Developing a Culture of Compliance by Embracing the Impact of Emotional Contagion

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Recognising the impact of emotional contagion on risk could be the key to developing a true compliance culture. To achieve it, however, firms will have to look inside themselves.

Smile and the world smiles with you, goes the old saying. If you cry, though, it might not be alone. Emotional contagion is now a well-established phenomenon. Members within groups pick up and reflect the emotions – both positive and negative – of the others.

That is important in investment banks and other financial firms because we know that emotions drive behaviour, both good and bad. Negative emotions, such as stress, tend to make people become more task-focussed, for example, to the exclusion of other considerations.

In financial institutions, that increases the risk of compliance breaches. Attention can become focussed on the primary task of generating performance, potentially to the detriment of compliance requirements. And, due to emotional contagion, that attitude quickly spreads.

The emails and other communications between traders that came out in the aftermath of the Libor scandal[1] provide good evidence of this.

Acting Out

Understanding this mechanism – and how emotions drive behaviour – could be the key to fostering a true compliance culture.

Without this understanding, well-intentioned interventions by compliance departments can actually prove counter-productive. A stern warning to a trader for straying slightly over limits, for example, can add to their stress or annoyance. That, in turn, may just increase their focus on achieving performance targets, regardless of the limits firms want to enforce.

If compliance can use such incidents as opportunities to demonstrate an understanding of the pressures on the front office instead, however, it can mitigate stress, foster positive emotions and help traders think about factors other than performance.

1 http://www.amf-france.org/en_US/L-AMF/Missions-et-competences/Transactions.html#

Barriers to Implementation

Firms face three key challenges in adopting this approach, though.

The first is that compliance departments, and individuals within them, face pressure from regulators to show they take infringements seriously. They may feel the need to be seen to be cracking down on poor behaviour. If they are to take a softer approach to minor infringements, their strategy and reasons for doing so will need to be well-documented. There will also need to be clear lines dictating when a more forceful approach is appropriate.

The second challenge is that understanding the psychological triggers, motivations and behaviours that increase risk takes time and resources. The increasing burden on compliance departments means many do not have the luxury of being able to engage in this analysis.

Finally, they also need the right people. To respond effectively to the pressures driving potentially risky behaviours, compliance functions need people with wider experience of the business that understand them. If they can do that, it could be the key to keeping everyone happy – the regulators included.