused to honour their commitment to make a market for fear of another mass order. Trading volume on MTS declined by more than 30 per cent in the three months afterwards, causing European governments to worry about a rise in the cost of servicing their debt.

From an ethical point of view, some outside Citigroup as well as within argued that this was a market for professional traders who knew how to look after themselves. In this view, exploiting a structural weakness in

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the MTS market was fair game. Others felt Citigroup had cynically breached a gentleman's agreement central to the workings of the market. Either way, Citigroup's traders were undoubtedly flouting the bank's stated ethical values which declared that "we treat our customers, suppliers and competitors fairly".

Chuck Prince sought to address the problem by asking the group's 300,000 employees in more than 100 countries to adhere to a new code of conduct. This declared that Citigroup would aspire to be:

- a company with the highest standards of ethical conduct;
- an organisation people can trust;
- a company dedicated to community service.



Ethics strategy: Chuck Prince

Yet despite huge efforts to embed the code through training programmes and ethics courses, it became a hostage to fortune when Citigroup's London operations were mired in controversy over a trade in the European sovereign bond market that raised important ethical issues.

In July 2004 the European government bond desk was under pressure to increase profits. So the traders planned a move that came to be known as the Dr Evil trade. It aimed to exploit a weakness in the structure of the Italian-based MTS electronic bond market, in which marketmakers had to commit themselves to quote prices for bonds for at least five hours a day for minimum amounts.

On a quiet day in August the trading desk placed sell orders worth €11.3bn in 18 seconds, which was equivalent to a full average day's trading volume on MTS. Together with further sales of €1.5bn on other domestic bond markets the total sale of no fewer than 200 different bonds was worth nearly €12.9bn. It then bought back bonds the same morning at a lower price, earning a profit on the deal of €18.2m. Competitors were stung for

From a business perspective the trade was a disaster. Angry European governments withdrew business from Citigroup. Britain's Financial Services Authority imposed a fine of £14m for a failure to exercise due skill, care and diligence, together with failures of internal control and risk management – its highest ever fine. An investigation by MTS's own independent appeals board found that Citigroup had prejudiced the smooth operation of the market in the long run; shown a lack of professionalism in its disregard of how the trade would affect MTS; and been incompetent in the execution of the trade because of a failure to test software properly.

In a leaked e-mail, Tom Maheras, Citigroup's head of global capital markets, admitted that "we did not meet our standards in this instance and ... we failed to fully consider [the transaction's] impact on our clients, other market participants and our regulators". Chuck Prince called the trade "knuckleheaded". Yet in due course the traders, briefly suspended, returned to work. There was no news of anyone being fired.

The morale of those who did believe in the values was thus undermined. As one (understandably anonymous) employee put it to us: "Not to fire these bond traders or their management is to internally celebrate their doings and it has led to an uncomfortable vacuum about what values the organisation stands by and what the strategy is."

This, then, was a classic example of how a huge effort to instil values could be subverted by top executives' failure to enforce them.

Tomorrow: managers under pressure to hit the numbers

All You Need To Know About Ethics And Finance, by John Plender and Avinash Persaud, will be published in September by Longtail Publishing (www.allyouneedtoknowguides.com)

The authors will answer readers' questions on business ethics at 1-2pm BST on August 24. Go to www.ft.com/ethicsqa