THE SOCIAL RESPONSIBILITY AND THE DEONTOLOGY OF THE BANKING PROFESSION UNDER THE CONDITIONS OF THE GLOBAL FINANCIAL CRISIS

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1. Introduction

The current financial crisis started in the month of August 2007, when the "American Home Mortgage" collapsed, one of the largest American banks for the loans for housing building, as a consequence of the real estate market collapse in the United States.

Also during the month of August 2007, "BNP Parisbas", one of the largest in France, suspended three of its investment funds in value of two billiards Euro, invoking the problems from the real estate sector from the United States. On September 13th, 2007, the largest British mortgage bank, "Northern Rock", ceased to dissimulate the lack of cash flow and launched a rapid migration of clients to other banks, and then it went bankrupt in the autumn of 2007 because of the mortgage crisis from the United States. The losses amounted around the sum of 35 billiards Euro.

The British state had to play the role of the deposit guarantor, and the banks assets have been taken over by the company, which converted them into treasury bonds guaranteed by the state and placed them into the private sector.

On January 20th, 2008, "Group Societe Generale" discovered a fraud of 4.9 billiard Euro committed by a collaborator of the financial and investments division, who knowing the control procedures managed to hide the placements, using a complex scheme of fictitious transactions, as well as a loss of 2.5 billiard Euro from the revision of the reduction of the accountancy value of some assets associated to the mortgage loan market from the United States.

Fortis, the largest Belgian financial group, received, in September 2008, a help in the amount of 11.2 billiards Euro from the Belgian, Dutch and Luxembourg authorities, after showing signals according to which the investors were preoccupied with the economic situation of the bank. Moreover, the Treasury of Great Britain announced that the British bank Bradford & Bingley (B&B) would be nationalised and its performing assets would be transferred to the Spanish group Santander, while the non-performing assets would be administered by the state.

The interest of the mortgage loans in the USA between the years 2002-2005 was of approx. 1 - 2%, stimulating the loan demand, in an environment characterised by a real negative interest "when the currency is virtually free, any rational lender will continue to lend until there is no one else [19, p. 12]. Moreover, the pledge was three times lower than the loan amount as U.S. banks estimated that the economy would grow in the future, and the debtors would gradually increase their revenues, which meant a lowering of standards to ensure an increase in the volume of loans and on this basis an increase in the revenue from fees. But with the increasing interest rates, many borrowers had difficulty in the repayment of loans, because, contrary to expectations, the U.S. economy entered in recession and it was shown that

housing prices increased not due to increasing disposable income of house buyers, but because of the ease with which U.S. banks gave the loans. When they began to perform enforcements and the volume of mortgages granted by banks lowered, the real estate prices started to decrease until they collapsed, reaching a level of 4-5 times lower than before the onset of the subprime crisis. So, it seems obvious that the current crisis in U.S. economy and its echoes in the international stock exchanges overlapped with an acute liquidity crisis of the major economies (U.S., Japan, EU), "reality that stems from the entropy of the system itself, which is older than 500 years and which tends to make the centre “a huge black hole” ready to swallow the “periphery system” within some profound transformations."

The two largest U.S. mortgage providers, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association (nicknamed "Freddie Mac" and "Fannie Mae”) and other banks started offering mortgages to people who, under normal banking criteria, presented a risk of not carrying out their obligations. They were called “the substandard mortgages” (subprime).

There have been many discussions on the influence of CRA[1] in the creation of what later became the subprime crisis. However, there is the view that many banks were forced to enter the high-risk lending market section, which would not have been taken into account if they had used the usual commercial criteria. Therefore, since the '90s there was a wave of aggressive selling of subprime mortgages, often to individuals who had no realistic prospect of being able to ever repay the debt.

2. The Social Responsibility of the Banking Profession

The Business Ethics brought to the forefront of discussions in recent decades the idea of corporate social responsibility. The point of view of the Nobel Laureate for Economics, Milton Friedman, published by New York Times in 1970, was stated even from its title - "The responsibility of a business is to increase its profits"[2]. The monetarist leader believes that managers of corporations are accountable to shareholders for how they manage their wealth by working to maximize profits. Any involvement in charity or social projects is viewed as a theft of money of the shareholders or as an impermissible extension of the area of responsibility.

The answer to this narrow vision is the concept of stakeholder that joins all the shareholders those parts that are affected by corporate activity: employees, suppliers, customers, authorities, general public, through an extension of corporate social responsibility. "Conceptualized as such, the corporate social responsibility is not a burden for the corporation, but a part of its essential interests, to meet and to be fair not only to investors / owners, but also to employees, customers, partners business, neighbours or other persons affected by the activities required and rewarded by the market economy system.[3]

Large private banks in their capacity of corporations have a double social responsibility reflected by their social responsibility to the own stakeholders, but also from stakeholder firms in contact with them and the bank, primarily those companies that run high volume loan programs. The occurrence of toxic assets raises a big question mark

[1] CRA is the sign for the Community Reinvestment Act - the law appeared in the '80, which, through the further amendments, has tried to eliminate the discriminating practices of awarding the bank loans;

[2] M. Friedman, *The social responsability of the business is to increase its profits,* in The New York Times, September 13, 1970;

[3] P. Singer, Ethics Treaty, Polirom Publishing House, Iasi, 2006, pg. 391;

on how banks have dealt with their social responsibility issue.

When banks lend through mortgages, credit cards, car loans or other forms of lending, they are invariably going to "reduce" their risk through a warranty process. Such loans are a financial asset in the balance sheet, representing cash flow that will be charged by the bank in future years with payments of interest and the eventual repayment of the amount borrowed. By the securitization of loans, the bank removes the risk attached to its future earnings and retransforms the loan in cash that can be lent again, and so on, in an extended cycle of credit creation.

The securitization is obtained by transferring the loan to specially created companies, called "special purpose vehicles" (SPV). In case of the conventional mortgage, SPV actually acquires a bank's register of mortgages for cash that are raised by issuing bonds backed by cash flow obtained from the owner of mortgages. In case of the substandard mortgages, high levels of risk required a different type of securitization, obtained by creating derivative type instruments, known as "collateralized debt obligations" or CDO.

CDOs are a different way to present the risk of many risky assets such as substandard mortgages. Unlike a bond issue where the risk is small scale distributed among all holders of bonds, CDOs focus on levels of investment risks or "instalments", so some investors proportionally assume a greater risk as the incomes that are to be achieved are higher, while others assume little or no risk for a much smaller profit.

Each instalment of CDO is securitized and "assessed" upon issue in order to give the appropriate profit to investors. CDO gradual investment instalment will be the most popular, giving a low income, but with a reduced risk attached. On the other hand, the instalment of "capital" involves a high risk - will be less popular with a high potential to have a high profit. More details about this case will be presented in the next section.

Therefore, CDOs are a mechanism through which the losses are transferred to investors with the greatest appetite for risk (such as hedge funds), leaving most investors in CDOs (mainly other banks) with a source of cash with low risk.

When the substandard mortgages were issued, nobody knew which of them would not be paid, but the issuers acknowledged (or, in case of the U.S. market, they assumed) that the overwhelming majority of borrowers would pay the interest and the debt upon the due date. When the substandard mortgages were issued, the perception was that with the increased number of U.S. employment and the increased property prices, most of CDO capital could be safely located in the main instalment, with relatively small amounts allocated to the secondary and fair instalments. The rating agencies played a critical role, meaning they endorsed the establishment of subprime CDOs and graded the instalments. Until 2005, many CDO structures were formed with very optimistic structures, so that when non-payments started appearing not only of the capital rates were left unfulfilled, but also the secondary instalments and then, progressively, the main instalments assessed as AAA.

According to the Commission rules for U.S. Stock and Securities, CDOs could only be traded among banks and other financial institutions. Thus, at the beginning of the early credit crisis, since the CDOs and other secured assets by mortgages have been traded between banks, and in the balance sheets there appeared a trillion dollars of subprime debt in the form of what they believed to be the evidence value with a very low risk investment. With the property values declining, many sub-prime borrowers found themselves in "negative equity" (the asset with which

they guaranteed the loan was worth less than the amount of loan remaining to be repaid), the rising unemployment led to a significant increase in the number of non-payment and the depletion of liquidity that CDOs require to satisfy their investors. Indeed, the depletion of cash flow from those who took on mortgages meant that not only dividends but also other instalments from the CDO structures did not have funds. Banks started to worry only when they felt the effect of the amount held by the mortgage in the main instalment.

Banks also encountered another problem - how to evaluate CDOs. There were models with different degrees of complexity, but there was no actual market from which one could take a price as a benchmark. CDOs could not be "listed according to the market", but they had to be "listed according to the model" in the financial balance sheet. On the financial markets appeared the suspicion that some bank balance sheets contained large amounts of CDOs which did not value as much as they seemed. The banks and other lending institutions with funds began to think it was quite possible that other banks held assets that on a real market value less than the amount of the bank debt. In other words, banks were in a situation where the value of mortgaged property was less than the amount of the loan.

The problem was that the trillion dollars of subprime debt issued in U.S. was distributed to all the global markets and indeed smaller subprime problems began to emerge in other countries where banks had issued movable secured assets to refinance the issue of subprime mortgages on other housing markets in developing countries. Banks, who had been away from this problem, began to suspect the lack of value of the other banks credit and, as a result, began to hesitate to lend on the inter-bank market in. LIBOR, the rate at which banks lend on a short term, began to increase, thus threatening the liquidity of banking operations and, thus, the restriction of the credit became a collapse.

The danger with such a situation is that the fundamental vulnerability of banks in front of the risk slips in the real economy soon, as the loan begins to exhaust and loan instalments rise due to the low number of lenders willing to lend. The home buyers cannot increase the mortgages and, as a result, the property price falls more, aggravating the crisis. A recession in the real economy, with job losses and insolvencies, means that more people do not pay for home loans. The Consumer's confidence begins to deteriorate, and the strong economies start to lag behind.

There are a number of opportunities to get out of this crisis - but all are painful. The American solution is that the federal government purchases the so-called toxic assets from banks, and up to 850 billion dollars have already been set aside for this purpose. The UK solution is that the government injects fresh capital into banks through preferred securities and supports financial markets operations by providing loan guarantees and loans to banks that are in difficulty. There is a serious risk that government intervention, to no matter what extent it will be, will not restore the confidence, with the result that the banking sector may not be able to offer services to the financial markets. In this case, the government investment will be record a significant loss. However, the other side of the coin is that banks recover – they are returning to normal activities as much as possible - and the governments involved withdraw with large capital gains. Only one problem remains: what to do with these toxic assets[4]?

A part of the problem is the fact that there is no market for such securities other than the financial institutions. That means that the market value of CDOs

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[4] Unfortunately, CDOs are not the only toxic assets, to these we can add the CLO (guaranteed loan bonds) and the CDS (swap on loan risk);

and similar instruments is well below the intrinsic value of the mortgage trust (the current value of national income flows and associated reimbursements). Finally, if held long enough, at least some basic mortgages will be reimbursed. However, it is beyond the time horizon of any government, so a new market has to be created where investors looking for a speculative investment can freely sell the debt outside the small circle of financial institutions and governments. Indeed, the creation of such markets could be the missing piece of the puzzle needed to restore confidence and to make the financial world work again.

3. The Banking Profession Code of Ethics

The financial crisis that started in the centre of the international financial industry acting in concentric circles over the entire world economy has called into question older defence issues of the ethical values. The triggering factor was the crisis in the real estate activity, but this was not the structural cause; the mortgages are not toxic, but the securities based on them can be assessed and sold poorly. "Remuneration schemes that determine the decisions of market managers and agents and their irresponsible behaviour, these were toxic"[5]

Banks have ethical obligations to both their customers and to the society. The issue of ethics in banking is seen both in terms of financial and banking legislation as it is regulated nationally and internationally and in terms of their rules of conduct and banking practice. Recently trends have emerged to develop codes of conduct and banking practice recommended by professional associations for banking staff.

We can give the example of the C**ode of banking practice of Great Britain,** established in 1992 and successively amended. This code aims to establish minimum standards relating to the banking system, the banking practices and the customer bank relationship, establishing that banking institutions:

- will act fairly and reasonably in dealings with customers;
- will help customers understand their operating techniques within the accounts and banking services they can access;
- must maintain the confidence in the integrity of the bank and the payment system, ensuring that systems and technology represent confidence and safety.

Another example is **the Greek banking ethics code** adopted in 1997 by the Hellenic Banks Association to ensure the transition from a strictly regulated banking system to one that is progressively liberalized and to emphasize the rules of conduct governing relations first between banks and secondly the relationship between them and their customers.

The goal was to:

- increase transparency and openness of the banking system;
- strengthen the mutual trust between banks and their customers;
- encourage the healthy competition between banking institutions;
- continue the growth of the quality of the banking products and services.

During 2009 the Romanian Banking Association adopted the **Banking Code of Ethics** to which all the licensed banks adhered to conduct business across the country.

Through the implementation of the Code of Banking Ethics, RBA proposes:

- to promote the proper conduct of employees of credit institutions towards customers, authorities, banking environment, the business community, colleagues, etc..;

[5] Daniel Dăianu, Capitalism where to?, Polirom Publishing House, Iaşi, 2009, pg. 16;

- to strengthen customer confidence in the banking sector as a whole;
- to promote the public image that credit institutions and bank staff offer customers products and services at a high level of quality;
- to encourage and promote better cooperation between member banks;
- to support a fair competition on the banking and financial market depending on market conditions,
- to promote mutual respect within the banking community.

The Banking Code of Ethics applies to all the credit institutions, members of the RBA. The Banking Code of Ethics, translated into national regulations of the credit institutions members of the RBA are mandatory for all persons working within the credit institutions.

Where credit institutions outsource certain activities to third parties, the responsibility for the code compliance, is of the credit institution that has outsourced those activities.

The Banking Code of ethics refers to:

- the relationship between credit institutions and customers;
- the relationship between credit institutions and authorities;
- the relationship between credit institutions;
- the relationship between credit institutions and employees;
- the relationship between employees of the credit institutions.

The fundamental principles which the employees of the credit institutions must comply with in the professional relationships they have with customers or with authorities and with other employees of other credit institutions or other employees of the credit institution operating are:

- moral integrity, a principle that forbids employees to solicit or accept, directly or indirectly, for themselves or others, any advantage or benefit related to their title, or to abuse in any way by their title;
- impartiality and non-discrimination principle according to which the employees of credit institutions are obliged to have an objective attitude, neutral to any political, economic, religious interest or otherwise, in the exercise of duties;
- professionalism and transparency, the principle according to which the employees of the credit institutions are required to perform duties with responsibility, competence, efficiency, fairness, clarity, and conscientiousness;
- the compliance with the law, the principle according to which the employees of the credit institutions shall comply with the law applicable to their activity, and with the regulations of these institutions;
- the confidentiality principle which states that the employees of the credit institutions must not disclose confidential information about facts, data and information related to their work, as well as any facts, data or information concerning the person, property, business, personal relationships or business relationships with customers, to persons that are not authorized to receive such information. The employees of the credit institutions are obliged to keep the professional secrecy regarding any information or data not intended for publication, of which they became aware during the performance of their duties and will not use this information for personal benefit, any infringement being punished by law and the Banking Code of Ethics. The persons who are not an employee of the credit institution, but are entitled to request and receive information or data of professional secrecy in the banking sector, are required to maintain confidentiality and may use it only for the purpose for which they have requested , or have been provided by law or agreements.

- preventing and combating corruption, money laundering and funding terrorism by reporting any transactions that may relate to them and avoiding the completion of such transactions in accordance with legal provisions;
- exercising by the employees of the financial and banking institutions of prudent activities of financial transactions through the responsible management of the credit institution's own resources and the correct information of the customers on the bank products and services offered;
- the social responsibility, a principle which takes into account their involvement in solving various social problems and supporting the promotion and achievement of humanitarian initiatives
- avoiding the denigration, meaning that the employees of the credit institutions exercising their activity in good faith with honest practices in accordance with the interests of the parties involved and the requirements of a fair competition in specific market conditions;
- the compliance with all the provisions of the Banking Code of Ethics by the employees of the credit institutions by taking responsibility, understanding and reporting of any activities likely to violate its provisions.

The conflict of interest regulation is done by the banking code of ethics through specific provisions. The conflict of interests arises when there is an incompatibility between the employee quality of the credit institution and the personal status, translated through any act or omission which may affect the reputation of the credit institution.

Employees may carry out activities outside the credit institution provided they do not prejudice the position held and the work as an employee of the credit institution. Each employee must avoid the involvement in activities that conflict with the interests of the credit institution and its shareholders. To avoid the conflicts of interest, including the situations that may generate conflicts of interest, a credit institution staff has the following obligations:

- not to pursue a personal or financial interest and to act only in the interest of the credit institution they work for, its shareholders and clients;
- not to pursue a personal interest in the outcome of the customer service or a customer transaction account, which differs from the customer interest in terms of that result;
- not lend money from its own sources to clients or customers of the credit institution;
- not provide services other than those of the credit institution, or part of the group as determined by the job description or the duties by superior chiefs;
- not to accept gifts or rewards from customers, employees, suppliers, to facilitate obtaining services or benefits. Exceptions are gifts with symbolic value, the participation in events where the refusal could affect the credit institution's relationship with the client;
- not to seek to obtain benefits or advantages resulting from the quality of employee of the credit institution; he/she may not use the information obtained as an employee of the credit institution for its own benefit or a third person’s benefit, directly or indirectly, and to comply with the strict rules on confidentiality of the transactions;
- not to participate in order to obtain their own benefit, directly or indirectly, in financial transactions / trading as a result of the information obtained in his/her capacity as employee of the credit institution;
- not to use goods or insignia (logo, letterhead etc.) of the credit institution for personal purposes and not to engage the name of the credit institution in personal businesses.

4. Conclusions

Banks have a huge social responsibility both to their shareholders and to the depositors, borrowers, governments, supervisory authorities and to the general public. In their chase for profits, they have favoured the emergence of toxic assets which have triggered the global economy crisis.

Is the present evidence of professional conduct contained in the codes of ethics or the banking regulation sufficient or is the regulation of the banking operations in more detail required? What is now the optimum ratio between regulation and deregulation? Can the corporate governance resolve the ethical conflicts in the bosom of the large bank corporations?

These are questions awaiting an answer during the following period, after the current international financial crisis will have been overcome by most countries of the world.

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