Finance Watch

Making finance serve society

Introductory speech by Christophe Nijdam, Secretary General of Finance Watch, at the Finance Watch conference *"Confidence, ethics, and incentives in the financial sector"*

Tuesday 17 November 2015, Hotel Leopold, Brussels

Ladies and gentlemen,

Welcome to our conference on *confidence, ethics and incentives in the financial sector*.

When I co-created in 1983 the derivatives business of a then medium-sized French bank, now called HSBC France, we were confronted with the dilemma of offering such complex products to the ancestor of what became Dexia Bank. Well, we quickly decided that it would have been unethical to do so for two reasons:

- **one,** you should never sell a product to a customer who doesn't understand it
- **and two,** you should always provide advices with the only interest of your customer first and not of your bank as a profit center, or your own bonus in mind.

That decision was taken with the entire assent of our top management at the time.

Too bad that the same Dexia twenty years later had no scruples whatsoever in peddling embedded derivatives in structured loans to French municipalities and hospitals.

What had changed during that period of time? Ethics and incentives… Monetary incentives went exponentially up and ethics went in the exact opposite direction.

Ethics used to be a system of values "*above the law*", and it quickly became "*equal to the law*" to finish in the doldrums with some management quietly acquiescing to "*you can disrespect the law, as long as you don't get caught because if you do, you'll be on your own*".

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I am delighted to welcome a select group of delegates, which includes not only policymakers but also a large number of civil society representatives. This is exactly why Finance Watch exists– to help rebalance the chorus so that one group of voices – that of the financial sector - does not drown out the other singers. I hope our discussions today will thus be even more harmonious and melodic than usual.

In preparing for today's event, I came across two useful little books:

- **one written in French in 2015** by Professor Paul Dembinski who will be properly introduced later on as he is moderating our second panel this afternoon. It is called in French "Ethique et responsabilité en finance"
- **and a second one published in English in 2007** on the eve of the financial crisis. It is called "All you need to know about ethics and finance" by John Plender, the FT writer, and the academic Avinash Persaud.

The authors write that a book on ethics is a risky project as it leaves one open to charges of moral superiority. I feel the same risk in hosting this event, so let me say upfront that - while I am extremely interested in ethics – none of us at Finance Watch claims any special expertise. We are all here to learn.

People in finance have always faced ethical dilemmas but they have not always behaved unethically. Understanding what makes the difference – or what makes '*good people do bad things*', as the Archbishop of Canterbury put it recently - is a complicated task, but it is one of profound importance for public trust in finance and this is our topic for today.

Our objectives this afternoon are twofold, as illustrated by the two expert panels we have assembled for you.

The first panel will debate on restoring confidence in the financial sector.

We will hear and, I hope, challenge spokespeople for three political parties on what they would like to see in the Commission's upcoming green paper on retail financial services, and hear how they would protect citizens in an ever-more complex financial world.

Citizens are also consumers and consumption represents 2/3 of GDP. So, if we want growth and jobs, we need to restart that main engine, not by offering more consumer debt but by having citizens opening up their wallets again. For that, you need confidence and trust first.

Public trust is indeed a vital ingredient for the financial system to serve the economy and society. Without trust, there will be less capital for entrepreneurs and innovators. Trust is therefore a pre-condition for the European Commission's agenda of sustainable jobs and growth and for our long term prosperity, both inside and outside the financial sector.

Unfortunately, trust in the financial sector has collapsed.

A Gallup poll found in 2013 "a widespread lack of public trust in EU financial institutions:

- In six EU countries, a quarter of respondents or less expressed confidence in their banks,
- and in 24 out of the 28 EU member states, confidence was lower than the global average of 60%."

So we have a problem on our hands. What could be the solutions?

In the second panel, we will debate the role of ethics and finance more generally.

This discussion, like the first panel, will also include time for audience participation, and I hope that by the time we head for cocktails this evening, we will have a stronger grip on this difficult topic, which goes way beyond the simplistic ideas and excuses we often hears, such as the view that financial scandal is caused only by 'a few rotten apples'.

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Before we start, please allow me to share five personal thoughts with you about today's topic.

First, problems that seem far removed from financial regulation – such as climate change or the refugee crisis - are far easier to tackle when people feel economically secure. The lack of trust in the financial sector is therefore a topic that concerns everyone in the EU.

Second, this is more than a PR issue. I understand that banks do not want to read about trading scandals or million euro bonuses, but citizens also do not want to see their retirement funds eaten up in fees and low performance or their public services sacrificed in the wake of financial crises. To paraphrase Forest Gump, "*ethics is as ethics does*". The financial sector must start putting customers and citizens first, before it can expect to regain their trust. I recognise that this is not an easy task:

- How to reconcile the need for competition and choice with the need for customer protection?
- How to provide financial advice without the guidance becoming distorted by the advisor's interests? There are many difficult questions and we will not get all the answers today.

Third, as a former banker I can confirm that we are all human. When incentives are set to be irresistible, they will not often be resisted. If these conditions lead to ethical problems, the fault lies with the system and those responsible for it, and not only with the human being doing the transaction.

<u>Our keynote speaker today, Bob Jenkins</u>, will have more to say about the special responsibilities and accountability that apply to those at the top of the financial system.

Fourth, we all know that one cannot legislate for good behaviour. As Bob Diamond, the former CEO of Barclays, said, *culture is what people do when no one is looking*. But laws and policy <u>can</u> mould the environment to make ethical behaviour easier. They can nudge, push, sanction or in some cases require business models to evolve in ways that are positive for society. I firmly believe that the financial sector should not resist such moves, for its own long term good.

Fifth, and this is my last point, we should realise that ethical problems in today's financial system did not arise by accident. In a famous comment about architecture, Winston Churchill once said: "*We shape our buildings, thereafter they shape us*".

The deregulation of finance from the 1980s and 1990s was a massive re-shaping of the architecture of finance and, thereafter, of the people that work in it.

This era saw the end of partnerships in investment banks, the rise and toleration of universal megabanks with their funding cross-subsidies, the re-engineering of trading and the privatization of trading venues, the massive growth of speculative trading and of derivatives that separate risk from reward. Regulators and central banks have been dealing with the consequences of these changes for financial and economic stability ever since.

On the surface, deregulation and financialisation increased competition and launched a golden period of finance. It was only later that the costs started to become apparent.

In my view, any attempt to improve ethics in finance must start with where things went wrong by reshaping the "building" of finance. This requires hard measures, by which I mean tough regulatory and structural reform, as well as soft measures such as voluntary codes and self-regulation.

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The authors of my helpful books on ethics and finance must feel some disappointment at the lack of progress in the eight years since the crisis began: as a matter of fact, many of the scandals that have taken place either started after the beginning of the crisis or continued during the crisis.

Only last year, John Plender wrote in his column in the Financial Times that "*The financial system appears to have become an ethics-free zone*".

And the legendary investor Warren Buffett is the one with his no non-sense wisdom who said: "*when selecting top management, you look for three qualities: intelligence, energy and… integrity. If you find only the first two qualities, the third one will kill you*".

Christine Lagarde, the director general of the IMF, reminded on the 5th of November that the amount of legal fines for banks in the US has totalled $230bn over the last six years, or a mere one and a half year of the systemic banks profits. She now thinks that jail terms for bankers will be the only efficient deterrent as fines have become just a cost of doing business (in *Les Echos*, 06/11/2015).

Our discussions today are a step to ensuring that integrity becomes again a proper incentive and value to rebuild confidence.

Ladies and gentlemen, please enjoy today's conference and give a warm welcome to our first panel.