Improved Corporate Culture and Ethics in the Financial World

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Good afternoon.

Let me offer a very brief contextual comment by way of introduction.

Clearly it is an imperative that we understand the root causes of each and every crisis so that lessons can be learned and steps taken to prevent recurrence, so that the future can be faced with the confidence that the financial system will deliver outcomes with a high degree of predictability once again.

The most important word in the above is 'confidence' - and it is worth observing in passing that there is no model, no proven recipe to recover or improve confidence – which is essential to economic recovery – and without confidence in the future there is no investment, no one willing to borrow, and you will have your own views whether our leaders today - whether political, financial or business – are doing enough to build confidence about the future through their words and actions.

And if we are to inspire the confidence that underpins economic risk-taking, there needs to be trust in the financial system that is the transmission mechanism between economic policy and actual activity.

There needs to be trust in its motives and trust in the data which it presents to support the financial decisions society is invited to take - which is why so many policy makers currently are so focussed on culture and ethics – because they are essential to restoring a solid and trusted financial system.

The question now being posed is - has there been too much focus to date on products, platforms, infrastructure, capital and liquidity because they can be defined and measured, as opposed to focussing on culture and behaviour which are much more difficult to pin down objectively.

So part of the debate today is about the extent to which we should regulate by simply defining the desired outcomes or by legislating the actions believed to be most consistent with achieving those desired outcomes.

This debate understandably reflects how difficult it is for the official sector to get to grips with ethics, character and behaviour. How can these be measured? How can they be assessed? How can a regulatory body demonstrate it has adequately monitored values and behaviour? How can there be comparability across business lines and across jurisdictions with different cultures?

And if the official sector can't do that, how can they judge the right balance between prohibition and permissiveness, reassurance and reliance? How can they accept accountability if there is no objective framework of measurement against which to judge performance?

But if it were possible both to manage and supervise conduct risk through the industry establishing and demonstrating the right ethics and culture, surely there would be greater opportunities to build trust?

And if it were possible to prove lessons have been learned, could there even be a potential reward? That is, would it still be necessary to be so prescriptive about so many actions designed to constrain a tendency to get off the reservation?

The essential point here is to recognise that banking, indeed all of financial services, is subject to societal expectations that are constantly changing and evolving.

We cannot change this and indeed must accept that if we do not fit into a role acceptable to society, then it will reject us and replace us with a model suited to its requirements.

We also have to recognise that what was once deemed acceptable may no longer be so. We have to accept that societal expectations may swing too far towards what is impractical or unrealistic. We may well need through trial and error and advocacy to convince society what its reasonable expectations ought to be, but if we are to do that we need to restore trust and credibility.

And we deceive ourselves – as would our supervisors - if we believe that it is possible to engineer a system that eliminates failure and unintended consequences. So given that there will be exceptions, there needs to be a mutual understanding between supervisors and the industry as to what 'good' looks like – again built on trust.

Once again we come back to that word 'culture'. It is worth noting that a simple word search in the Independent Commission on Banking Report mentions capital 463 times and culture 6 times. In the FSA's report into the failure of RBS, the numbers are 1389 for capital and 122 for culture respectively. By the time we get to the PCBS report on the failure of HBOS there are 27 mentions of culture versus 31 for capital. Simplistic - but all the same interesting.

If we are to learn the lessons of the crisis, improve the sustainability of the financial system and demonstrate its overwhelming social value, it will be because we have changed behaviour.

Indeed, perhaps the greatest opportunity for improvement will come from defining, teaching, reinforcing, rewarding and enforcing values in terms of behaviour.

And if we are to seek to rely on behavioural values, it has to be based on trusting organisations to deliver them, and organisations trusting their people to deliver – and that trust has to be built over time and evidenced by experience.

Culture and behaviour can and should be underpinned by regulatory and even criminal sanction, but achievement of the high standards now expected can only come from within the industry, from its own self-regulation. And we need to find a way to build assurance into the system that culture is such that trust has been earned.

So, on the one hand I would encourage the regulatory and public policy bodies to think more deeply about how they can get to understand, and if necessary shape, the character and culture of the organisations critical to the financial system.

It is the aggregate of behaviour evidenced within the system and in particular how it has changed that will change society's perception of banks and their regulators rather than the scale of impressive new regulations based on financial system design.

So rather than obsess about whether an organisation can break down and stress-test its exposures by the hour, by product, by customer, by industry classification, by business line, by country, by region – supervisors should care more about tone from the top, how individuals are screened for behavioural characteristics when recruited or promoted, how ethics and values are taught and reinforced, how values are enforced and rewarded, and how an organisation looks for and adapts to changing expectations within the communities it serves.

And management has to go well beyond producing codes of conduct and statements of ethical values and produce the evidence that the business models they pursue mandate being staffed by individuals who exhibit, are trained to deliver and are rewarded for independence of thought, character, judgment, accountability, responsibility and a sense of duty that goes beyond the individual's self-interest or the narrow interest of his employer.

What does this mean in practice?

It means understanding in detail through surveys, appraisals and mystery shopping how employees think about what is really expected of them.

It means being constantly vigilant on unintended incentives.

It means calling out both good and bad behaviour and rewarding those who escalate their concerns.

It means continuously obsessing about the balance of economic interest in products between customer and provider, and it means focussing on what drives good people to cross the line occasionally.

It means understanding what is driving customer behaviour individually and collectively and having a process to determine when to lean against customer preferences.

It means ensuring the organisation does not drift lazily towards financial exclusion because it is easier not to have to think about how to address the needs of the less well-off customer.

It means having some of the best people in the organisation, future leaders, in charge of building the right culture, with the authority to reward and punish irrespective of seniority.

It also means greater oversight from Boards and, indeed, investors around how returns are being generated, as opposed to simply that they are adequate.

I firmly and truly believe that the vast, vast majority of people within our industry exhibit day in, day out the integrity society expects. As leaders of the industry we owe it to them to ensure that their values and integrity are not called into question by the actions of a few bad actors who don’t want to embrace the societal responsibilities expected of them.

That is the journey we are on and at this point I shall stop and allow our moderator to engage with what is an outstanding panel to address this subject.

Thank you for listening.