



GETTING OUT OF OUR SILOS / SORTIR DE NOS SILOS

ETHICS & TRUST IN FINANCE
7th Edition 2018/2019

Nominated Essays:

- *Andrea Bancone, Italy*
- *Mikael Homanen, Finland*
- *Aleksander Kowalski, Poland*
- *Mateusz Kucz, Poland*
- *Adam Morris, United Kingdom*
- *Marta Rocchi, Italy*
- *Andrea Roncella & Luca Roncella, Italy*
- *Christopher Stubbs, Ireland*
- *Monika Swaczyna-Pruchnik, Poland*
- *Colin Sweetman, Ireland*
- *Matthew Wharton, United Kingdom*

Ethics & Trust in Finance
7th Global Prize



Previously «Robin Cosgrove Prize»



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Ethics & Trust in Finance 7th Edition, 2018-2019
Review "Finance & bien commun / common good" N°46 & 47

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Ethics & Trust in Finance Global Prize
Awards 2012-2017
Paul Dembinski, Josina Kamerling and Virgile Perret (eds)

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Ethics & Trust in Finance, Global Prize

7th edition 2018-2019

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Preface by Angel Gurría

Secretary-General Organisation for Economic Co-operation and Development (OECD)

Public trust in the financial sector is crucial for market economies. Yet, ten years after the crisis, and in spite of significant reforms, trust in financial institutions in OECD countries remains low. According to the *2019 Edelman Trust Barometer: Financial Services Report*, although the levels of trust in the sector among the general population have improved slightly, financial services remains the least-trusted sector measured by the barometer, with levels of trust of 57%. This needs to change.

Financial systems are made of trust. Their strength stems from public confidence. This is why ethics in financial institutions are vital. This is why we need to reflect and debate about ways to make this sector more reliable, more accountable, more transparent, more inclusive. And this is why efforts like the “*Ethics & Trust in Finance*” *Global Prize*, now in its 7th edition, published by Observatoire de la Finance are so important.

Building trust in finance and financial institutions is critical to the OECD’s mission and work. The OECD is helping governments to strengthen their financial regulations; promote competition within their financial systems; increase the transparency and integrity of financial institutions; and connect financial services to environmental priorities. We are also working with financial authorities to develop policies to promote financial literacy and more effective financial consumer protection. Moreover, our work on Automatic Exchange of Information (AEOI) and on Base Erosion and Profit Shifting (BEPS) is helping to build a fairer, more transparent and reliable global financial system.

We also work on a broader spectrum to help promote ethics and integrity in the business sector. We are helping to improve corporate governance and prevent corporate misconduct, including in the financial sector. Thus, the OECD and the G20 partnered to revise and upgrade the *G20/OECD Principles of Corporate Governance*, which provide globally-recognised standards on transparency, accountability and business integrity.

We are also home to the *OECD Guidelines for Multinational Enterprises*, the first international corporate responsibility instrument to include risk-based due diligence. In this context, we have provided due diligence guidance to support enterprises in implementing our global standard for Responsible Business Conduct. In addition, in October 2019, the OECD released a *Guidance for Responsible Business Conduct in General Corporate Lending and Underwriting Transactions*, which sets out the first broadly recognised environmental and social standards for corporate lending and

underwriting transactions. The Guidance was developed in close consultation with leading global banks and approved by 48 governments - a clear and concrete example of constructive collective action to strengthen ethics and trust in finance. Likewise, we are also helping the finance sector implement OECD global standards against tax evasion and avoidance, as well as combat transnational bribery and corruption through the *OECD Anti-Bribery Convention*.

Our newly launched *Trust in Business Initiative* brings public and private sector leaders together to encourage good corporate conduct, examine market incentives for business decision-making, and respond to society's expectations in meeting current and future challenges. The OECD also recently created the *Business for Inclusive Growth (B4IG) Platform*, to unite governments and businesses behind a broad-based, sustainable growth agenda that places social and environmental returns at the same level as financial returns. Taken together, these efforts play a powerful role in supporting a level playing field.

I very much hope that this collection of essays will stimulate our imagination and enrich the debate on how to strengthen the ethical behaviour and the integrity of the financial sector. I want to congratulate all the finalists of the Ethics & Trust in Finance Prize for their ground-breaking works, their new ideas and their faith in more responsible and trusted financial sectors.

Paris, October 2019

Sortir de nos silos

En janvier 2018, dans le décor feutré du grand auditoire de la Banque de France à Paris, les gagnants de la 6^{ème} édition du « Ethics & Trust in Finance Global Prize » ont eu l'honneur et la joie d'être félicités par le Gouverneur de la Banque de France, M. François Villeroy de Galhau, et par le Secrétaire général de l'OCDE, M. Angel Gurría. Les deux éminents orateurs ont insisté sur l'importance de l'éthique. Ils ont souligné que l'éthique et la bonne régulation peuvent - et devraient - se compléter pour conjointement renforcer la stabilité, l'efficacité et la pertinence sociétale des activités financières locales et globales.

Deux ans plus tard, nous en sommes aujourd'hui à présenter les textes nominés et gagnants de la 7^{ème} édition qui s'achève aussi à Paris, au siège de l'OCDE, là où elle avait été lancée officiellement le 18 septembre 2018 avec la remise des travaux fixée au 30 juin 2019. Si aujourd'hui, la 7^{ème} édition est sur le point d'être clôturée, c'est grâce au soutien sans faille des partenaires stratégiques du Prix et des personnes en charge de cette relation : le CFA Institute, avec Mme Josina Kämmerling (Co-présidente du Prix) ; Euroclear, avec M. Martin Gregson, et SWIFT avec SWIFT Institute et son directeur, M. Peter Ware. Cela sans oublier nos autres partenaires: Association of Certified and

Getting out of our silos

In January 2018, the Award Ceremony of the 6th edition of the "Ethics & Trust in Finance Global Prize" took place in the great auditorium of the Banque de France in Paris. The winners have had the honour and pleasure to be congratulated by two eminent keynote speakers: the Governor of the Banque de France, Mr. François Villeroy de Galhau, and the Secretary-General of the OECD, Mr. Angel Gurría. Both speakers, each from his own perspective, emphasized the importance of ethics. They stressed the fact that ethics and good regulation can and should complement each other and jointly contribute to the stability and to the efficiency of the financial activities making them more meaningful for society locally and globally.

Two years later, we are introducing today the nominated essays, and among them the winning ones, of the 7th edition which will culminate with the Award Ceremony at the OECD headquarters in Paris. It is precisely there that this edition was launched on the 18 of September 2018 with the final deadline for essay submission on the 30th of June 2019. This 7th edition would not have been possible without the wholehearted support and cooperation of the Prize's strategic partners: the CFA Institute, with Mrs. Josina Kämmerling (Co-chair of the Jury); Euroclear, with Mr. Martin Gregson and SWIFT

Chartered Accountants (ACCA) ; l'Association des Banques Polonaises (ZBP) ; l'Ecole Supérieure de la Banque (CFPB) ; le Weltethos-Institut (Université de Tübingen) et l'Organisation pour la Coopération et le Développement Economiques (OCDE) avec Mme Mathilde Mesnard. Nous les remercions tout particulièrement pour leur fidèle soutien

A cœur du dispositif opérationnel, se trouve l'Observatoire de la Finance avec sa petite équipe très dévouée, fidèle et aux compétences multiples : Mme Hannah Soissons, Mme Nati Garcia et, plus récemment arrivé, Dr. Virgile Perret – responsable du projet au sein de l'Observatoire de la Finance. Nous voudrions leur exprimer ici nos plus vifs remerciements et nos félicitations : une fois de plus, le succès des gagnants est aussi leur succès.

C'est grâce au concours bénévole des membres du Jury, que le Prix a pu tirer le meilleur de sa notoriété croissante. Pour cette édition, le Jury a ainsi accueilli de nouveaux membres : M. Pascal Cescon (Banque de France) ; le Prof. Henri-Claude de Bettignies (INSEAD) ; M. Elco Fiole(Alpha Governance) ; Mme. Maggie McGhee (ACCA) ; Mme. Mathilde Mesnard (OCDE) ; M. Brett Scott (primé de la 6ème édition);

le Prof. Bernd Villhauer (Weltethos-Institut) et le Prof. Joël Wagner (HEC Lausanne). Le Jury s'est aussi doté d'une charte définissant son approche dont le texte est à découvrir dans les pages consacrées au Jury.

Les textes soumis offrent une vue panoramique des thématiques qui sont, à un moment donné, au cœur des préoccupations des jeunes générations en matière d'éthique en finance.

Le travail de sélection du Jury a été structuré en trois étapes couronnées par une réunion dans les locaux de CFA Institute à Bruxelles, le 12 septembre 2019. Tous les membres ont été consultés et neuf ont pris part aux débats. A cette occasion, le Jury s'est penché sur les onze textes « nominés » pour choisir ceux qui seront récompensés par des prix. Le lecteur pourra découvrir l'ensemble des textes nominés dans les pages qui suivent. Les auteurs – et il s'agit d'un des aspects très positifs du Prix – proviennent à parts quasi-égales du monde de la recherche et de celui de l'académie ainsi que de l'activité économique ou financière. Deux autres équilibres sont à signaler : la présence des femmes et celle des auteurs provenant de pays qui ne font pas partie des capitales financières mondiales.

D'une édition du Prix à l'autre, les textes soumis offrent une vue panoramique des thématiques qui sont, à un moment donné, au cœur des préoccupations des jeunes générations en matière d'éthique en finance. Dans cette 7ème édition, trois séries de problèmes méritent d'être mentionnés :

- La question du nécessaire mais difficile dialogue entre les ingénieurs – notamment financiers – en charge des développements technologiques, et les financiers soucieux de la dimension éthique de leur activité et de leur impact sociétal.

together with SWIFT Institute and its director Mr. Peter Ware. This being said, other partners have also played an important role in helping the Prize reaching out to new audiences: the Association of Certified and Chartered Accountants (ACCA); the Polish Bank Association (ZBP) with Mrs. Agnieszka Wicha; l'Ecole Supérieure de la Banque (CFPB); the Weltethos-Institut (University of Tübingen) and the Organisation for Economic Cooperation and Development (OECD) with Mrs. Mathilde Mesnard. We do thank them for strong support.

The Observatoire de la Finance is the operational hub of the Prize. Three fantastically devoted and highly competent persons play a key role: Mrs. Hannah Soissons, Mrs. Nati Garcia and Dr. Virgile Perret who recently joined the team as project manager. We take this opportunity to express our warmest thanks and also our congratulations to all of them. The success of the winners of the 7th edition is also – and once again – the success of the Observatoire's team.

The Jury plays a crucial role in the selection and assessment process. Jury members generously devote their free time to this heavy task and we thank them for this. New members have joined the Jury for this 7th edition: Mr. Pascal Cescon (Banque de France); Prof. Henri-Claude de Bettignies (INSEAD); Mr. Elco Fiole (Alpha Governance) ; Mrs. Maggie McGhee (ACCA); Mrs. Mathilde Mesnard (OCDE); Mr. Brett Scott (one of the winners of the 6th edition); Prof. Bernd Villhauer (Weltethos-Institut) and Prof. Joël Wagner (HEC Lausanne). In recent months, the Jury has agreed on a set of principles which is to be found in this publication, in the section devoted to the Jury.

Essays submitted offer a thematic panorama of what the younger generation is preoccupied with in the domain of ethics in finance.

The Jury's final selection operated in three steps, which finalized with a Jury meeting on the 12 of September 2019 at the Brussels premises of the CFA Institute. Before the meeting all the Jury members had been consulted, and nine actively contributed to the meeting. The Jury in its final step looked at the eleven 'nominated' texts in order to choose the laureates. The reader will discover all nominated essays in this book. One of the most interesting aspects of the prize is that essays originate in similar numbers from the academic and research world and from the economic/financial one. Other point worth noting is the presence of women and of authors not coming from major financial capitals.

From one Prize edition to the other, essays submitted offer a thematic panorama of what the younger generation is preoccupied with in the domain of ethics in finance. In this 7th edition three key subjects came up:

- The issue of the necessary but difficult dialogue and mutual understanding between, on one side, engineers – especially financial ones in charge of technical and digital developments or of new product design, and, on the other side, of financial

Deux textes soulignent qu'il est urgent de « sortir des silos » voire de « faire sortir les autres de leurs silos » pour mieux comprendre les préoccupations réciproques. Cela peut être facilité en adaptant en conséquence le contenu des formations, notamment, techniques.

- Au moins trois des textes publiés mettent l'accent sur l'insuffisance des seules chartes ou codes éthiques. En effet, c'est uniquement en cultivant auprès des collaborateurs la qualité éthique des comportements, le sens de la responsabilité et l'aptitude à identifier les dilemmes éthiques que les activités financières auront fait leur part d'effort pour rendre notre monde meilleur. C'est seulement ainsi que l'esprit de la règle a des chances d'être mis en œuvre dans la pratique. Mais cela ne suffit pas, les jeunes auteurs proposent aussi – parfois simultanément – de resserrer le cadre réglementaire.

- Plusieurs textes contiennent des propositions institutionnelles, réglementaires ou de services intéressants. En effet, si l'éthique est en dernière analyse une affaire de comportements individuels, les structures peuvent les encourager ou, au contraire, les dissuader. Aussi, la prise en compte de la qualité de la culture d'entreprise dans la fixation du niveau de capital réglementaire est une idée très prometteuse.

Le meilleur moyen de se rendre compte de la façon dont les moins de 35 ans abordent les thèmes de l'éthique et de la confiance en finance est de lire les onze textes qui suivent. Ce faisant, le lecteur comprendra ainsi la difficulté qu'a eue le Jury à choisir ceux qu'il a distingués. En effet, tous les textes publiés sont de belle tenue, et leur juxtaposition fait ressortir leurs qualités, à travers les points de convergence, mais aussi de divergence entre les auteurs. La variété des points d'entrée et des conclusions est ainsi frappante. Pour parachever le processus, on se met à rêver de pouvoir organiser une rencontre pour permettre aux jeunes auteurs de débattre, d'échanger et d'affûter les arguments respectifs, et – peut-être – de parvenir à quelques conclusions communes.

Co-Présidents du Jury

Prof. Paul H. Dembinski

Mrs Josina Kamerling

operators concerned with the ethical dimension of their activity and with the consequences of this activity on society and the environment. Two essays stress the urgency to “get out of the silos”, or in some cases “help others get out of their silos” to discover and understand the concerns and doubts of the other stakeholders. This can be achieved by designing ad hoc trainings and exposure tracks.

- At least three of the essays published underline the fact that ethical charters and codes are not sufficient. It is only by working together with the staff on the enhanced ethical quality of behaviour, on the sense of responsibility and on the capacity to spot ethical dilemmas when they arise, that financial activities will have contributed their share to make the world better. This is the only way to implement in practice the spirit of the letter of the rule. But alone this is not sufficient, and some of our authors, also propose to strengthen the regulatory framework.

- Some texts put forward proposals; some concern institutions, other regulations or new interesting services. Even if, in the last analysis, ethics relates to personal decisions and actions, structures either work as enablers of such behaviours or prevent them. For instance, one of the proposals developed in this book, suggests that the ethical quality of corporate culture should be taken into account by the regulator when deciding the level of capital requirements. This is a promising idea.

The best way to understand how the under 35s look and try to apprehend ethics in finance is to read the eleven essays which follow. So, the reader will understand that the Jury did not face an easy task to choose the laureates. All essays are raising important issues; their variety sheds specific light on their respective qualities and weaknesses. Sometimes, they converge, sometimes not. Each author starts from a different point of entry into the problematic and follows a specific path. At the end, one can dream of a final step: organizing a meeting that would allow these young authors to discuss and refine their respective arguments, and possibly reach some common conclusions.

Co-Presidents of the Jury

Prof. Paul H. Dembinski

Mrs Josina Kamerling

Global Jury: Values and Principles of the Jury

The Jury comprises some twenty individuals with distinguished reputations (see the Jury biographies on the website). Originally the Jury members were co-opted, based on recommendations by the co-Chairs of the Jury so as to maintain a balance in terms of regions, professions and genders. They sit in their private capacity and on a pro bono basis and are appointed for initially one edition of the Global “Ethics & Trust in Finance Prize”, renewable from one to another, unless exceptional circumstances.

The Jury members share a number of key qualities, values and principles, which ought to be spelled out when new members join, so as to ensure a fruitful collaboration.

- **Competence, excellence and experience** regarding the issue of “ethics & trust in finance”.
- **Familiarity with the world of finance**, be it financial markets, enterprises, banking and financial institutions, insurance companies, fintechs and other financial sectors. In addition, they may come from financial regulators and academic circles. The jury members link their professional experience with a sensitivity to the core challenges of ethics in finance, or more broadly social ethics. This blend is indispensable for the fruitful work of the Jury.
- **Concern for harmony and the common good**: Jury members share the conviction that finance in a broad sense should serve its users and society.
- **Independence of judgement**: each Jury member works faithfully in his/her own capacity and no specific interest, institutional or otherwise, does interfere with his/her judgment.
- **Openness to debate**: a spirit of openness to cultures, new approaches, disciplines and methods is indispensable, not only to individual Jury members but also to their collective debate and decisions.
- The Jury members share **common expectations** as to the core aspects of the papers submitted for their evaluation: clarity of the proposition; the quality of the argument; coherence in the use of sources of information; and relevance of the conclusions to the theme of “Ethics & Trust in Finance”. Jury members are aware that they should be capable of seeing beyond style and mode of expression to assess the intrinsic merits of the texts submitted for the Prize.

Global Jury : Seventh Edition 2018/2019

Co-chairs of the Jury

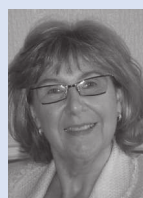


Prof. **Paul H. Dembinski** is the initiator and Director of the Foundation of the Observatoire de la Finance. The mission of the Observatoire de la Finance is to promote awareness of ethical concerns in financial activities and the financial sector. Paul H. Dembinski is the founder and editor of the quarterly bilingual journal entitled *Finance & the Common Good/Bien Commun*. In parallel, he is partner and co-founder (with Alain Schoenenberger) of Eco'Diagnostic, an independent economic research institute working for both government and private clients in Switzerland and elsewhere. Paul H. Dembinski is also Professor at University of Fribourg where he teaches “International Competition and Strategy”. Latest published book: *Ethics and Responsibility in Finance*, Paul H. Dembinski, Routledge, 2017.



Mrs **Josina Kamerling** is Head of Regulatory Outreach at CFA Institute, responsible for supporting CFA Institute’s policy development, in the Europe, Middle East, and Africa (EMEA) region, advancing the impact of advocacy efforts, and promoting capital market integrity and investor protection issues. Prior to joining CFA Institute, Josina was a Specialist Adviser on financial services in the European Parliament for six years, advising most significantly the Economic and Monetary Affairs Committee and the Special Committee on the Financial, Economic and Social Crisis on all aspects of financial services policy issues and technical information. Prior to this, Josina was a banker for 15 years in a variety of functions and locations, most notably as a senior banker in the global clients division of ING (managing a group of multinational clients on a worldwide basis and on all business lines) and prior to that as head of sales in the financial markets division of ING group (overseeing different sales teams in the dealing room). Josina holds a Bachelor of Arts with honours degree from Cambridge University in Law and modern languages. She is a Dutch national having lived and worked in five European countries, and she speaks five languages fluently (Dutch, English, Spanish, French, Italian, and some Greek).

Honorary Members of the Jury



Dr **Carol Cosgrove-Sacks**, Robin’s mother, lives and works in Geneva. She is co-founder of the “Ethics in Finance, Robin Cosgrove Prize” which she co-chaired from 2005 to 2015. Dr Carol Cosgrove-Sacks was formerly Director of Trade in the United Nations in Geneva (1994-2005); since 2006 she is a Professor at the College of Europe, Bruges; a Professor at the Europa Institute, University of Basel; and the Senior Advisor on International Standards Policy to OASIS, the global eBusiness standards organisation. She also maintains interest in some British academic centres, including the Institute of Development Studies (IDS), University of Sussex, and the Centre for Euro-Asian Studies (CEAS), University of Reading.



The Most Reverend **Justin Welby**, Arch-Bishop of Canterbury and a member of the House of Lords, is an Honorary Member of the Jury. He served as a member from 2006-2013. He was previously a senior executive in a UK oil company, before ordination in the Church of England. For many years, he was responsible for the reconciliation work of Coventry Cathedral, travelling widely in Africa and the Middle East. Justin Welby has written extensively on ethics and finance. In July 2012 he was appointed to the Parliamentary Commission on Banking Standards.

Members of the Jury



Mr **Stéphane Bernard**, Managing Director, has been recently appointed CEO of the Euroclear Bank Poland Branch. He is also a member of the Board of Directors of the ESES (Euroclear Settlement of Euronext-zone Securities) central securities depositories (Euroclear Belgium, Euroclear France and Euroclear Nederland) and a member of the ESES Audit Committee. Prior to taking his current position, Mr Bernard was COO for the ESES CSDs as well as being and part of its management committee. Mr Bernard was General Manager of Belgian central securities depository, from 2001 until 2006, when CIK joined the Euroclear group. Mr Bernard started his career with a broker dealer in 1989. He holds degrees in Commercial and Consular Sciences from the Saint Louis Institute of Commerce in Belgium, a degree in Marketing from Institut Supérieur Economique Ixelles and a Masters in Treasury Management from the University Antwerp Management School.



Mr **Pascal Cescon** is the Chief Ethics Officer of the Banque de France, reporting to the Governor. He is in charge of designing and controlling internal ethics rules, promoting ethics awareness and culture, advising the Governor, the managers and the staff. He represents the Banque de France in the Ethics and Compliance Officers Task Force of the central banks and supervisory authorities of the Eurosystem. He is member of the Cercle d'Ethique des Affaires, the French association for business ethics. Pascal was previously Labour Relations Director of the Banque de France and Chairman of its Health & Safety Committee in Paris. He negotiated collective agreements in particular on social dialogue, psychosocial risks, gender equality and telework. He succeeded in increasing threefold the Banque de France staff seconded to the European Central Bank when the European Single Supervisory Mechanism was set up. Pascal holds a Master's degree in Public Organizations and Policies Analysis from Sorbonne University and graduated in Public Affairs from Sciences Po Paris.



Prof. **Marc Chesney** is Professor of Finance at the University of Zurich. Previously in Paris, he was Professor and Associate Dean at HEC, President of the CEBC (Centre d'Etudes sur le Blanchiment et la Corruption) and an external expert with the World Bank. He has published articles and books in the areas of quantitative Finance and also of financial crime mechanisms. In addition, he focuses on the subject of Ethics and Finance. At the University of Zurich, he is member of the Board of the Graduate Programme for interdisciplinary Research in Ethics and co-organizer of the Ethical Finance

Research Series. He is also member of the advisory Board of Finance & Common Good/ Bien Commun. Marc Chesney holds a Ph.D. in Finance from the University of Geneva and obtained his Habilitation from the Sorbonne University.



Mr **Henri-Claude de Bettignies**, the Aviva Chair Emeritus Professor of Leadership and Responsibility (INSEAD) is also the Distinguished Emeritus Professor of Globally Responsible Leadership at the China Europe International Business School (CEIBS) and former Director of the Euro-China Centre for Leadership and Responsibility (ECCLAR) that he created in Shanghai, at CEIBS, in 2006. Between 1988 and 2005, and again since 2013 he has a joint appointment at Stanford University (Graduate School of Business), and he shared his time equally between Europe, California and the Asia Pacific region. Among the 8 books published under his name are: Business Transformation in China (Thompson Business Press, 1996), Le Japon (Flammarion, 1998), Business Ethics: Policies and Persons (McGraw Hill, 2005), and (with F. Lepineux) Business, globalization and the Common Good (Peter Lang, Oxford, 2009) and Finance for a better world: the shift toward sustainability (Palgrave, 2009) and more recently Puissance et Responsabilité: où en est la Chine? (Gulbenkian, 2014) and (with M. Thompson) Leadership, Spirituality and the Common Good (Garant, 2010).



Mr **Christopher de Mattos** is a non-executive director and is on the advisory board member of several companies, including London-based investment firm RAB Capital Ltd. He has spent over 30 years in the financial services industry, working as a financial analyst and investment banker in Europe and Latin America as well as in investment management. Christopher joined the founding team at RAB in 1999 and, as Finance Director, was instrumental in taking the company to flotation on London's AIM market in 2004. He holds a degree in Mechanical Engineering from Imperial College, London and an MBA and Certificate in Corporate Governance from INSEAD. He has taken a particular interest in the role of the board in promoting corporate governance, is an INSEAD Certified Director and past chair of the INSEAD Directors' Network. Christopher is also a trustee of the Lord Kitchener National Memorial Fund and a member of the Imperial College Court.



Dr **Edward Dommen** is a specialist in economic ethics. He is past President of the Scientific Committee of the Geneva International Academic Network (www.ruig-gian.org); he was a member of the Scientific Committee of the Swiss Network for International Studies (www.snis.ch). He is a founder member of "Actares, Shareholders for a sustainable economy" (www.actares.ch). He was a founder member of the Ethics Committee of the Swiss Alternative Bank (Banque Alternative Suisse) and a member of the Board of Geneva's Caisse Publique de Prêts sur Gages as well as a member of the Council of the RA-FAD Foundation, an institution that guaranteed micro-credit. Edward Dommen has been a university professor, but he spent most of his career before he retired as a researcher with the United Nations conference on Trade and Development (UNCTAD). He written and compiled several books on economic ethics. "A Peaceable Economy" (World Council of Churches 2014) was awarded the Daniel Colladon Prize 2015 as "the most remarkable Protestant work of the previous four years by a Geneva author".



Dr **Eelco Fiole** is co-founder and sole managing partner of Alpha Governance Partners in Zurich, the international partnership providing high-end risk-focused professional fiduciaries to financial institutions dealing with complex assets. Eelco is an adjunct professor in finance ethics at HEC Lausanne for the MSc in Finance and M in Law and Economics programs and has almost 25 years in the financial services industry, of which a decade in fiduciary CFO- and COO-roles, lastly at the Tezos Foundation (blockchain) in Zug and with Credit Suisse Alternative Investments with teams in Zurich, London and New York. A Dutchman based in Switzerland and Singapore with substantial private exposure to China, he graduated in Economics (PhD, Basel), Ethics (Zurich), Leadership (Madrid), Laws (London), Business and Engineering (both Rotterdam) and holds a.o. the CFA- and CDir-designations. He chairs the Annual Conference Advisory Group at CFA Institute and is a regular speaker in the field of investment governance, finance ethics and risk.



Dr **Philippa Foster Back** has over 25 years of business experience. She began her career at Citibank NA before joining Bowater in their Corporate Treasury Department in 1979, leaving in 1988 as Group Treasurer. She was Group Finance Director at DG Gardner Group, a training organisation, prior to joining Thorn EMI in 1993 as Group Treasurer. She was appointed Institute of Business Ethics' Director in August 2001. Philippa Foster Back has a number of external appointments, including at the Ministry of Defence, The Institute of Directors and the Association of Corporate Treasurers, where she was President from 1999 to 2000. In 2006 she was appointed Chairman of the UK Antarctic Heritage Trust.



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Mr **Ross Murdoch** is a lawyer at the Financial Conduct Authority (FCA) in London, within its Enforcement and Market Oversight Division. Ross specialises in regulatory enforcement proceedings, particularly within wholesale financial markets, including market abuse, benchmark manipulation (e.g. LIBOR), and other market misconduct. Prior to working at the FCA, he worked as a lawyer at a commercial law firm within its Commercial Dispute Resolution & Regulatory practice in London. He is dual qualified as a solicitor in England & Wales (2011) and Scotland (2010). In September 2015, Ross was awarded first prize in the

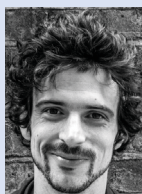
Global Edition of the Ethics in Finance Prize (2014/2015). This was presented at a ceremony co-hosted by the Managing Director of the International Monetary Fund (IMF), Christine Lagarde, at its headquarters in Washington DC. From May 2019, Ross will be on a year long detail to the United States Department of Justice, Criminal Division, Fraud Section.



Mrs **Clare Payne** is a leading voice on ethics and trust in society. She tracks trends and writes about their implications in her monthly 'Ethical Len's column in The Australian Financial Review BOSS Magazine. She is also the co-author of, 'A Matter of Trust – The Practice of Ethics in Finance'. Clare is a former employment lawyer who went on to manage the Integrity office of Macquarie Bank and founded the Banking and Finance Oath, a Hippocratic-type oath for the finance sector. Clare is an advocate for tobacco-free finance, which she sees as an ethical case study for the finance sector. Prior to the global financial crisis, Clare's paper titled, 'Ethics or Bust' was awarded the inaugural Ethics & Trust in Finance Prize by the Observatoire de la Finance, Geneva. Clare was recognised as a World Economic Forum Young Global Leader in 2014 and as an Australian '100 Women of Influence' in 2016.



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Mr **Brett Scott** is an author, journalist and economic hacker exploring the intersections between money systems, finance, digital technology and cities. He is the author of The Heretic's Guide to Global Finance: Hacking the Future of Money (2013), and collaborates with a wide range of groups on diverse topics, including banking systems, alternative currencies, financial activism, digital finance, blockchain technology, hacker culture, technology politics and the dynamics of cashless society. He has spoken at over 260 events in 32 countries, has written for publications such as The Guardian, New Scientist and CNN.com, and has appeared in a wide range of TV shows, radio and documentaries. He won third place in the 2016/2017 Ethics and Trust in Finance Prize for work on the ethics of fintech, and was also a finalist in the 2014/2015 prize for work on blockchain technology. He tweets as @suitpossum.



Mr **Domingo Sugranyes Bickel** graduated from the University of Fribourg (Switzerland) in 1969. He was Secretary General of the International Christian Union of Business Executives (UNIAPAC) based in Brussels from 1973 to 1981. He moved to Madrid in 1981 and joined the MAPFRE insurance group, a Spanish agricultural mutual which was at the time starting to grow internationally and has developed into a multinational insurance and reinsurance group now present in 44 countries. As one of the vice-chairmen of the group and Executive Committee member, he participated in the internationalisation and the demutualisation process and was in charge of Finance and Economic affairs. After retiring from executive office in 2008, he remained on the Board of the MAPFRE Foundation until reaching the statutory age limit of 70 in 2015. From 2009 to 2019 he was Chairman of the Centesimus Annus pro Pontifice Foundation, a Vatican body dedicated to spreading and debating Catholic social teachings in economic and business circles.



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<http://www.ethicsinfinance.org/ethics-trust-in-finance-prize/about-us/the-jury/>

Part I

Ethics in the Fintech Era

Technomoral Financial Agents: Ethics in the Fintech Era

Ethics & Trust in Finance
Global edition 2018-2019

First Prize *ex-aequo*

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* The views expressed herein are those of the author and do not necessarily reflect those of the Organization she is affiliated with or of the Jury.

The discussion on the future of finance, with particular reference to the fintech (financial technology) sector, is lively in academia (Bussmann, 2017; Lynn, Mooney, Rosati, & Cummins, 2019; Turner et al., 2010), among practitioners (e.g. KPMG International, 2018; PwC, 2017), and in the public arena (e.g. in Europe and in the USA, see Karakas & Stamegna, 2017; Mnuchin & Phillips, 2018; Stamegna & Karakas, 2019). It is part of the wider debate on the future of work (World Economic Forum, 2018) and the disruptive wave of the Fourth Industrial Revolution (Schwab, 2016).

The future of finance shares some of the same questions and concerns about the future of work: whether and to what extent artificial agents will be able to replace human agents in their daily jobs; how

employment will be affected; what new occupations will be generated by technology, and consequently which new roles will human agents be able to perform (Bartleby, 2018; World Economic Forum, 2018). Specifically in reference to finance, this debate mainly concerns the rise of the fintech industry and the increasing automation of financial activity (Chishti & Barberis, 2016). Can financial technologies replace what traditional finance currently encompasses? Which jobs will be completely automated and which new ones will be created in the future of finance (Mancher, Huff, Grabowski, & Thomas, 2018)? How is the generation of trust affected (Greiner & Wang, 2010)? How will regulation keep up with the pace of technological change (Treleven, 2015)?

La discussion sur l'avenir de la finance, avec une référence particulière au secteur de la Fintech (technologies financières), est animée à la fois dans le monde universitaire, chez les praticiens et sur la scène publique. Elle fait partie du débat plus large sur l'avenir du travail et la vague disruptive de la quatrième révolution industrielle. Alors que le débat sur l'avenir de la finance est particulièrement riche et animé, il n'en va pas de même pour le débat sur l'avenir de l'éthique en finance. L'analyse éthique menée jusqu'à l'avènement de la Fintech peut-elle encore s'appliquer à cette nouvelle vague de l'activité financière?

While the debate on the future of finance is particularly abundant and animated, the same cannot be said for the debate on the future of ethics in finance. Is the ethical analysis conducted up until the advent of fintech still applicable to this new course of financial activity? Should the moral standards required of financial agents be updated in light of the changing context? Is it necessary to develop a techno-financial ethics for techno-financial agents?

The aim of this article is to look at the future of ethics in finance in order to advance a theoretical and practical proposal, guided by three questions:

- 1) What kind of ethical reflection is able to support the future of finance?
- 2) What are the virtues that financial agents need to develop, in order to be excellent financial professionals and excellent people in the fintech era?
- 3) How can we implement an educational strategy with which to train technomorally virtuous financial agents in the fintech era?

In order to answer these questions, the article is organised as follows. Section 1, answering the first question, shows the relevance of a first-person ethics for present and future financial activity. In response to the second question, Section 2 compares the classical virtues with the virtues required of financial agents in the fintech

era. This section covers the main theoretical contribution of this article concerning the development of the technomoral virtues of financial agents. Section 3 suggests guidelines to implement curriculum changes in finance education according to the proposal advanced by this article, thereby providing an answer to the third question.

1. Aristotle and Fintech: An Agent-Centred Ethics for Finance

What sort of ethical reflection is able to support the future of finance? The word “ethics” is probably one of the most misused in different domains of human activity. Everyone speaks about “ethics” and the importance of being “ethical.” However, when it comes to providing a definition, it is hard to characterise what “ethics” really is.

The philosopher Abbà offers an insightful classification of the different approaches to ethics (Abbà, 1996). He distinguishes two ways of looking at ethical enquiry: a first-person and a third-person approach to ethics. The first-person approach views ethics as the discipline that asks what is the good life for human beings, a life worth living. This approach looks at a person's actions in the context of their life understood as a narrative unity, oriented to their flourishing, to the realisation of the best version of themselves. Aristotle can be considered the father of this approach (Aristotle, 2000). Virtue ethics is the label under which this

Tout le monde parle d'«éthique» et de l'importance d'être «éthique». Cependant, il est difficile de définir ce qu'est réellement l'«éthique». Le philosophe Abbà distingue une approche de l'éthique à la première personne et à la troisième personne. Aristote peut être considéré comme le père de l'approche à la première personne, qui considère l'éthique comme la discipline qui cherche à savoir ce qu'est une vie bonne pour les êtres humains, une vie digne d'être vécue. L'approche à la troisième personne quant à elle considère l'éthique comme la discipline qui répond à des questions telles que: cette action est-elle licite ou illicite? Cette action est-elle conforme aux normes existantes? Les théories éthiques déontologique et utilitariste sont des exemples de cette approche.

first-person approach to ethics is generally known. On the other hand, the third-person approach views ethics as the discipline that answers questions such as: Is this action licit or illicit? Does this action comply with existing norms? Under the category of a third-person ethics, it is possible to collect deontological ethical theories (e.g. Kant), approaches typical of Utilitarianism (e.g. Bentham), and more recent theories on neo-contractualism and justice (e.g. Rawls).

Similarly to the first-person/third-person distinction, Annas (1993) suggests a distinction between agent-centred and act-centred approaches to ethics. She clearly explains how “ancient ethics centres on the notions of happiness, of virtue and of the agent's deliberation about his life as a whole” (Annas, 1993, p. 5); while modern ethical theories tend to consider “isolated problems in the abstract” (Annas, 1993, p. 124) and to view morality as “punitive or corrective” (Annas, 1993, p. 4). Ancient ethics can thus be considered “agent-centred,” while modern ethical theories are “act-centred.”

In the ethics of finance, the debate has mainly relied on third-person or act-centred approaches to ethics: What is it licit to do in this particular situation? Is this course of action “ethical?” Thinking about the diffusion of codes of ethics, compliance departments, and standards of practice, it is easy to retrace the origin of the ethical evaluations of financial activity

in deontological and Utilitarian theories. The main textbooks on the ethics of finance also generally prioritise the description of the morality of certain acts or situations without considering the life of financial agents as a whole, or how they can grow in the virtues. The virtues of those working in finance are actually a marginal element of the majority of the most used and renowned textbooks in the field (e.g. Boatright, 2010, 2014).

The dominance of a third-person approach to the ethics of finance can be retraced in the history of philosophy. Ancient virtue theory was obscured during the history of ideas,¹ and the publication of Anscombe's essay *Modern Moral Philosophy* (Anscombe, 1958) is generally recognised as the beginning of the rediscovery of an ethics centred on the virtues of human beings, rather than merely act-centred or duty-oriented. Since then, reflection on the ethics of business – which can be considered a parallel field to the ethics of finance – also rediscovered an ethics of the first person. A recent handbook illustrates just how broad is the scope of virtue ethics in business (Sison, Beabout, & Ferrero, 2017), and the work of the Neo-Aristotelian philosopher Alasdair MacIntyre has a particular influence on teaching and research about virtue ethics in business (Beadle, 2017).

¹ The analysis of the reasons why this happened would go far beyond the scope of this article. For an accurate overview, see MacIntyre, 2007 [1981].

Virtue Ethics in Fintech:
Excellent Financial Agents
and Excellent People

Although its rediscovery has happened at a slower pace than in business ethics, virtue ethics is currently a presence in academic research on the ethics of finance (e.g. Sison, Ferrero, & Guitián, 2019). Alasdair MacIntyre’s critical reflections on finance have also sparked a considerable debate in this growing discussion on virtue ethics in finance (e.g. Ferrero & Sison, 2017; Robson, 2015; Rocchi, 2019; Rocchi & Thunder, 2019; West 2018; Wyma, 2015). However, too little has been done so far about shaping the education of financial professionals according to the standards of virtue.

The adoption of virtue ethics in the context of financial activity holds that the analysis of a particular activity must take into account the life of the acting person (i.e. the financial agent or manager) as a narrative unity, and consider the social context in which the activity happens. On the one hand, at the level of personal ethics, a person tends to their personal development, which

ultimately concerns their happiness (Annas, 1993; Aristotle, 2000; MacIntyre, 2007); and the virtues are those specific qualities of character which enable a person to flourish, the habitual dispositions with which to pursue the life worth living (Aristotle, 2000). On the other hand, virtue ethics informs reflection on life in society, considering the common good as the ultimate end of social life and as the horizon of human work (MacIntyre, 1998). Ultimately, from the perspective of virtue ethics, ethics can be defined as “a guide for human excellence” (Melé, 2009, p. 10).

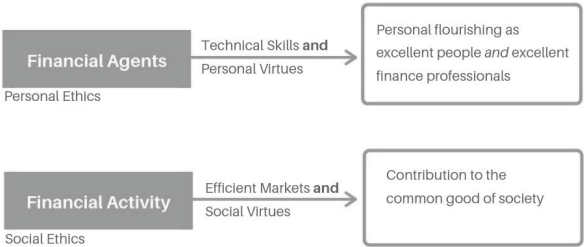
Figure A synthesizes this dual tendency to personal flourishing on the level of personal ethics and to the common good on the level of social ethics.

Applying this perspective to the ethics of finance brings to the forefront the need for a characterisation of the personal virtues of those working in finance, and of the contribution of finance to the good of society.

There are academic contributions that develop both personal and social ethics in finance. A wide range of authors have worked to demonstrate

L’adoption de l’éthique de la vertu dans le contexte de l’activité financière suppose que l’analyse d’une activité particulière doit être effectuée en considérant la vie de la personne qui agit (c’est-à-dire l’agent financier ou le gestionnaire) comme une unité narrative et en tenant compte du contexte social dans lequel l’activité se déroule. En définitive, en se basant sur l’éthique de la vertu, l’éthique peut être définie comme un guide de l’excellence humaine (Melé, 2009).

Figure A - Virtue Ethics in Finance: Personal and Social Ends



Quelles sont les vertus que les agents financiers doivent développer pour devenir d'excellents professionnels de la finance en même temps que d'excellentes personnes à l'ère de la Fintech? Les vertus du XXI^e siècle doivent être cultivées «avec une adaptation nouvelle et explicite à notre environnement technomoral mondial émergent» (Vallor, 2016, p. 119). Cet article s'efforce de caractériser les vertus technomorales pour des agents financiers technomoraux.

the contribution of finance to the common good of society (social ethics perspective),² but what has been developed less is an agent-centred personal ethics in finance, which is what this article seeks to develop further.

The next section explores what virtues are needed for an excellent practice of finance, i.e., what are those qualities of moral character which enable a person to flourish both as an excellent professional *and* an excellent person, taking into account the new technological context. The final aim of this inquiry is to demonstrate that the approach of virtue ethics provides the best groundwork for ethical reflection, not only for traditional finance, but also for the future of ethics in finance. It gives Aristotle the chance to walk the corridors of a fintech company.

2. The Technomoral Financial Agent: Human Agency and Virtues in the Fintech Era

Section 1 suggested virtue ethics as the approach *par excellence* to the ethics of finance, given that it considers the lives of financial

agents in their narrative unity and the contribution of finance to the common good. This section will further the discussion by providing a solid basis for the answer to the second guiding question of this article: What are the virtues that financial agents need to develop in order to be excellent financial professionals and excellent people in the fintech era?

In *Technology and the Virtues*, Shannon Vallor argues that the classical accounts of the virtues “still have much to offer us” (Vallor, 2016, p. 119), warning at the same time that “our current patterns of thinking about ethics and the good life may well prove ineffective, deleterious, or even catastrophic if we do not adapt them to these new technosocial realities” (Vallor, 2016, p. 23). For this reason, she formulates the notion of “technomoral virtues.” She does not suggest completely brand new virtues, but rather that 21st century virtues need to be cultivated “with a *new and explicit adaptation* to our emerging global technomoral environment” (Vallor, 2016, p. 119, emphasis in original).

This article will now carry out the same effort made by Vallor, with particular reference to financial agents working in the fintech era: *the technomoral financial agents*. However, before entering into the characterisation of two technomoral virtues for technomoral financial agents, it is necessary to clarify whether the impact of technology on finance will still leave space for

² For example, Schlag and Mercado discuss free markets and the creation of a culture of the common good (Schlag & Mercado, 2012); Dembinski reflects on what kind of society we desire and how finance contributes toward its shaping in the era of financialisation (Dembinski, 2009), and what the responsibilities of finance are (Dembinski, 2017); the Nobel Laureate Shiller describes finance as the “science of goal architecture” (Shiller, 2012, p. 6), and highlights the contribution of finance to the good society.

human moral agency. Put simply, if many tasks and even decisions will be made by artificial agents, is it really possible to speak of a human responsibility in future finance? Are virtues needed in the future financial sector, or will processes and even decisions be automated?

Fintech as Context for the Technomoral Virtues: Is There Still Space for Moral Agency?

A document from the European Parliamentary Research Service broadly defines fintech: “The financial technology (fintech) sector encompasses firms that use technology-based systems either to provide innovative and cheaper financial services directly (i.e. without the involvement of banks or other intermediaries) or to make

traditional financial business more efficient” (Stamegna & Karakas, 2019, p. 1). This document highlights how fintech “covers a range of services and products, such as cashless payment, peer-to-peer (P2P) lending platforms, robotic trading, robo-advice, crowdfunding, and virtual currencies” (Stamegna & Karakas, 2019, p. 1).

Arner et al. (Arner, Barberis, & Buckley, 2016) describe a topology of the fintech industry as comprising five major areas: “(1) finance and investment, (2) internal operations and risk management, (3) payments and infrastructure, (4) data security and monetization, and (5) customer interface” (Arner et al., 2016, p. 1291). The following Table A offers a description of each of these areas.

Table A: Topology of Fintech

Topology of Fintech*	Description**
1. Finance and Investment	Alternative financing mechanisms (e.g. crowdfunding and peer-to-peer lending); the financing of technology itself; robo-advisory services.
2. Internal Operations and Risk Management	Mainly related to compliance systems, and the automation of internal processes. RegTech, as the management of the application of financial regulations through technology, is part of this area.
3. Payments and Infrastructure	Internet and mobile communications payments; financial trading; disintermediation.
4. Data Security and Monetisation	Sensitivity of collected financial data; monetary value of data collected; vulnerability to cyberattacks.
5. Customer Interface	User experience for online and mobile financial services.

* From Arner et al. (2016, p. 1291). ** For a more detailed account, see Arner et al. (2016) and Karakas & Stamegna (2017).

Avec l'avènement de la Fintech, il semble qu'un large éventail d'activités habituellement exercées par des agents humains soit repris par des agents artificiels ou des processus automatisés. Serait-il alors utile de prendre en considération les vertus de ceux qui travaillent dans le secteur de la Fintech ou est-ce que toutes leurs responsabilités personnelles seraient déléguées à des agents artificiels? Le secteur de la Fintech partage bon nombre des questions éthiques traditionnellement analysées dans la relation entre l'éthique et la technologie.

With the advent of fintech, it seems that a wide range of activities usually performed by human agents have been taken over by artificial agents or automated processes across these five major areas. Would it then be useful to consider the virtues of those working in the fintech sector, or would all their personal responsibilities be delegated to artificial agents?

The fintech sector shares many of the ethical issues classically analysed in the relationship between ethics and technology. Franssen et al. report four recurrent themes in the ethics of technology: neutrality versus moral agency, responsibility, design, and technological risk (Franssen, Lokhorst, & van de Poel, 2018). Translating these issues into the language of fintech raises questions such as the following: Would artificial financial agents have responsibility for a mistake or illegal or unethical behaviour? Who should be considered accountable for the actions of the artificial agents? The debate on the neutrality of technology includes those who believe that technology has no moral content, but that its use has moral significance; others who argue that the design of technology has a moral content in itself; and others who state that both the way we design technology and the way we use it carry moral significance. Sheila Jasanoff (2016) in *The Ethics of Invention* gives voice to this debate, arguing that the way technology is designed bears moral significance,

insofar as it contributes toward shaping the society we desire. The discourse can be translated to finance: the design of the innovation of fintech not only advances the technical side of the financial sector, but also shapes the contribution of finance to the society of the future.

With regard to responsibility in finance, as in other sectors, technology also amplifies the so-called “problem of many hands” (van de Poel, Royakkers, & Zwart, 2015). In this instance, it is useful to look at the distinction drawn by Mancher et al. (2018) between unattended and attended bots in finance. According to these authors, unattended bots can perform “period-end close, reconciliation, maintain master data, cost accruals, travel accruals, labor accruals, daily report generation and compilation, PP&E activities (valuation, inventory, accountability)” (Mancher et al., 2018, p. 37); while attended bots can look after more complex activities such as funds distribution and control or cost and obligation transfers, and many others, which *need to be triggered by a human worker*.

This is the reason why it is still important to speak of the virtues of the financial agent: even in a scenario where automation and artificial agents will take over many tasks, these tasks must not only be performed, but also set and assigned. While repetitive and process-based activities can be replaced, therefore avoiding many common human

La sagesse pratique peut être décrite comme la vertu qui permet à l'agent d'identifier ce qui est bon et de choisir le meilleur moyen de le réaliser. Cette vertu a été largement étudiée en lien avec la gestion, alors qu'elle est moins étudiée en finance, même si elle est particulièrement pertinente pour les différentes décisions que doivent prendre les agents dans l'environnement financier. Vallor revisite la définition de la sagesse pratique dans le contexte des innovations technologiques. En prenant en compte la définition aristotélicienne de la sagesse pratique, celle mise à jour sous mode techno de Vallor et la description détaillée de St Thomas, cette section examine comment la sagesse techno-morale peut agir dans les cinq domaines de la Fintech précédemment esquissés.

errors (for example, robots do not seem to have the “problem of the fat finger,” and do not have issues with memory and data storage), the same cannot be argued for other actions that human agents will need to learn in order to be able to perform. In this context of a revised human agency in the future of finance, it makes sense to take a closer look at two virtues.

Technomoral Wisdom in the Fintech Era

Practical wisdom (PW) can be described as the virtue that enables the agent to identify what is good, and to choose the best means to achieve it (Aristotle, 2000). This virtue has been widely studied in relation to management, as a large body of literature witnesses (e.g.: Bachmann, Habisch, & Dierksmeier, 2018; Beabout, 2012; Melé, 2010; Moberg, 2007). It is less studied in finance, even if it is particularly relevant for the numerous different decisions that different agents in the financial environment need to make. Schwartz (2011) argues that rules and incentives do not help people desire to do the right thing and choose the best means to achieve it; it is rather the cultivation of PW that helps people decide for the good in every situation.

Vallor rereads the definition of PW in the context of technological innovations. She argues that technomoral wisdom is “a *general condition* of well-cultivated and integrated moral expertise that expresses successfully – and in an intelligent, informed, and authentic

way – each of the other virtues of character that we, individually and collectively, need in order to live well with emerging technologies” (Vallor, 2016, p. 154, emphasis in original).

Even if Vallor describes technomoral wisdom as a “general condition,” it is also fruitful to explore a detailed account of the parts of PW as described, for example, by Aquinas (1964). He identifies eight integral elements essentially linked to the exercise of PW: memory, reason, understanding, docility, shrewdness, foresight, circumspection, and caution (Aquinas, S. Th. II-II, q. 49). According to Aquinas, memory relates to the knowledge of the past; understanding, to the knowledge of the present; reason refers to ways of using knowledge, combining sources and evaluating alternatives; docility helps in acquiring knowledge through the experience or the knowledge of others; shrewdness is the capacity to acquire knowledge through one's own personal research; foresight helps balance the means that the person has in the present with the purpose set for the future; circumspection helps take into account the relevant circumstances of the decision; caution helps one to avoid obstacles.

The following Table B shows how techno-moral wisdom can act along the five areas of fintech previously sketched, taking into consideration the Aristotelian definition of practical wisdom (Aristotle, 2000), the techno-updated one by Vallor (2016), and the detailed description by Aquinas (1964).

Table B: *Technomoral Wisdom in Fintech*

Topology of Fintech*	Technomoral Wisdom
Finance and Investment	<p>Technomoral financial agents need to exercise foresight, circumspection and caution in deciding the best investment choice possible, not just the most efficient. Even if the processes are automated, the decisions about how to utilise them still require human wisdom. For example, a robot can detect an advantageous investment opportunity in buying shares in a company selling non-renewable energy. A human agent can mediate the efficiency of the choice by examining the historical and geographical context. Regardless of whether the choice is profitable, the question arises of whether one should support a company that helps enhance the future of humanity or one that makes a profit by taking advantage of environmental vulnerability.</p> <p>From the technomoral user's perspective, memory is greatly reinforced by automation, with the presence of reviews of the users of the platforms, availability of records of every transaction and project supported, amount of money spent, etc. The technomoral user's docility and shrewdness are greatly reinforced by bots and other available technical instruments that gather knowledge, while the way of using the knowledge (reason) remains human, or at least subject to human control.</p>
Internal Operations and Risk Management	<p>This might be the area in which human skills are more replaceable. Indeed, the automation of processes simply deducts from human agency some areas of interaction and automates efficient workflow and relationships.</p> <p>The reign of technomoral wisdom in this area is the wisdom of managers. Indeed, the automation impacts on how processes are developed, but cannot determine the "why." One of the strongest criticisms of managers in the postmodern era concerns exactly this point (MacIntyre, 2007; Mangham, 1995): a manager is a mere executor unless he or she is able to direct, define, and set the objectives of the firm. Technomoral wisdom is exercised in the definition of the good purpose that is achieved by the activity of the financial company operating in the fintech era. Technology is an element of the choice regarding which are the best means to achieve this purpose.</p>

Payments and Infrastructure	The fact that payments are easier to perform does not necessarily mean that the decision about payments is easier to make. However, there are studies on the impact of contactless technology on spending behaviours: if we do not see the money we use, it seems that we are inclined to spend more (Trütsch, 2014). This is where technomoral wisdom comes heavily into play. While automation takes care of the means of payment, practical wisdom helps in discerning the best purchasing option and, thanks to techno-foresight, balances present possibilities and real future needs.
Data Security and Monetisation	Technomoral wisdom helps in assessing the value of data and in choosing its best use. Any company can own data, but not every company would make the best use of it. This area, especially in Europe – given the detailed regulation under GDPR (European Commission, 2018) – lies at the border between ethical reflection and regulation.
Customer Interface	Technomorally wise developers of technological systems devoted to financial services will strive to provide the best platform for the clients, i.e. a platform which clearly helps the final user to find information without hiding potential risks and terms of use. The choice of the best means to achieve a good end is an essential part of the definition of technomoral wisdom.

* According to Arner et al. (2016, p. 1291).

This overview is illustrative but by no means exhaustive. The level of detail involved in each of the aspects of practical wisdom, updated for the digital context, reveals not only the complexity of this virtue, but also the complexity of the fintech environment in which this virtue needs to be exercised. The dawn of fintech brings an opportunity to redefine the specificity of human intervention in critical decisions (e.g. *The Renaissance of Practical Wisdom* in risk management, Hoffmann, 2017, ch. 10), and gives birth to a new educational need: training technomorally wise financial agents.

Digital Integrity

“Integrity” is another buzzword often used in the domain of finance. According to MacIntyre, “To have integrity is to refuse to be, to have educated oneself so that one is no longer able to be, one kind of person in one social context, while quite another in other contexts” (MacIntyre, 2006, p. 192). Integrity is the habitual disposition to show the same moral character in different situations. In finance, living according to the standard of integrity means, for example,

Vivre avec intégrité en finance signifie faire preuve de la même force morale avec des collègues, des clients ou à la maison. Le contraire de l'intégrité est la compartimentation, ce qui signifie montrer une force morale différente en fonction de la situation dans laquelle se trouve une personne. L'avènement de la Fintech appelle à une réactualisation de cette vertu, qui a été largement étudiée en finance et qui doit maintenant être examinée dans le contexte numérique. On appellera cette vertu «intégrité numérique» et elle peut être définie comme «la disposition habituelle à montrer la même force de caractère dans différents contextes numériques».

treating other people's money as if it is yours, or applying the same moral judgment to a situation in which others are involved as if you were the protagonist of this situation. Living with integrity in finance means showing the same moral character when with colleagues, clients, or at home. The opposite of integrity is compartmentalisation (MacIntyre, 2006), which means to show a different moral character depending on the situation in which a person finds themselves.

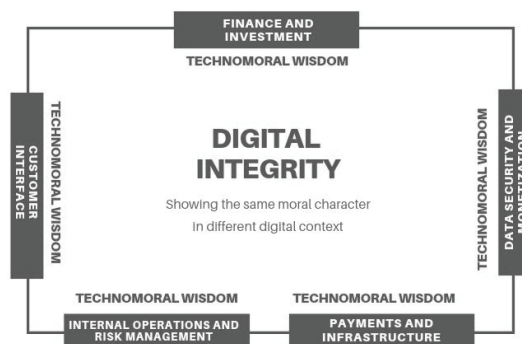
The advent of fintech calls for an update of this virtue, which has been widely studied in finance (Boatright, 2011; Cowton, 2002; Erhard & Jensen, 2012; Spitzeck, Pirson, & Dierksmeier, 2012) and now needs to be considered in the digital context. This virtue is going to be named “digital integrity,” which can be defined as the “habitual disposition to show the same moral character in different digital contexts.” Different authors have worked on identity in

digital contexts, discovering that the exposure to different digital platforms can give rise to the existence of different digital identities for the same person. For example, Sherry Turkle, in her book *Life on the Screen: Identity in the Age of the Internet* refers to decentred and multiple identities (Turkle, 1997), while Walker warns about the fact that “the Internet self is postmodern, transitory, deceptive, and fragmented” (Walker, 2000, p. 99).

Digital integrity is needed in a transversal way in all of the five areas encompassed by fintech and where technomoral wisdom enables the agent in multifaceted aspects: it is the coherent exercise of the traits of technomoral wisdom across any activity in the future of finance. In this specific characterisation, digital integrity does not concern the markets, but each human agent operating in the fintech environment.

Figure B illustrates this dynamic interaction.

Figure B - Digital Integrity in Fintech



3. Fintech and the Virtues: A Proposal for Technomoral Education in Finance

Bien que de nombreuses universités offrent déjà des diplômes spécialisés en Fintech, elles n'intègrent pas toutes l'éthique dans leurs programmes. De même, bien que certaines contributions académiques traitent de l'éthique en Fintech, la recherche et l'enseignement dans ce domaine n'ont pas encore été systématiquement développés. Afin de former des agents financiers technomoraux, des « Ascenseurs Instantanés Technoéthiques » (AIT) peuvent être introduits dans le programme d'études Fintech. Un AIT est conçu pour être une voie d'apprentissage rapide enseignée avec un contenu théorique solide, des lectures brèves et informatives et une conception adaptée aux technologies.

While many universities already offer specialised degrees in fintech, not all of them integrate ethics into their curricula. Some academic contributions deal with ethics in fintech (e.g. Scott, 2018; Trieu, 2016), but research and teaching in the ethics of fintech have not yet been systematically developed. At the same time, the integration of ethics into business school degrees is highly valued by those bodies assessing the value of business schools' curricula (e.g. Ethics Education Task Force to AACSB International's Board of Directors, 2004).

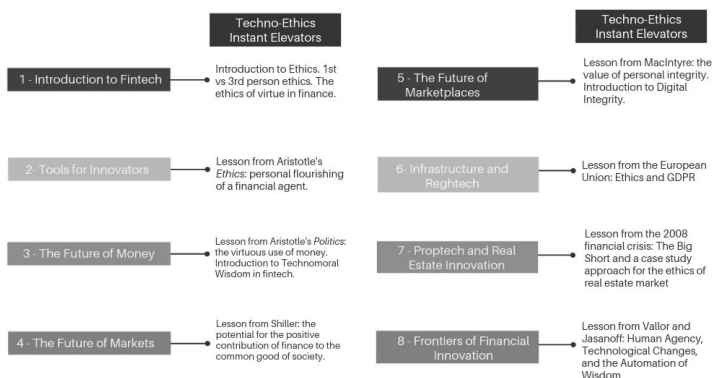
Integrating ethics in the newly-designed fintech curricula would save the finance of the future one of the criticisms against business education in the aftermath of the financial crisis: "Most of the people at the heart of the crisis [...] had MBAs after their name ... In recent years about 40% of the graduates of America's best business schools ended up on Wall Street, where they assiduously applied the techniques that they had spent a small fortune learning. You cannot both claim that your mission is 'to educate leaders who make a difference in the world'... and then wash your hands of your alumni when the difference they make is malign" (Schumpeter, 2009). According to Dobson (2008),

it is possible to integrate ethics into finance curricula at different levels, and Dembinski (2017) also suggests that the method of teaching finance itself can be different, enlarging the reductionist concept of human beings upon which the theory of financial markets is based.

In order to train technomoral financial agents, *Techno-ethics Instant Elevators* (TIEs) can be introduced across the fintech curriculum. In order to have a concrete visualisation of how a fintech curriculum can be impacted by these "TIE breaks", the following Figure C replicates the fintech online 8-module curriculum offered by Oxford University, as found in the publicly accessible sections of their website (<https://www.sbs.ox.ac.uk/programmes/oxford-fintech-programme>), and integrates each module with a TIE. A TIE is designed to be a learning fast track taught with solid theoretical contents, brief and informative readings, and technology-friendly design. Each TIE involves one hour of online engagement. Each hour is divided into four 15-minute learning steps: a 15-minute introduction to the topic; a 15-minute interaction with the instructor and the other learners; 15 minutes to explore the resources (readings and videos); and 15 minutes to write two paragraphs on how to face a situation related to the topic, to solve a case study, or to perform a related activity. Figure C shows the integration of TIEs in the abovementioned fintech curriculum.

L'éthique de la vertu est l'approche par excellence pour envisager l'activité financière future dans sa complexité technique et morale, en considérant à la fois la vie des agents financiers dans leurs unités narratives et la contribution positive de l'activité financière au bien de la société. L'avènement de la Fintech laisse une place à l'agence morale humaine, et les agents financiers impliqués dans cette industrie doivent développer les vertus technomorales afin de se développer en tant qu'excellents professionnels de la finance et en même temps comme excellentes personnes. En particulier, ils doivent développer une sagesse technomorale et pratiquer constamment l'intégrité numérique. Les Ascenseurs Instantanés Techno-éthiques sont conçus pour offrir une opportunité d'apprentissage efficace qui transforme la manière dont les agents financiers réfléchissent à la moralité de leur profession pour l'avenir de la finance.

Figure C- Techno-Ethics Instant Elevators Across the Fintech Curriculum



All the topics and related bibliography for Modules 1-5 and 8 have been sketched throughout this article, while Module 6 on regulation would be best left to an expert on GDPR. Module 7 uses the movie *The Big Short* (McKay, 2015) to provide a basis for discussion on the future of real estate and fintech.

A more advanced integration of the future of ethics in finance education would consist of adding an entire module on techno-ethics, which can be introduced by reading MacIntyre's provocative article on the character of financial agents, *The Irrelevance of Ethics* (MacIntyre, 2015). Learners are engaged in a structured discussion about whether MacIntyre's criticisms of the behaviour of financial agents and financial markets as a school of anti-virtuous behaviour could change positively or negatively in the fintech era.

Conclusions

This article considers the future of the ethics of finance in the fintech era. It answers the three questions proposed in the Introduction, arguing that:

- 1) Virtue ethics is the approach *par excellence* to look at future financial activity in its technical and moral complexity, considering both the life of financial agents in its narrative unity and the positive contribution of financial activity to the good of society.
- 2) The advent of fintech leaves space for human moral agency, and financial agents involved in this industry need to develop technomoral virtues (Vallor, 2016) in order to develop themselves as excellent financial professionals and excellent people. In particular, technomoral financial agents

need to develop technomoral wisdom across the five areas of fintech defined by Arner et al. (2016), and to constantly practise digital integrity.

- 3) A proposal for the integration of ethics into existing and future fintech curricula has been discussed: in particular, examples of TIEs (Techno-ethics Instant Elevators) are designed to offer an effective learning opportunity that

transforms the way financial agents reflect on the morality of their profession in the future of finance.

If fintech were the context which finance professionals can become the best version of themselves while contributing to the common good of society, finance would finally recover its original social function of bridging savers and investors in order to realise worthwhile projects for the common good. •

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Finance Needs 'Bilinguals' Too

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First Prize *ex-aequo*

"It is, in fact, arguable that economics has had two rather different origins, both related to politics, but related in rather different ways, concerned respectively with 'ethics', on the one hand, and with what may be called 'engineering', on the other."

Sen (1988, p.2),

In celebrating the inauguration of the Schwarzman College of Computing, MIT's new artificial intelligence hub, Rafael Raif, the president of the prestigious university, claimed the world needs *bilinguals*: engineers with better education in the liberal arts, able to build ethical products and platforms and who know how to interact with civil leaders and policy makers in order to develop responsible innovations. For this reason, MIT set up an interdisciplinary faculty that researches and teaches

disciplines ranging from STEM (science, technology, engineering and mathematics) subjects to social sciences and humanities (Hao, 2019). This is an example of a concrete response to the modern problem of reductionist knowledge which sees the need for specialisation taking the form of solving complex problems through a single, and usually technical, lens.

A similar concern which to date is unresolved characterises the financial innovation process. In the aftermath of the great crisis of 2008 and the subsequent economic recession and suffering that it caused (Better Markets, 2015), there have been at least two positive consequences. The first is defined as institutional and concerns the regulatory side, which over the last 10 years has been strengthened

Cet article pose la question de savoir si le débat actuel sur l'éthique et la finance devrait pas être enrichi sur un aspect central. Le monde de l'innovation financière repose en grande partie sur l'innovation technologique. Bien que les connaissances techniques jouent un rôle fondamental dans le processus éducatif, nos recherches indiquent que l'éducation en matière d'éthique ou de sujets similaires qui pourrait mettre en lumière la responsabilité sociale de la finance reste absent. Cet article souligne la nécessité d'une sorte d'éducation prenant en compte une composante humaniste afin d'intégrer les dimensions non quantitatives de la finance, de ses produits et de ses institutions dans les programmes techniques. L'objectif principal est d'éviter que les ingénieurs financiers n'acquiescent qu'une connaissance intransigeante et abstraite qui les éloignerait des éventuelles conséquences sociales que leur travail pourrait avoir.

with measures that have made the financial system as a whole more stable, and specifically, the banking sector. The second one is concerned with cultural aspects, which is the central theme of this article and is largely about various reflections on the relationship between ethics and finance that followed that terrible September of 2008.

This “ethical” wave has seemingly spared no sector related to finance. Many, including academics and practitioners alike, have raised their voices to highlight the need to deepen the ethical dimension of economics and finance as a safeguard against similar errors in the future. In this respect, a special effort has been made to include the teaching of ethics, which has seen “business ethics” courses added to the curricula of schools of economics, finance and management. Moreover, some of the most reliable finance professional associations such as the CFA have incorporated ethics and social responsibility into their programmes.

A Gap in Finance Ethics Education

These initiatives are definitely worthy of praise. However, this article asks whether the current debate about ethics and finance might be informed by a key point. The evolution of our economic system towards what is defined as *financial capitalism* has been and continues to be conveyed mostly by unprecedented

technological advances in terms of speed and pervasive capacity. Consider, for example, the rapid spread of algorithmic trading, cryptocurrencies and structured finance, and it is evident that the world of financial innovation is largely underpinned by technological innovation. Financial institutions have adapted quickly to this environment, setting up entire units of *quants* and financial engineers¹, with the aim of designing innovative products suited to their clients' most demanding expectations. The purely computational and quantitative skills that these product development roles require means that the personnel selection process increasingly draws from the exact sciences, which in turn has seen universities create a proliferation of masters degrees in financial engineering and quantitative finance. Furthermore, *ad hoc* certifications have been designed and accredited, such as the Certificate in Quantitative Finance (CQF), as proof of quantitative and mathematical skills, a key requirement for these new positions.

While technical knowledge is absolutely central to the educational process of those who fill these roles, our research indicates that ethics

¹ In this article we use the two terms analogously. In particular, *quants* - as those involved in investment strategies - can be categorised as financial engineers who are more concerned in structuring financial products, if we consider the investment strategy as a kind of financial product.

Nous commençons par analyser le parcours pédagogique d'un ingénieur financier hypothétique et montrés sans trop les simplifier les caractéristiques les plus saillantes d'un tel profil. Nous l'avons comparé avec celui d'un conseiller financier, en tant qu'exemple d'une tâche qui correspond au côté vente d'un produit. Les récits rassemblés montrent clairement une tendance nette vers une éducation quantitative de ceux qui occupent ces postes. Ces récits, bien qu'exceptionnels, donnent un aperçu de ce qui constitue un profil de réussite à l'ère de la finance technologique et confirment en même temps que le secteur financier a attiré des talents qui auraient autrement s'exprimer dans des domaines tels que la physique et l'ingénierie, entre autres.

education or a similar subject that might emphasise the financial sector's social responsibilities, remains absent. We argue that this is a cause for concern. Even though at first glance it might seem that the task of financial engineers is purely technical, and that it requires only mathematical knowledge, this article highlights the need for a kind of education that takes into account a humanistic component in order to integrate the non-quantitative dimensions of finance, its products and its institutions. The overarching aim is to prevent financial engineers from acquiring a purely radical and abstract knowledge that would distance them from the potential societal consequences of their work.

The article is structured as follows. The first part uses a "life history" methodology to reconstruct a typical narrative path of a financial engineer or quant. This narrative is based on our own research, with the results shown in the Annexe, which confirms the educational biases of this kind of profile while highlighting both the limits of the current financial innovation network as well as the university's role in defining these limits. The second section focuses on the reasons why the role of the financial engineer is not just a technical one. The third section focuses on the critical issues related to the current educative process of a financial engineer. Lastly, we conclude with some proposals to improve the current situation.

A Financial Engineer's Narrative

We start by analysing the educational route of a hypothetical financial engineer and show without oversimplifying, the most salient characteristics of such a profile. We also draw upon real narratives collected by Patterson (2010) and Lindsey & Schachter (2007). In order to illustrate better the specificity of a financial engineer's education, we compare it with that of a financial advisor², as an example of a task that corresponds with the sell-side of a product. Although a financial advisor's role is considered to be central in the financial sector, the greater complexity of financial products means that banks and investment funds have increased the number of *quants* and technicians they employ to address the technological challenges that they face and to gain a competitive advantage.

The stories collected clearly show the decided tendency towards a quantitative education of those who occupy these positions. An exemplary case is that of Edward Thorp, who is considered to be one of the *quants'* founding fathers. Thorp has a PhD in physics from

² We use the term 'financial advisor' throughout the paper to refer to investment professionals who are registered with FINRA in the US. We do not claim that financial advisors are devoid of misconduct, even though this paper compares *quants'* lack of ethical education with financial advisors. (Egan et al., 2019).

Les statistiques suggèrent qu'un nombre croissant d'étudiants ayant une formation technique se tournent vers des carrières professionnelles dans la finance et effectuent leur transition grâce à une formation académique telle qu'un master en ingénierie financière. Pour tenter de correspondre au CFA (Chartered Financial Analyst), le secteur des quants développe également sa propre certification, dont un exemple est le certificat en finance quantitative (CFQ) qui, contrairement à l'équivalent CFA, n'a pas de références éthiques. Créé par le gourou quantitatif Paul Wilmott, son objectif est de certifier la connaissance qu'ont les candidats des modèles quantitatifs tels que les modèles de la théorie Black-Scholes et ceux du risque de crédit ainsi que de ceux des marchés financiers tels que les marchés des actions, des titres à revenu fixe et des devises, ainsi que des connaissances de la science des données.

UCLA, is a professor at MIT and an expert in creating strategies to beat the casino at blackjack and the market on Wall Street (Patterson, 2010, p. 14). He was probably one of the most important *quants* during the 1970s and 1980s. His Princeton Newport Partners Fund, set up in 1969, is recognised as the first *quant* hedge fund. During a period of 18 years it turned \$1.4 million into \$273 million compounding at more than double the rate of the S&P 500 and did not suffer any losses during any quarter. (Authers, 2017). His book *Beat the Market* is among the bestsellers for would-be *quants*. Through his ideas, Thorp inspired young talents and directed them toward a career in finance. Among these are Ken Griffin, founder of the financial giant Citadel, and Bill Gross, father of the investment fund PIMCO; both of them heeded Thorp's recommendations to launch their respective careers.

There are also several cases of investors who followed in Thorp's footsteps, leaving the world of physics and venturing into finance. One of them is Ronald N. Kahn, who has a PhD in physics from Harvard and who is the current Global Head of Scientific Equity Research at BlackRock. He famously started his career in the financial sector without even knowing the difference between a "share" and a "bond" (Lindey & Schachter, 2007, p. 32).

These stories, while exceptional, offer an insight into what constitutes a successful profile in the era of

technological finance, and at the same time confirm that the financial sector has attracted talents that might otherwise have enriched fields such as physics and engineering.

Business Schools in the Age of Financial Engineering

Even more rigorous statistics³ suggest that an increasing number of students with technical backgrounds are turning their attention to professional careers in finance, making the transition to the financial world by an academic route such as a master degree in financial engineering.⁴ The rankings offered by two of the main industry forums, QuantNet and Rank.net, allow us to observe the curricula that some of the best universities in financial engineering offer. As shown in Table 1 in the Annexe, all these masters degrees are highly specialised and apply mathematical and physical science models to disciplines such as financial risk management, financial model planning and derivatives structuring. Conspicuously, only

3 A report by the Institute of Physics (2012, p. 12) states: "Respondents in employment one year after graduation in Physics were working in a wide range of employment sectors with the largest numbers choosing jobs in education, finance or scientific and technical industries".

4 An example is provided by the Master of Financial Engineering Program at Berkeley University which reports that 39% of students have a background in mathematics/statistics and 27% in engineering. Only 16% have a background in economics/finance (<https://mfe.haas.berkeley.edu/admissions/class-profile>)

Malgré ces avertissements et en raison de l'utilisation généralisée des modèles, les profils de premier plan au sein des institutions financières sont de plus en plus purement quantitatifs. Un exemple illustratif est celui de Chavez, ancien responsable de la section Strat de Goldman Sachs (la division R & D chargée de la création de produits financiers sur mesure) et récemment nommé responsable mondial de la division Titres. L'histoire de Chavez n'est qu'un exemple récent de la manière d'atteindre les plus hauts rangs de l'une des plus importantes banques d'investissement de Wall Street sans aucune formation formelle en finance, encore moins en éthique des affaires. Pourtant, ses connaissances en informatique et sa capacité à résoudre des problèmes quantitatifs lui ont permis d'obtenir des résultats significatifs à l'ère de la finance quantitative. En fait, et en s'appuyant sur les données collectées, les *quants* n'ont souvent pas la possibilité, au cours de leurs années universitaires, de traiter des

Imperial College (UK) and MIT (US) offer a business ethics course. In contrast, a typical MBA programme, as a path to becoming a financial advisor⁵, is organised more holistically. Table 2 in the Annexe shows how business ethics courses are in fact present and considered central to the training of good professionals. All the MBAs covered by the research offer a course in business ethics, of which 75% are "mandatory".

This empirical evidence is also reinforced by the importance that a prestigious finance association such as the Chartered Financial Analyst Institute (CFA) upholds ethical and professional standards through their investment analysis and portfolio management certification programmes. Candidates are required to meet three levels to obtain the CFA. The first is focused on the ethical behaviour and the standards of conduct of a financial manager. In an attempt to match the CFA, the *quants* sector is also developing its own certification. One example is the Certificate in Quantitative Finance (CQF) which unlike the equivalent CFA, does not have any ethical references⁶. Established by the *quant* guru Paul Wilmott, the CQF aims to certify a candidate's knowledge of quantitative finance models such as Black-Scholes Theory and Credit Risk models; their knowledge

of financial markets, including equities, fixed income and currency markets; and their knowledge of data science.

The difference between these two spheres of finance confirms what is claimed by West (2012, p.26): "Financiers and traders are subject to ethics oversight and professional codes of conduct; the quants are left to operate in a relative ethics vacuum". However, events where financial technology played a key role such as Black Monday in 1987, the collapse of the hedge fund Long-Term Capital Management, and the Flash Crash of May 6, 2010, have highlighted that the lack of ethics in quantitative models and strategies cannot be justified, since the majority of risk models and the complex derivatives that *quants* create for customers, are not easily understood by front-office managers. Paul Wilmott warns about the limitations of the creators of certain financial products:

"Many of the people who produce mathematical models and write books know nothing about finance. You can see this in the abstractness of their writing and their voices when they lecture. Sometimes they are incapable of understanding the markets, mathematicians are not exactly famous for their interpersonal skills. And understanding human nature is very important in this business. It is not enough to say 'all these interacting humans lead to Brownian Motion and efficient markets'. Baloney. Sometimes they don't want to understand the

5 As shown in Table 2, the financial sector, along with consulting, are the industries with the greatest work demand after an MBA. About a quarter of the best MBA students in the world end up working in this area.

6 See <https://www.cqf.com/>

questions liées aux dimensions humanistes et sociales de l'économie et de la finance, nécessaires pour acquérir une perspective plus intégrale du travail qu'ils réalisent.

Le fossé entre le monde des sciences humaines et celui des sciences « dures » s'est progressivement étendu à des disciplines particulières, avec une évidence claire dans le cas de l'économie. Née d'abord comme une branche de la philosophie morale, un processus de spécialisation permanente a vu l'économie passer de « l'économie politique » à une « économie mathématique » de plus en plus importante, donnant lieu à un nouveau sujet vers les années 1980 qui consistait en une fusion de statistiques, de mathématiques et d'économie, et qui devint plus tard connu sous le nom de finance.

markets, somehow they believe that pure mathematics for its own sake is better than mathematics that can actually be used. Sometimes they don't know they don't understand" (Wilmott, 2019).

A Goldman Sachs' Story

Despite these warnings and as a result of the widespread use of these models, prominent roles in financial institutions are increasingly occupied by purely quantitative types. An illustrative example is Martin Chavez, the former head of Goldman Sachs' Strats section (the R&D division in charge of creating customised financial products) and recently appointed Global Head of the Securities Division. Chavez's personal history is emblematic of the new Wall Street leaders. He has a PhD in Medical Information Sciences from Stanford University and a masters in Computer Science from Harvard, and began his professional career by founding an energy software company. He then entered the financial sector, and specifically the Currency and Commodities division of Goldman Sachs. In 1997 he was hired by Credit Suisse as Global Head of the Energy derivatives division. In 2000 he founded KiodeX, a trading software company where he was CEO until 2004, when he returned to Goldman Sachs. He has since held a series of global positions at Goldman Sachs, including Head of the Strats section, Chief Information Officer, Chief Financial Officer, and

finally his current position of Global Head of Securities Division.⁷ This is just a more recent example of how to ascend to the highest ranks of one of the most important Wall Street investment banks without receiving any formal training in finance, let alone in business ethics. Yet his knowledge of computer science and his ability to solve quantitative problems has allowed him to achieve significant success in the era of quantitative finance.

As the data collected shows *quants* often do not have the opportunity during their university years to deal with issues related to the humanistic and social dimensions of economics and finance in order to gain a more integral perspective of their work. It is likely that a financial engineering graduate would not have a background in finance or business, but would have come from the fields of physics, mathematics or computer science, and would then learn how to apply the techniques studied during the undergraduate degree to the financial sector.⁸

Quants and financial advisors are two key roles in a properly functioning financial institution. Despite their distinct competences, both discharge important responsibilities. There are several

⁷ Goldman Sachs: <https://www.goldmansachs.com/our-firm/leadership/management-committee/r-martin-chavez.html>

⁸ See the requirements of the University of Chicago <http://finmath.uchicago.edu/page/admission-requirements>, and the University of California, Berkeley <https://mfe.haas.berkeley.edu/admissions/requirements>

Même si cette évolution s'est produite principalement dans le monde universitaire, elle a rapidement trouvé son chemin dans le monde des praticiens. Wall Street, à l'origine un royaume des courtiers et des analystes capables de déchiffrer non seulement les processus économiques, mais aussi les nuances plus humaines des marchés, est aujourd'hui le royaume des quants où l'élément technique d'ingénierie est considéré comme fondamental et a remplacé l'élément le plus humaniste, peut-être parce qu'il est moins apte à proposer des solutions immédiates. Bien que la finance corresponde à la définition d'une science exacte, cet article développe la thèse selon laquelle aucune analyse technique ne devrait être dépourvue de considérations éthiques.

routes one can take in managerial finance, including the CFA and an MBA, to learn about the human dimension of finance. This article argues that even the quantitative sector has to take into account what it contributes to the good of society. But why is such a claim relevant?

The Separation Thesis

In an essay published in 1959, the writer and scientist C. P. Snow used the University of Cambridge as an example to argue that Western intellectual life can be divided into two contrasting groups. On the one hand there are the "scientists", exemplified in particular by the physicists, while on the other, there are the *literati*, who define themselves as the "intellectuals". Between these two poles there lies an abyss of mutual incomprehension which sometimes is characterised by hostility and contempt. It is this polarisation which according to the author causes untold harm to both groups as well as to society in general (Snow, 1959/2012).

This divide that Snow portrays between the worlds of the humanities and science has gradually spread to individual disciplines, and is clearly manifested in the case of economics. Originally a branch of moral philosophy, a process of ongoing specialisation has seen economics transformed from "political economy" to an increasingly "mathematical economy", giving rise to a new subject in the 1980s involving a fusion of statistics, mathematics and economics, and which later became

known as finance (Fox & Sklar, 2009). Since quantitative analysis took root, finance has become even more intertwined with pure engineering models, fulfilling part of Amartya Sen's epigraph which we quoted at the start of the article.

Even though this evolution occurred primarily in academia, it soon found its way into the world of practitioners. Wall Street, once a kingdom of brokers and analysts who could read not only economic processes but also more human nuances of the markets (Abolafia, 2001), is nowadays the realm of *quants*, where the technical-engineering element is seen as fundamental, having displaced the more humanistic element, which is perhaps less apt at offering instant solutions. This is in line with what Whately defined as the *non-overlapping magisteria* (NOMA): the principle that the economy, and hence finance, is a *free-value* subject (Whately, 1831, p. 45). Even though finance fits the definition of an exact science, this article is based on the thesis that no technical analysis should be devoid of ethical considerations.

If Financial Engineers were just like Nuclear Physicists

An anecdotal analogy, concerning the great Russian physicist: Andrej D. Sacharov, supports our suggestion. In his book *My Country and the World* (Sacharov, 1975), the future Nobel Peace Prize winner recounted how

Une analogie anecdotique concernant le grand physicien russe, Andrej D. Sacharov, appuie notre suggestion. Sacharov en proie aux images de deux morts dues à une expérience nucléaire, a exprimé l'espoir que les armes russes n'exploseraient jamais sur les villes. Le haut responsable des expériences a répondu que la tâche des scientifiques était d'améliorer les armes; comment elles seraient utilisées n'était pas leur problème. L'histoire de Sacharov et de son référent politique est éclairante dans la mesure où – par analogie – elle met en évidence la responsabilité morale des ingénieurs financiers, étant donné que certains produits financiers peuvent potentiellement être transformés en armes de destruction massive.

in November 1955 he had started to participate in some groundbreaking experiments on thermonuclear weapons. On a specific occasion these led to two tragic events: the death of a young soldier and a two-year old child. The evening after the experiment, during a small banquet, Sacharov - plagued by the images of the day before - expressed the hope that Russian weapons would never explode on cities. The high official who ran the experiments replied that the task of the scientists was to improve the weapons; how they would be used was not their concern. Intellect alone was not qualified to deal with it.

Sacharov illustrated through this episode how no one can evade his or her share of the responsibility for actions on which the existence of humanity depends. Faced with the official's denial of the existence of morality as a category in itself and insistence that there was only specialised scientific, political or military expertise, Sacharov argued that it was not possible to deny the existence of a common humanity, defined by some as conscience, that allows one to acknowledge that what concerns human beings takes precedence over any specialisation.

The history of Sacharov and the official underlines the moral responsibility that financial engineers also bear. The leading investor Warren Buffet has reflected metaphorically that certain financial products have the potential to be turned into weapons of mass

destruction⁹. It does not therefore seem out of place to imagine the military personnel in our anecdote as a financial advisor ready to launch a market security product which might be as noxious as a *time bomb* designed by a nuclear physicist. In this context, the relevance of having *quants* with a moral awareness of their role is shown in all its urgency, alongside the concern that few people in academia are confronting this issue.

Reification and Practical Wisdom

We refer here to two major contributions regarding the ethical education of financial engineers: Rooney (2013) and West (2012). Rooney focuses on the composition and structures of the networks at the centre of financial innovation and emphasises the danger that a kind of abstract knowledge, typical of these processes, easily turn into *reification*. This concept is derived from Marxist philosophy and considers abstract knowledge as if it were true and concrete (Marx referred to the fetishism of commodities), eventually becoming more real than reality. Reification means that the facts – the real world - are secondary to theory and that if there is a discrepancy between theory and reality, it is reality that should step aside.

⁹ In his 2002 letter to shareholders (p.15) derivatives are defined as “financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal”. <http://www.berkshirehathaway.com/letters/2002pdf.pdf> Accessed March 2019.

Dans ce contexte, il est urgent de faire en sorte que les quants soient conscients de leur rôle moral, notamment en prenant le relais de ceux qui – peu nombreux – dans le milieu académique attirent l'attention sur ce problème. Rooney (2013) se concentre sur la composition et les structures des réseaux au centre de l'innovation financière et insiste sur le risque qu'une sorte de connaissance abstraite, typique de ces processus, puisse facilement se transformer en réification. La réification signifie que les faits viennent après la théorie et que s'il existe un décalage entre la théorie et la réalité, c'est la réalité qui devrait s'écarter. Selon Aristote, la sagesse pratique (la *phronèse* ou la prudence) est la vertu de choisir le moyen approprié pour atteindre les bonnes fins et elle fait référence à la bonne action dans les choses morales (faire les choses).

According to Rooney (2013, p. 452), the risk of reification is particularly vivid in the networks underlying the creation of financial products - see Willmott's quote above - since these networks are generally shaped to generate private positive consequences rather than public benefits. At the root of this issue is the fact that the innovation processes are marked, on one side, by a lack of openness, which implies that they usually happen within the research units at private financial institutions while universities and research centers are oblivious to them; and on the other, by the homogeneity of the actors involved. Conversely, the university – hopefully free from that short-term focus that characterises business and able to focus on larger and more complex problems - could be the ideal place for critical thinkers to develop good financial technology and understand its implications beyond mere financial objectives.

Rooney's proposal hinges on the need to rediscover the practical wisdom component within the technical processes. According to Aristotle, practical wisdom (*phronesis* or prudence) is the virtue of choosing the suitable means to the right ends (Aristotle, 1985, 1144a) and it refers to the right action in the moral things (to doing things). It implies an ethical approach, also defined as “first person account” (Abbà, 1996), according to which an action will be right if a virtuous agent would characteristically do

it under similar circumstances. By contrast, our claim is that financial engineering education is exclusively focused on the “productive skill” (to make things), defined by Aristotle as *techné* (1985, 1140), and its criteria of success are as neutral as the standards utilised in the exact sciences.

Rooney's words echo West's call for a “common sense” approach rather than a blind trust in mathematical models when designing new products (West, 2012). West points out that financial engineers are not exempt from the fiduciary duty and the responsibility to match the complexity of a product with the level of clients' sophistication; nor from considering the implications of limited engineering models. In this context, he proposes intervening in the education of a financial engineer by identifying those moments in the decision-making process where ethical issues can emerge (West, 2012, p. 35).

Virtue Ethics in Financial Engineering

Both authors focus on the supposed role that the university should play in creating more integral financial innovations. At the same time, this proposal clashes with the financial engineering university curriculum, characterised by an evident reductionism as described previously. To solve this puzzle we found a useful contribution in Han (2015), which is relevant

La proposition de cet article, à la suite de Han (2015), est le résultat d'un mélange original d'éthique de la vertu, en particulier en ce qui concerne la sagesse pratique, et de psychologie positive. Les effets positifs d'une éducation morale basée sur cette théorie ont été confirmés par différentes études psycho-sociales. Des récits vrais et exemplaires peuvent être une source d'inspiration morale pour les étudiants. Promouvoir de nouveaux modèles de comportement en finance capables de transcender les aspects techniques de l'innovation financière et de faire preuve d'une meilleure compréhension des répercussions éthiques et de la manière dont elles peuvent être traitées, est un chemin concret par lequel les universités et les établissements d'enseignement peuvent améliorer le processus d'innovation financière.

to understanding *how* ethics can effectively have a meaning in a quantitative curriculum beyond the fact of introducing specific humanistic classes.

Han's proposal is the result of an original mixture of virtue ethics¹⁰, in particular with regard to practical wisdom, with that of positive psychology. The author expresses the need to propose positive role models that can stimulate students' aspirations, given the clash between personal values and those dictated by science or work which is typical of a Kantian morality focused on rules' fulfilment. The positive effects of a moral education based on this theory have been confirmed by different social psychological studies (Han, 2015, p. 451) and real stories of exemplary models can be a source of moral inspiration.

A concrete way through which universities and educational institutions can improve the financial innovation process is by promoting new role models in finance which are able to transcend the technical aspects of financial innovation and foster a better comprehension of the ethical repercussions of their task and how they can be addressed. One trailblazing example concerns the former trader and risk analyst

¹⁰ Virtue Ethics is one of the main approaches in normative ethics, along with deontology and utilitarianism. Its origins in Western culture can be traced back to Plato and Aristotle. It was revived in the twentieth century through the works of Anscombe and MacIntyre. The virtue ethics implies a 'first person approach' as the one previously underlined.

Nassim Taleb and his Real World Risk Institute, the "first quantitative program embedded in the real world". Here again we can see a curriculum that is devoid of explicit ethics courses, yet the fact that the mission statement claims to "understand model error before you use a model" and declares that "when and if we model, we go from reality to models not from models to reality", suggests that the Institute is a good antidote to the risk of reified abstract knowledge typical of financial innovation processes. More generally, we argue that Taleb's intellectual project (contained in Taleb, 2016) is centred on the idea that financial operators should take risks to which they are also exposed, or where they have *skin in the game* ("Take risks you understand, don't try to understand risks")¹¹.

Another real case that could work for our aim is that of Markopolos, the quant who first exposed Bernard Madoff's Ponzi scheme. Markopolos's case is recounted by De Bruin (2015, p. 143) in order to underline both his quantitative knowledge as financial mathematician and his *epistemic* virtues – in particular of courage and inquisitiveness – to ask questions where others kept silent. According to De Bruin it is the combination of traditional mathematical skills reinforced by epistemic virtue which explains Markopolos's success.

¹¹ See <http://www.realworldrisk.com/>

Un autre domaine complexe de la science est celui des neurosciences, où l'utilisation des nouvelles technologies suscite d'importants progrès dans la compréhension du fonctionnement de l'esprit et dans la recherche de traitements pour des maladies ou des dysfonctionnements liés au cerveau. La communauté scientifique débat actuellement de ces risques dans plusieurs disciplines, et il est intéressant de noter qu'ils réfèrent à la manière dont les menaces passées ont été abordés par la physique nucléaire. Ils soulignent la nécessité de mettre en place un organe analogue à la Commission de l'énergie atomique des Nations Unies «qui a été créée pour s'occuper de l'utilisation de l'énergie atomique à des fins pacifiques et pour contrôler la prolifération des armes nucléaires» (Yuste et al., 2017). Il convient de souligner ici le volet institutionnel, qui est également important pour faciliter les processus d'innovation éthique.

The Case of Neurotechnology

Obviously, the ethical challenges posed by technology do not merely concern financial innovation. Another intricate area of science is that of neuroscience where the use of new technologies (such as artificial intelligence) is spurring important advances in the understanding of the functioning of the mind and in finding cures for diseases or dysfunctions related to the brain¹². Innovation comes with threats here too, such as the ability to manipulate free will (Yuste et al., 2017). The science community is currently debating these risks across several disciplines, and it is noteworthy how they refer to a case study on past threats from nuclear physics. In particular, they emphasise the need to set up a body analogous to the UN Atomic Energy Commission “which was established to deal with the use of atomic energy for peaceful purposes and to control the spread of nuclear weapons” (Yuste et al., 2017). While Sacharov’s anecdote emphasized the cultural or ethical aspects of the individual agent, here it is worth dwelling on the institutional side, which is also important for facilitating ethical innovation processes.

Neuroscientists argue that

¹² We make reference to the BRAIN Initiative, the global project aimed at revolutionising our understanding of the human brain. <https://www.braininitiative.nih.gov/>

“the mindsets behind technical innovation could be altered and the producers of devices better equipped by embedding an ethical code of conduct into industry and academia. A first step towards this would be to expose engineers, other tech developers and academic-research trainees to ethics as part of their standard training on joining a company or laboratory. Employees could be taught to think more deeply about how to pursue advances and deploy strategies that are likely to contribute constructively to society, rather than to fracture it” (Yuste et al., 2017). Lastly, they advance the idea of a Hippocratic Oath, analogous to the one taken by doctors, which commits neuroscientists to work for the good of human beings and to observe the highest professional standards.

While it is heartening to see how these scholars are dealing with purely ethical issues linked to technological development, this article wishes to show the deep “gap” that still characterises the world of financial innovation. We think that there are still many steps to take towards a socially responsible financial engineering process, even though the years since the financial crisis have seen an increased interest in issues related to the ethics of finance, including among practitioners (it is worth noting, for example, the Dutch “bankers’ oath”).

The Road Map for an Ethical Financial Engineering

Dans cet article, nous voulions premièrement faire le point sur ce problème, en soulignant les raisons philosophiques et pratiques pour lesquelles il est urgent de s'intéresser au caractère moral des quants et des ingénieurs financiers. En second lieu, nous avons brièvement esquissé quelques idées qui pourraient, espérons-le, contribuer à définir le cadre: 1. Repenser l'éducation en ingénierie financière au travers de la lentille l'éthique de la vertu et en tirant parti notamment de la sagesse pratique. 2. Impliquer les universités et les centres de recherche universitaires dans les processus d'innovation financière laquelle se cantonne aux unités de recherche – souvent inaccessible -. 3. Adopter les meilleures pratiques et des normes de conduite pour les ingénieurs financiers, dans le sens indiqué par le CFA.

In this article, we firstly took stock of this problem, underlining the philosophical and practical reasons why it is urgent to delve into the moral character of *quants* and financial engineers. Secondly, we briefly sketched some ideas that can hopefully contribute to defining the framework. In particular, the main insights can be summarised as follows:

1. Rethinking financial engineering education through the lens of virtue ethics and leveraging in particular *practical wisdom*. This virtue captures the moral side of an action, overcoming an exclusive focus on technical aspects. Moreover, virtue ethics is a first-person approach and as such fits particularly well with the “use” of role-models in order to take into account reality when designing products or strategies. As a result, the risks of a reified abstract knowledge would be reduced.
2. Involving universities and academic research centres in the processes of financial innovation which are currently the inaccessible domain of the research units of financial institutions. This would enrich the debate and the perspective, while limiting the damage that a reductionist approach could have on the financial world.

3. Adopting best practices and standards of conduct for financial engineers along the lines identified in the CFA. The experience accumulated over the years in facing the ethical challenges of financial advisors could work as a roadmap for similar strategies for quants and anyone else involved in the financial innovation process. This could eventually lead to a “Quants’ Oath” that underscored their responsibility towards their clients and society.

These are all initial cues that need to be explored in depth in any future research undertaking. The hope is that just like nuclear physicists and neuroscientists, men and women involved in financial innovation could be “bilinguals” too. •

Table 1: Master in Financial Engineering

University	Programme	Business Ethics in the Programme	Link
Princeton University	Master's in Finance	NO	https://bcf.princeton.edu/master-in-finance/courses/
Baruch College, City University of New York	Master's in Financial Engineering	NO	https://mfe.baruch.cuny.edu/curriculum/
Carnegie Mellon University	Master's in Computational Finance	NO	https://www.cmu.edu/mscf/academics/curriculum/index.html
University of Chicago	Master's in Financial Mathematics	NO	http://finmath.uchicago.edu/page/required-courses
ETH Zurich	Master's of Science in Quantitative Finance	NO	https://www.msfinance.uzh.ch/en/courses/springsemester2019.html
Columbia	Master's in Financial Engineering	NO	https://ieor.columbia.edu/masters/financial-engineering/curriculum
MIT	Master's in Finance	Finance Ethics and Regulation	https://mitsloan.mit.edu/mfin/academic-excellence/mfin-curriculum
UCLA	Master's in Financial Engineering	NO	https://www.anderson.ucla.edu/degrees/master-of-financial-engineering/academics
Berkeley	Master's in Financial Engineering	NO	https://mfe.haas.berkeley.edu/academics/curriculum
Imperial College	Master's in Risk Management & Financial Engineering	Ethics and Professional Standards in Finance	https://www.imperial.ac.uk/business-school/programmes/msc-risk-management/programme/modules/
University of Oxford	Master's in Mathematical and Computational Finance	NO	https://www.ox.ac.uk/admissions/graduate/courses/msc-mathematical-and-computational-finance?wssl=1
NYU Tandon School of Engineering	Master's in Financial Engineering	NO	https://engineering.nyu.edu/academics/programs/financial-engineering-ms

Table 2: Ranking of MBAs¹

¹ Ranking MBA according to the Financial Times in 2019: <http://rankings.ft.com/businessschoolrankings/global-mba-ranking-2019>

Ranking MBA FT in 2019	School	Programme	Business Ethics in the Programme	Elective	Workers in finance %	Link
1	Stanford	MBA	Ethics in Management	Mandatory	35%	https://www.gsb.stanford.edu/programs/mba/academic-experience/curriculum
2	Harvard	MBA	Leadership and Corporate Accountability	Mandatory	25%	https://www.hbs.edu/mba/academic-experience/curriculum/Pages/required-curriculum.aspx
3	INSEAD	MBA	Business and Society	Mandatory	20%	https://www.insead.edu/master-programmes/mba/core-courses
4	Wharton	MBA	Legal Studies & Business Ethics	Mandatory	37%	https://mba.wharton.upenn.edu/mba-curriculum/
5	Ceibs	MBA	Business Ethics and Corporate Governance	Mandatory	20%	http://www.ceibs.edu/mba/core-courses
6	LBS	MBA	Managing Responsibility: Ethics in Work, Organizations and Society	Mandatory	27%	https://www.london.edu/masters-degrees/mba/programme-content/core-courses
8	Chicago	MBA	Business Environment	Mandatory	27%	https://www.chicagobooth.edu/programs/full-time/academics/curriculum

8	MIT	MBA	History, Environment and Ethics	Elective	15%	http://catalog.mit.edu/subjects/15/
9	Columbia	MBA	Executive Ethics	Elective	37%	https://www8.gsb.columbia.edu/courses/mba/2019/Spring
10	Berkeley	MBA	Ethics and Responsibility in Business	Mandatory	23%	https://mba.haas.berkeley.edu/academics/curriculum
11	Yale	MBA	Business Ethics/ Ethical Choices in Public Leadership	Elective	20%	https://som.yale.edu/elective-core-courses
12	IESE	MBA	Business Ethics	Mandatory	30%	https://mba.iese.edu/program/

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Part II

Beyond compliance

How to Shape Moral Attitudes in Banking - the Polish example

Ethics & Trust in Finance
Global edition 2018-2019

Second Prize

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* The views expressed herein are those of the author and do not necessarily reflect those of the Organization he is affiliated with or of the Jury.

This paper concerns the practical problem of the evolution of moral attitudes among representatives of Poland's banking sector in the face of the requirements imposed by the Sectoral Qualifications Framework for Banking in Poland (SQFB). In order to answer the question addressed in the title, we should reflect on whether work in the financial sector has a moral aspect. I will tackle this problem in the opening chapter of the paper.

In the second part, various methods and tools will be highlighted that are currently used to influence moral attitudes in professional practice. After demonstrating some downsides of such tools, part three will explore possible solutions to some emerging issues and identify relevant tools to meet the requirements established by the SQFB.

In the same section I will discuss an approach to shaping moral attitudes based on Aristotle's ethics of virtue. In the classical sense, virtue ethics is often juxtaposed with calculating and selfish economic motivation. I will try to demonstrate that it does not have to be the case and that, when some criteria are met, Aristotle's concept can be aligned with market activities. In particular, his concept of *phronesis* (practical wisdom) can significantly improve and complement some existing mechanisms and help nurture moral attitudes in the financial sector.

Moral aspects of work in the banking sector

Before identifying the moral aspects of work in the banking sector, we should define what is meant by morality. Morality can be considered

Cet essai porte sur l'évolution des attitudes morales parmi les représentants du secteur bancaire polonais face aux exigences imposées par le Cadre sectoriel de qualifications pour les banques en Pologne (SQFB). J'ai mis en évidence certains des défis auxquels le secteur bancaire est confronté dans le cadre de la mise en œuvre des exigences éthiques recommandées par le SQFB et traité les problèmes générés par le choix des méthodes employées jusqu'à présent pour développer des attitudes morales parmi les employés de banque. Lorsque les banques font de l'argent leur seul objectif, elles perdent toute possibilité de croissance morale. Cela présente le risque de créer une culture d'irresponsabilité et de déni de la réalité, comme c'était le cas avant la crise financière de 2008. Les codes ne sont pas un outil idéal pour promouvoir les attitudes morales ; pourtant, la loi, les règlements et les codes sont là pour empêcher les banquiers d'agir de façon insouciante.

as a set of social facts. If so, the technical dimensions become critical in professional ethics. The primary challenge is to find the answer to the question of what methods and techniques should be employed for effective, secondary socialisation of a specific professional role.

In this paper, however, I will rely on another understanding of morality as a person-to-person relationship based on taking responsibility for others. In my opinion, given the discussed context, every socially useful work somehow involves a relationship of responsibility for another person; by extension, it has a certain moral aspect. This aspect is obvious in the case of a physician or a lawyer. Less conspicuously, the moral aspect of a paver's work includes taking care that people will not trip and fall on the pavement; while for a baker it involves taking care of food quality. In such a moral context defined in this way, it becomes clear that banking sector work also has a certain moral dimension

Academic economists are increasingly aware of the moral aspects of work in banking and finance. There is growing research interest in matters surpassing the neoclassical paradigm in economics. There are publications appearing on the philosophy of economics and meta-economy or the ethics of economics which challenge the division of the subject into a science free of any axiological elements and normative economics defining goals

for the former. The growing number of members of the Polish Network of Philosophy of Economics also testifies to mounting interest in the subject. Recently, a Department of Meta-economics has been established as a new unit of the Institute for Market, Consumption and Business Cycles Research at Poland's National Research Institute.

Furthermore, there are numerous attempts to provide practical answers to the ethical challenges arising in the financial and banking sector. Some of the key projects in the banking sector have been the drawing up of the Code of Best Banking Practice in 1995, known since 2013 as the Code of Banking Ethics (CBE) and the appointment of the Banking Ethics Committee in the same year. Importantly, references to the CBE can be found in the SQFB, a constituent and detailed component of the Polish Qualifications Framework. In a concise manner, the SQFB defines "qualification (by industry) necessary for 67 job positions related to: customer service and consulting, retail, SME sector, corporations, risk (credit and other, as well as risk controlling and efficiency), dealing operations, internal audit, compliance, security (including IT), marketing, and macroeconomics." (Żurawski, Panowicz, Danowska-Florczyk & Kochańska, 2017). At a basic level regarding knowledge, the SQFB requires familiarity with the banking codes of best practice and ethics (Żurawski et al., 2017, 41).

Il existe un intérêt croissant pour la recherche dans des domaines dépassant le paradigme néoclassique de l'économie. Ainsi, il existe des publications sur la philosophie de l'économie, la méta économie ou l'éthique en l'économie qui remettent en question la division entre une économie scientifique dépourvue d'éléments axiologiques et une économie normative dont serait issus les objectifs de la première. Certains des projets clés du secteur bancaire ont sans aucun doute été l'élaboration du Code de bonnes pratiques bancaires en 1995 (le Code d'éthique bancaire depuis 2013; CBE) et la création du Comité d'éthique bancaire la même année. Il est important de noter que les références au CBE se trouvent dans le Cadre sectoriel de qualifications pour les banques en Pologne (SQFB), qui est lui-même une composante détaillée du Cadre polonais de qualifications.

The SQFB's guidelines on social responsibility for higher qualification levels are also important in the context of the development of ethical attitudes in Poland's banking sector. Level 4 is worded as follows: "Assumes responsibility for satisfying the needs of external and internal customers in accordance with applicable regulations, supervisory regulations, internal procedures, quality standards and professional ethics" (Żurawski et al., 2017, 42).

Responsibility aligned with professional ethics is vital to the context of this work. Level 5 requires an even higher ethical standard, where an employee at this level should be a role model of ethical behaviour in his or her team (Żurawski et al., 2017, p.43). Level 6 requires an employee to be able to resolve complex ethical dilemmas in his or her professional practice (Żurawski et al., 2017, p.44). At the highest Level 7, a banking sector employee additionally promotes attitudes based on the professional ethos by developing a culture of communication and cooperation focused on solutions that generate an added value for all partners (Żurawski et al., 2017, p.45).

In conclusion, the level of moral awareness required of financial sector employees, especially in banking, is relatively high. This theme is explored both in academic discussions and by practitioners, including members of the Polish Bank Association (PBA). A

noteworthy outcome of this interest is the requirements regarding employees' moral attitudes which are embedded in the SQFB. Such a programme suggests a fair degree of moral maturity across the sector.

At the same time, the proposed programme is very ambitious and demanding. I discuss below the currently available methods and tools for shaping moral attitudes in the banking sector in relation to the requirements included in the SQFB.

Classical ways of moulding ethical attitudes in professional practice

When there is a need for shaping moral attitudes due to a growing number of new ethical challenges, or a certain moral crisis erupts in a specific sphere of public life or a specific profession, we reach for two standard tools: regulations and incentives. The classic example was the response to the 2008 financial crisis. An overwhelming majority of commentators demanded increased regulation or enhanced systems of financial incentives in the financial sector.

The first way to response to the emergence of a moral crisis is to attempt to regulate the condemnable action. In such cases, a standard approach would be to develop a code of ethics. As Magdalena Środa pointed out in her article in "Etyka":

"The very need to frame codes is cyclical. It emerges in those professions and institutions of public

Lorsqu'il est nécessaire de façonner les attitudes morales en raison d'un nombre croissant de nouveaux défis éthiques, ou qu'une certaine crise morale éclate dans un domaine spécifique de la vie publique ou dans une profession spécifique, nous avons recours à deux outils standards : les réglementations et les incitations. L'exemple classique est la teneur dominante des débats sur la crise financière de 2008. Une grande majorité des commentateurs ont réclamé une réglementation accrue ou des systèmes renforcés d'incitations financières dans le secteur financier.

life which face a crisis; it emerges where there is "insufficient" ordinary honesty and personal uprightness. ... The weaker individual decency, the more demands for codes" (Środa, 1994, p.168).

That low opinion of human behaviour seems to be well-founded if we look at numerous professional codes formulated in Poland since the 1990s. Most of them enumerate constraints and prohibitions to be observed by the representatives of various professions. These bans have an evident cyclical character and often address various specific, unacceptable behaviours.

This state of affairs rests on two popular, yet false assumptions. Firstly, many people naively and almost magically cherish a belief in ethical intellectualism. They assume that the mere identification and naming of morally reprehensible attitudes and behaviours will make people act well. However, the mere naming of moral evil is only the first step towards shaping what a moral action can be. Since Ovid's confession, *Video meliora, proboque, deteriora sequor* (I see and approve of the better, but I follow the worse), (Ovid, 7.20-21) it has been a commonly shared belief that to take a morally acceptable action we need something more than an awareness of our moral duty.

Secondly, people would like to receive a clear, unambiguous and conclusive instruction on how to act morally. Maria Ossowska gives a name to that need, "a hunger for the absolute" (Ossowska, 2000,

p. 17-24). If I have a right, rules of procedure or code, I can consider it conclusive in resolving what is morally right. In this situation, I do not need to ponder "what I should do" but just check "what the code requires." In other words, this kind of instruction helps to liberate me from the constant need to take responsibility when facing moral challenges and allows me to rely on a code to discover what is moral.

In order to grasp the problem fully, it should be noted that the moral dimension of our actions consists of several elements. In the cognitive order, the first one is awareness of the moral nature of our performance. The second element is a sense of agitation (empathy, sadness, fear, a prick of conscience) which calls for action. The final element is the decision to act, following the perceived moral challenge.

In this context, let us consider the incentives for moral conduct. As with the drafting of codes, the mechanism of incentives partly allows us to evade the question of responsibility. This is because it is another decision-maker who determines what actions are desirable and what incentives should be proposed for employees. In this situation, all pressure is put on the second and third components of moral conduct. The main question is how to persuade people to act as we believe they should. The fundamental problem, however, is that external stimuli very often replace moral motivation and start to drive our choices.

Cet état de fait repose sur deux hypothèses répandues mais erronées. Tout d'abord, de nombreuses personnes, naïvement et presque magiquement, croient profondément en l'intellectualisme éthique. En partageant une telle conviction, nous supposons que la simple identification et la désignation d'attitudes et de comportements moralement répréhensibles inciteront les gens à bien agir. Cependant, le simple fait de nommer le mal moral n'est que le premier pas vers la définition et formulation de ce que peut être une action morale. Leszek Kołakowski dissipe toute illusion quant à l'efficacité des codes d'éthique dans son essai classique, *Etyka bez kodeksu* [L'éthique sans code moral]. Kołakowski souligne trois faiblesses essentielles de la «pensée codexée» inhérentes à l'idée de codification des principes éthiques. Le premier problème est l'asymétrie des devoirs et des revendications; le second se rapporte à l'hétérogénéité des valeurs.

Why are ethical codes not an effective tool in cultivating moral attitudes?

Leszek Kołakowski dispels all illusions regarding the effectiveness of codes of ethics in his classic essay, *Etyka bez kodeksu* [Ethics without a Moral Code]. Kołakowski points to three key flaws of “codex-ridden thinking” which are inherent to the idea of codification of ethical principles. The first problem is the asymmetry of duties and claims; the second one comes down to the heterogeneity of values.

The asymmetry of duties and claims results from the tension between the duties that we assume and a claim of the right to demand from others, so that everyone in a similar situation would recognise the same duty. Kołakowski notes that the difference between the legal and moral standards is that the former are binding universally while the latter only in particular cases. He also observes that the most morally valuable deeds are those that we cannot demand of all as an absolute duty. Moral heroism is based on the unique nature of action taken and not on acting in line with a universal obligation.

The last element stressed by Kołakowski when defending the asymmetry of duties and claims is the “*cogito* factor.” It assumes that not all moral decisions translate into a universal duty. My decision, for example, regarding the choice

between mine and someone else's interests, cannot in a specific situation only refer to the assessment that a third party has the right to accept the transfer [of this assessment]. The formula expressed in the third person ends in a contradiction (Kołakowski, 2010). Every code will be flawed because it is not the result of a wrong formulation of some principle but of an existing attribute of every attempt to create an ultimate moral instruction. As Barbara Skarga points out:

“Morality has never been framed into legal regulations; and when some attempted to squeeze it into regulations or systems of do's and don'ts, it became a source of repression and wickedness and only fuelled social hypocrisy. Moral problems blow legal clauses apart; they are rarely unambiguous and most often arise from the clash of opposing values whose hierarchy is anything but evident. The ethical dimension of action is lost and deformed as soon as it is subjected to codification or captured in systems of binding norms whether by the state, churches or professional groups” (Skarga, 1994, p.170-171).

With reference to this objection, the SQFB's recommendations about the need to take responsibility in accordance with professional ethics appear to be a more difficult challenge than we might expect. It turns out that it is not enough to refer to a line in the code to identify your professional responsibility because in many practical situations these provisions

L'exigence d'être un modèle moral devrait découler de l'accomplissement des exigences auxquelles les employés se conforment, et non pas être un des éléments fondamentaux du développement moral. Sinon, nous risquons de promouvoir les attitudes de pseudo-modèles auto-proclamés. Si nous disons constamment aux gens ce qui est juste et ce qu'ils doivent faire sans respecter leur opinion, ils perdent tout intérêt à chercher leurs propres réponses aux questions morales. En conséquence, ils perdront tout intérêt pour la moralité et se concentreront sur l'obéissance aux ordres ou le changement d'emploi.

will not offer unambiguous guidance on the preferred action.

In the sale of goods or services, the seller wants to dispose of the maximum number at the highest possible price. The buyer has the opposite purpose: to purchase only as much as he or she needs at the lowest possible price. A bank employee offering a product faces a dilemma: show the customer all possible options and products that might interest the customer or only selected products that are the most profitable for the bank (Lipiński, 2008, p. 92). Furthermore, in such a situation, the code may even offer contradictory guidance. Seen in this light, the code can only indicate which moral obligation should be followed immediately and not as a source of solutions to professional ethics dilemmas. We thus end up not knowing how we should understand "compliance with professional ethics", due to the lack of criteria,

Another problem raised by Kołakowski is the heterogeneous character of values. In his opinion, every code author must accept that all values which are presented as the subject of moral duty can be sequenced on the same scale, like a thermometer (Kołakowski, 2010, p.166). Since we assume the possibility of making a code, we must be ready to resolve a conflict between different values. Given this *cogito* factor, it is not possible to create a universal rule that determines which value should prevail over another in a certain situation.

In this context, however, it is important to note Kołakowski's conclusion that each moral choice is at the same time a resignation. This awareness is needed both to accumulate energy to mitigate the negative effects of choice and in order not to lose the perspective of a different choice in similar future situations. In addition, such awareness is needed, to tolerate someone else's choices which are not aligned with ours (Kołakowski, 2010, p.169). We might otherwise conclude that codes instruct us about how to become ideal. Worse, acting according to a code can delude ourselves that we are already ideal.

This threat is explicit, especially in the context of Level 5 of the SQFB, which requires employees at this level to be moral models for their team. There is nothing worse than self-styled moral heroes who consider themselves superior only because they blindly follow some externally imposed set of moral rules. Such people tend to force others to imitate their behaviour, miss the nuances and complexity of moral problems, and inflate other people's mistakes while ignoring or downplaying their own.

You cannot force anyone to recognise a person as a model or authority. On the contrary, you have to earn the right to be regarded as an authentic moral model, by demonstrating competence in resolving tough moral dilemmas. In my opinion, the requirement to be a moral model should follow the

Si les codes présentent tant de difficultés, peut-être les incitations sont un meilleur outil pour façonner les attitudes morales? Si les gens veulent faire ce qui est juste et que nous les récompensons pour cette attitude, il est évident qu'ils seront encore plus désireux de copier ce type de comportement. Il semble bien évident que si nous avons deux raisons d'agir, la probabilité de passer à l'acte est encore plus grande. Parfois, deux raisons d'agir se font concurrence au lieu de créer un effet de synergie. C'est important lorsqu'il s'agit d'incitations financières et de moralité. Les recherches en psychologie sociale des 50 dernières années l'ont prouvé. Plusieurs études importantes confirment la thèse selon laquelle la «commercialisation» des actions entraîne des modifications de la façon dont nous les percevons.

fulfilment of those requirements by employees and not be defined as a precondition of moral development. Otherwise, we risk promoting the attitudes of self-proclaimed (and therefore false) models. If we constantly patronise people about what is right, without respecting their opinion, they will lose interest in seeking their own answers to moral questions. As a consequence, they will lose interest in morality at all and will focus on obeying commands or changing jobs.

Anyone wishing to develop and deepen their moral stance should bear this important point in mind, especially when they aim to master the ability to solve complicated ethical dilemmas effectively.

Demoralising aspects of incentives

If codes pose so many obstacles, perhaps incentives are a better tool for shaping moral attitudes? If people want to do the right thing, and we additionally reward them for such an attitude, it naturally follows that they will be even more eager to copy that kind of behaviour.

It seems quite obvious that if we have two reasons to do something, the probability that we will do it is even greater. Yet sometimes, two reasons to do something compete with each other instead of creating a synergy effect. This is important when dealing with financial incentives and morality, as has been substantiated by research in social psychology over the past 50 years.

Several pivotal studies confirm the thesis that the “commercialisation” of actions causes changes to how we perceive them.

The first such study is Richard M. Titmuss's classic analysis of a blood donation experiment in his 1970 book, *The Gift Relationship*. Titmuss compared the British blood collection system, where all the blood came from volunteer donors, with the U.S. system in which some blood came from volunteers and some was purchased by commercial blood banks. Titmuss found that the British system worked better than its American counterpart at all levels and in all dimensions. The quality of blood was higher, there was less blood deficiency, less blood was wasted, the risk of contamination was reduced, and the process of collection was more cost-effective. The researcher concluded that financial incentive weakened the sense of civic duty (Titmuss, 1997).

Another noteworthy study was carried out by two economists, Bruno S. Frey and Felix Oberholzer-Gee. In 1993 the Swiss village of Wolfenschiessen was selected as a potential storage location for nuclear waste. The local citizens were invited to a referendum to decide whether such a facility should be created in their community. Shortly before the voting, the two researchers conducted a survey among the locals. They asked 305 people (out of 2,000 inhabitants) whether they would have approved of the construction in their village of a radioactive waste

Les études susmentionnées montrent que la formation d'attitudes morales fondées sur un système d'incitations peut souvent s'avérer contre-productive. Le problème est que lorsque l'incitation est en place, elle influe sur le choix et les gens cessent de se demander «Quel est mon devoir?» et s'en tiennent à la réponse à la question «Quel est mon intérêt? ». Afin de trouver des outils capables de répondre aux exigences imposées par le SQFB aux employés du secteur bancaire et d'éviter en même temps les problèmes résultant des limitations des codes et des systèmes incitatifs, il est conseillé de se tourner vers l'éthique de la vertu. De tels essais ont déjà été faits par les philosophes contemporains en économie.

storage site with low and medium levels of radioactivity. To their surprise, 51% of the respondents said “yes.”

The villagers were aware of the hazard and the diminishing value of their property but were still positive because Wolfenschiessen had been selected by the Swiss parliament as the best destination for such a facility. The respondents also felt that it was their civil duty to take responsibility for the waste. Later, the researchers asked the respondents whether they would have been ready to accept the proposal of building a radioactive waste repository with low and medium levels of radioactivity in their village if the parliament had paid them compensation of CHF 5,000 per person per year. On this question, the level of acceptance dropped to 25%.

The researchers achieved similar results in subsequent studies in six other places that were considered as locations for another waste storage site. They concluded:

“Our theoretical and empirical knowledge has evolved considerably since Titmuss’ intuitive theory that monetary compensation destroys altruistic values. We can now rely on an established theory of motivation crowding-out which goes far beyond the example of blood donation. This theory is consistent with a rational choice [and] therefore can be incorporated in economics. The crowding-out effect explains why the support for the toxic artefact decreased when monetary

compensation was offered for its consumption (Frey & Oberholzer-Gee, 1997, p. 753).”

The studies discussed above show that the shaping of moral attitudes based on an incentive scheme can often prove counterproductive. The problem is that when an incentive occurs it begins to determine choice. People stop asking, “What is my duty?”, and stick to answering the question, “What is in my best interests?” One example is when executives ignore the long-term condition of their enterprises and pursue short-term profit, combined with extra financial bonuses. An over-reliance on incentives will demoralise employees in two ways. First, it causes incentivised people to lose morale, understood as a moral and inner motivation to do work. Second, professional activities lose their morality when replaced by stimuli derived from an incentive system, such as financial bonuses.

Virtue ethics as a tool for shaping moral attitudes in the Polish banking sector

It is advisable to look at virtue ethics in order to find tools that will help meet the requirements imposed by the SQFB on banking sector employees and, at the same time, avoid issues resulting from the limitations of codes and incentive-based schemes. Such attempts have already been made by contemporary philosophers of economics. Deirdre McCloskey has written about

Barry Schwartz et Kenneth Sharpe ont également écrit sur l'éthique de la vertu dans le secteur bancaire dans *Practical Wisdom* (La sagesse pratique). Ils soulignent que gagner de l'argent n'est pas la seule finalité de la banque. Les banques peuvent jouer un rôle socialement utile. La *phronesis*, ou sagesse pratique ou prudence, est une vertu décrite par Aristote. Elle repose sur le désir de faire la chose correcte et d'apprendre la bonne compétence ; elle découle d'une expérience individuelle et nous aide à poursuivre efficacement la bonne action. En pratique, assumer ses responsabilités conformément à l'éthique professionnelle peut se manifester dans la sagesse pratique, par exemple lors de la tenue minutieuse des registres des revenus et des ressources du client afin d'évaluer sa solvabilité.

the seven virtues of middle class economic life: love (kindness and friendship), faith (honesty), hope (entrepreneurship), courage (endurance and perseverance), temperance (moderation and humility), prudence (know-how and foresight) and justice (social balance and integrity) (McCloskey, 2006.). Similarly, Luigino Bruni and Robert Sugden have suggested that participation in work and trade is consistent with such virtues as self-help, entrepreneurship and vigilance, trust and credibility, respect for the desires of other people and the perception of others as potential partners in mutually rewarding transactions (Bruni & Sugden, 2013, p. 141–164).

Importantly, Sugden and Bruni attempt to address objections raised against economics by virtue ethics theoreticians. In their opinion, the criticism of Alasdair MacIntyre and Elizabeth Anderson is misguided because it ignores the possibility of the existence of an economics-specific *telos* or ultimate aim. The critics assume in advance that economics must always be driven by the instrumental logic of the market. From this perspective, it is not possible to practise virtues through economic activities (Bruni & Sugden, 2013, p. 144–148).

In response, Bruni and Sugden formulate a market-specific *telos* as the facilitation of voluntary, mutually beneficial transactions (Bruni & Sugden, 2013, p.153). At this point, I would note that the use of the word

“transaction” may be too narrow and limit the moral elements that might be incorporated into the spectrum of economic activities. I would rather refer to it as the facilitation of voluntary and mutually beneficial exchange. Such a wording would allow the inclusion of cooperation (Sennet, 2012) as one of the possible elements of the *telos* of economics.

Barry Schwartz and Kenneth Sharpe also write about virtue ethics in banking in *Practical Wisdom* (2010). They point out that making money is not the bank's only pursuit. Banks can play a socially useful function, for example, by supporting individuals in raising capital to grow their businesses while making money out of the loan. Bearing that in mind, banks can be said to generate profit but also to develop the community. According to Schwartz and Sharp, a good banker is a trustworthy person who serves a community, takes responsibility for customers and is interested in them. At the core of this concept of banking is the relationship between the banker and the customer, which is based on mutual trust and responsibility. In Schwartz and Sharpe's opinion, a banking system without trust is very vulnerable to collapse. And trust, in the authors' view, is mainly based on practical wisdom (*phronesis*) (Schwartz & Sharpe, 2010).

Phronesis, or practical wisdom or prudence, is a virtue described by Aristotle. It rests on the desire to do the right thing and learn the right competence; it is derived from

Les personnes travaillant dans une institution bancaire ne peuvent pas être motivées uniquement par des stimuli internes. Des incitations externes sont donc nécessaires pour les encourager à bien travailler. Le système bancaire dépend dans une large mesure de la capacité des banquiers de discerner à qui faire confiance et que eux-mêmes méritent de gagner la confiance et qu'ils soient ainsi perçus par les clients. La *phronesis* est certainement l'outil de promotion d'un tel système bancaire. Cette vertu doit être soutenue à tous les niveaux de la carrière bancaire afin que les exigences éthiques énoncées dans le SQFB deviennent une réalité.

individual experience and helps us pursue the right action effectively. Practical wisdom is therefore a combination of the will to do the right thing and the ability to act in line with this will. A person guided by practical wisdom knows how and when to make an exception to any rule if circumstances require.

To be able to be guided by *phronesis*, we must be able to improvise and not fall into a routine. Schwartz and Sharpe say that a prudent person is like a jazz musician. He or she has a musical score with some notes (some rules), but they also have space to improvise, building a moral competence by “bending” or temporarily suspending rules. Too many notes (rules) prevent a jazz musician from improvising (developing their moral competence) or make them lose interest in playing. In this context, a code only becomes a set of guidelines that we can use, but we are also aware that we cannot just follow its instructions blindly.

Practical wisdom can be developed by learning from senior, experienced, and wise colleagues (mentors). There are several moral figures in banking, as noted by Schwartz and Sharpe. The most outstanding figure is perhaps the Nobel Peace Prize winner, Muhammad Yunus, the founder of Grameen Bank and the mastermind of the micro-loan scheme for the poor. For a number of reasons, Yunus is a perfect example here. He needed specialist economic knowledge to

create his micro-loan programme. More importantly, Yunus possessed knowledge of people living in small rural communities. Without the trust, support and commitment of people from supported communities, the idea of micro-loans would not have been successful. A similarly noteworthy figure is Ron Grzywinski, one of the founders of ShoreBank, a leading American bank supporting community development, known as CDBs or Community Development Finance Institutions (CDFIs).

Taking care of practical wisdom can help meet the challenges framed by the SQFB. In reality, taking responsibility in accordance with professional ethics can be manifested in practical wisdom; for example, when keeping careful records of customer's income and resources in order to assess their creditworthiness. Practical wisdom will help solve ethical dilemmas in the professional practice of banking sector employees, by finding room for the complexity and ambiguity of moral situations that occur; for example, when assessing whether a loan applicant is trustworthy and whether the risk is worth taking.

Phronesis can help build an attitude that seeks solutions that bring added value to all partners when deciding how to manage the bank's assets and how to give good advice to customers. Implementation of these recommendations and putting them into practice in professional life can also earn individual people the status of moral models in their team.

Creating good conditions for the development of practical wisdom is not easy. It requires bank managers to offer their staff opportunities to meet the people whom they support. Consent to some degree of improvisation is necessary, which of course, involves the risk of making mistakes and accepting them. Yet fostering practical wisdom can lead to increased satisfaction and internal motivation, and also spawn innovations such as micro-loans. Additionally, encouraging practical wisdom will allow banks to cultivate virtues enumerated at the beginning of this chapter to be guided by them in the right situations and at the right time.

Conclusion

In this paper, I have highlighted various challenges that the banking sector faces in connection with the implementation of ethical requirements recommended by the SQFB. I have also covered the problems generated by the choice of methods so far used to develop

moral attitudes among bank employees. When banks make earning money their only goal, they lose the possibility of moral growth. This may foster a culture of irresponsibility and denial of reality, as was the case before the 2008 financial crisis. Codes are not an ideal tool for promoting moral attitudes; yet, the law, regulations and codes are there to prevent bankers from acting recklessly.

People working in a banking institution cannot be driven only by internal stimuli; some external incentives are also needed to encourage them to work. The banking system depends to a large extent on whether bankers know whom to trust, and whether they are perceived by customers as trustworthy. *Phronesis* is certainly a tool for promoting such a banking system. This virtue must be supported at all levels of an employee's banking career so that the ethical requirements framed in the SQFB become a reality. •

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The Moralisation of Contracts: An Islamic Perspective

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Special Commendation of the Jury

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In the wake of the 2008 Global Financial Crisis (GFC), perhaps the greatest downturn of the global economy since 1929, many Islamic financial professionals were ready to claim that history had proved the divine footprint of Islamic Finance principles and *Shari'ah* at large. Not a single Islamic Financial Institution (IFI) was impacted by the collapse of subprime mortgage bonds and the cascading effects it generated at a systemic level among the network of banks which were exposed to highly leveraged markets blighted with toxic assets, derivatives and all sorts of complex financial devices which were structured in Western countries and which shifted the object of their investments too far from the real economy.

Today Islamic Finance assets are worth \$2.2 trillion dollars

worldwide and are forecast to reach nearly \$4 trillion by 2022 (The Business Debate, May 2018). Targeting a market of approximately 1.6 billion Muslims around the world and offering their services to non-believers as well, Islamic Finance firms have reached Western countries, with major European hubs in France, Germany and the UK. They are currently competing, albeit quietly and not always holistically, with conventional financial institutions (The Economist, October 2018).

This paper will focus on the analysis of Islamic Finance theory and practice as opposed to conventional finance. If we are to investigate the financial service's industry's ethical drivers, or debate their shortcomings, then it is worth confronting them with a model that

Au lendemain de la crise financière mondiale (CFM) de 2008, peut-être le plus grave ralentissement de l'économie mondiale depuis 1929, de nombreux professionnels de la finance islamique étaient prêts à affirmer que l'histoire avait prouvé l'empreinte divine des principes de la finance islamique et de la Charia en général. Pas une seule institution financière islamique (IFI) n'a été touchée par l'effondrement des « subprimes » ni par les effets en cascade qu'il a générés au niveau systémique via les banques fortement exposées aux actifs toxiques, aux produits dérivés et à toutes sortes de mécanismes financiers complexes. Ces derniers ont tous été structurés dans les pays occidentaux lesquels ont déplacé l'objet de leurs investissements beaucoup trop loin de l'économie réelle.

proudly declares itself an alternative to Western secular finance by being founded on the moral principles of the Islamic faith and *Shari'ah*.

As Islamic Finance has gained momentum since 2008, questions have arisen about whether *Shari'ah*-compliant financial services firms provide for greater ethical awareness and outcomes in their business practices. Could the GFC have been avoided if the financial services industry observed *Shari'ah* principles? How will IFIs react when the risk of default materialises?

To answer these questions I will first explain the pillars on which Islamic financial regulation is based. I will then move on to showcasing how Islamic financial practitioners and jurists have worked towards the creation of *Shari'ah*-compliant financial products. In this regard, *Shari'ah* scholars play a crucial role in that each Islamic financial services firm must appoint a board of *Shari'ah* experts who will ultimately judge the permissibility of the products and services offered by the industry. As I will show, the ethicality of the Islamic Finance industry is located in the structuring phase of a deal, what I like to call the Moralisation of Contracts. In that sense I maintain that the Islamic model of capital financing is inherently formalistic; it cannot ensure that the morality of agents will follow from the morality of contracts. In the last sections the case of Dana Gas default procedure will be presented to support the

arguments discussed in this paper and to outline the ethical issues that may face Islamic Finance when exposed to a specific type of risk that does not affect conventional financial firms: namely *Shari'ah* non-compliance risk.

Islamic Finance Pillars

The complexities of Islamic normative and ethical frameworks are mainly the outcome of what has been referred to by sociologists and philosophers as legal pluralism, a phenomenon reflecting the coexistence of multiple legal or normative authorities and sources of law within a given region or state. Malaysia is a good example of a plural legal system where the federal constitution provides for a dual legal framework of *Shariah* laws applying to Muslim citizens and secular criminal and civil laws applying to non-Muslims.

The definition of *Shari'ah* is itself problematic due to the constant tension between its interpretive and literary nature. As will be shown, this tension is the fulcrum of current debates among traditionalists and reformists in Muslim countries.

There are four main sources of *Shari'ah* commonly reported in Islamic law texts: the *Qur'an*, the *Sunnah* (practice) of the Prophet, *Ijma'* (Scholarly Consensus) and *Ijtihad* (Independent Juristic Reasoning). While the *Qur'an* provides basic principles regarding how life on earth is to be lived, the *Sunnah* demonstrates through

Alors que la finance islamique gagne du terrain depuis 2008, des questions se posent quant à savoir si les sociétés de services financiers conformes à la Charia accordent une plus grande considération à l'éthique dans leurs pratiques commerciales. La CFM aurait-elle été évitée si le secteur des services financiers avait suivi les principes de la Charia ? Comment les IFI vont-elles réagir lorsque le risque de défaillance se matérialisera ?

the Prophet's practice how these principles are to be implemented. As reported by Abdur Rashid Siddiqui, *Ijma* and *Ijtihad* are often grouped together to represent a legal term which refers to the use of reason and judgement to determine *Shari'ah* rulings (Siddiqui 2018). These come into operation when both the *Qur'an* and the *Sunnah* are silent on a particular issue. Nowadays small groups of scholars and jurists may reach a consensus over a specific topic; however this consensus will only be accepted globally when an assembly of world-renowned jurists and scholars endorses it.

Islamic law with regard to Islamic Finance is mostly defined as *fiqh*, or Islamic jurisprudence. This definition has its origins in the colonial era when *fiqh* was institutionalised as the authoritative approach to Islamic law by European scholars and became the dominant form of applied religious knowledge in contemporary Islamic finance (Rudnycky 2019). *Fiqh* is often described as the human understanding of the *Shari'ah*. Whereas *Shari'ah* is considered immutable and infallible by Muslims, *fiqh* is considered fallible and changeable. As will be shown, changes in the interpretation of a specific aspect of *Shari'ah* will not come without ethical concerns regarding the general practice of the Islamic Finance industry.

Justice in Exchange: Islamic and Christian Views on Trade

In order to understand how Islamic finance is structured, consideration must be given to a number of principles defining the philosophy that underlies transactions and exchanges in Muslim countries.

In a lecture at the University of South Australia (2013), Professor Mervyn Lewis traces back the philosophy of transactions to the anthropological aspects of Muslim and Christian societies and explains how these aspects led to an earlier development and definition of justice in exchange in the former.

Christianity developed in feudal societies, where most transactions were in kind and the Church was a major land owner which accounted for 50% of production. By contrast, Islam was born in the merchant towns of Arabia; exchange and market transactions were therefore an everyday part of life. In this regard, one of the most popular passages from the Bible is emblematic, describing Jesus's reaction towards the merchants in the Temple: "The crowds replied, 'This is Jesus, the prophet from Nazareth in Galilee.' Then Jesus went into the temple courts and drove out all who were buying and selling there. He overturned the tables of the money changers and the seats of those selling doves. And He declared to them, 'It is written:

La définition de la charia est problématique en raison de la tension constante entre sa nature interprétative et littérale. Cette tension est le pivot des débats actuels entre traditionalistes et réformistes dans les pays musulmans. La loi islamique en ce qui concerne la finance islamique est principalement définie comme fiqh, ou jurisprudence islamique. Le fiqh est souvent décrit comme la compréhension humaine de la charia. Alors que la charia est considérée comme immuable et infaillible par les musulmans, le fiqh est considéré comme faillible et changeant.

‘My house will be called a house of prayer.’ But you are making it ‘a den of robbers’.” (Gospel of Matthew 21:12).

Conversely, a market economy existed in Muslim countries; therefore, Islam had to come to terms with the market and so the principle of justice in exchange was defined: “trading was extolled, the forms of unjust exchange elucidated and a system of just exchange was mandated” (Lewis 2013). Licence to trade culminates with the verses in *Surah AL-Baqaran*, the second and longest chapter of the *Qur’an*: “Those who devour usury (*riba*) shall not rise again [on the Day of Resurrection] except as he rises, whom Satan of the touch prostrates; that is because they say, ‘Trade is like usury (*riba*).’ But Allah has permitted trade, and forbidden usury (*riba*).” (*Qur’an* 2:275).

In the first place, Islam does not recognise the time value of money. A dollar is worth the same today as it will be worth in three months’ time, should one decide to lend it to a borrower. Money is not to be seen as a commodity either; when purchasing and selling products, money does not change hands until the item being purchased is delivered.

Closely linked to this principle is the *Qur’an*’s strict prohibition against the collection of interest or *riba*, which is sometimes also translated as usury or exploitation. This prohibition originates from the belief that money and profits

are earned. To charge interest is considered an unrighteous gain since the financial institution is only profiting from its ability to lend money.

The third main principle is the avoidance of *gharar*, often referred to as uncertainty or hazard and any activity linked to gambling and speculation. When entering an Islamic contract, the price, quantity, and time of payment must be known in advance by the parties. It is therefore no wonder that many of the products and practices currently accepted in Western countries, such as futures, derivatives, short-selling, interest-bearing products and even money market devices are not tolerated in Muslim countries.

Last but not least, pious Muslims cannot invest in products that are considered *non halal* like alcohol, drugs, tobacco and certain foodstuffs.

No Risk No Gain: Unconditional Rewards and other Dangerous Aspects of Debt-Based Economies

Islamic Finance professionals seem to locate the root cause of detachment from the real economy in the practice of lending at interest.

The main objection against *riba* is that it represents a gain that is fixed and certain in exchange for what is uncertain, such as the success of a venture. A financier will still be entitled to claim returns even if the venture fails. As will

be shown, this sets the ground for a major *moral hazard*. There are at least 12 verses in the Qur'an dealing with *riba*, with the very first one claiming: "And what you give in usury (*riba*), that it may increase upon the people's wealth, increases not with God". (Qur'an 30:39).

This verse suggests that an economy based on interest will only make the wealthy wealthier and the poorer, poorer. It basically keeps on strengthening the position of stakeholders who are already favoured in contractual terms.

Islamic Finance professionals provide additional reasons why lending at interest is considered morally unjust and dangerous. As they argue, conventional lending institutions can be defined by the practice of *risk transfer*. Despite benefitting from several years of low tax regimes, Western banks have always sought ways to minimise their risk exposure to the detriment of customers, requiring collateral in exchange for credit, as well as to the detriment of tax payers if they need a government bail-out. In a landscape where profits are certain and losses are almost always compensated by collateral or public funds, it is no wonder that secular financial institutions have crossed so many lines. This is the moral hazard that follows in an economy heavily reliant on interest-linked products.

Instead, a more balanced exposure to risk will result in greater moral consideration and outcomes as outlined in the legal maxim *Al-*

ghurm bil ghunm, or "There is no reward without risk."

Interestingly the assumption of risk plays the role of a moralising agent in Islamic Finance. As will be shown in the next section, every contract, to be considered *Shari'ah*-compliant, must elucidate the elements of risk undertaken by the signatories.

Shari'ah-Compliant Debt: A question of *Maquillage*?

To circumvent the limitations imposed by *Shari'ah* on interest, models of financing based on debt have been structured in the form of a sales contract that allows lending institutions to make a profit rather than collecting a fixed income.

There are three major ways Islamic Finance can structure a loan that is compliant with *Shari'ah* rulings: *Murabaha*, a sales contract where a bank will purchase an asset on behalf of its clients and sell it back at a mark-up price on a deferred payment basis; *Ijarah*, generally defined as an operational lease, where ownership of the tangible asset remains with the lessor, usually a bank that purchases a good, its usufruct being transferred to the lessee for specified rental payments incorporating profits; and *Sukuks* or Islamic Bonds, which are financial certificates defined by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) as securities of equal denomination representing individual ownership interests in

La stricte interdiction faite par le Coran concernant l'intérêt ou *riba* – traduits aussi parfois comme usure ou exploitation – découle de la conviction que l'argent et les profits sont gagnés.

a portfolio of eligible existing or future assets. The *Fiqh* academy of the OIC (Organisation of Islamic Cooperation) legitimised the use of *Sukuk* in February 1988 (Wikipedia). The risks assumed in these types of contract are the ones associated with the sale of a commodity for money in the case of a *Murabaha* structure or the termination of a lease and duty of repair which the lessor is committed to in an *Ijarah* deal.

The most popular *Sukuks* are those structured in *al-ijarah* contracts where the Originator holds assets that are the basis of return, the assets are then sold to a Special Purpose Vehicle (SPV) and leased back. SPVs sell *Sukuk* certificates to investors. Each certificate represents a share in ownership of the assets. Periodic distributions are paid to investors from rental revenues. This type of instrument is also transferrable at a mutually negotiated price, thereby allowing secondary market trading. These products can nowadays provide returns that are fixed like any interest-based instrument.

It comes as no surprise that, insofar as Islamic financial devices have been developed to replicate the performance of conventional finance products, many academics and *Shari'ah* scholars have fiercely criticised the massive use of debt-based products and the formalist approach of Islamic financial practitioners that define as permissible any action or object not explicitly forbidden by the scriptures. Criticism comes in different

wordings, from the more politically correct “*Shari'ah-Compliant*” as opposed to *Shari'ah-Based*, to “*Creative Shari'ah Compliance*”, which appeared in a recent publication by Ahmad Alkhamees (2017), to the more explicit attack of Rumei Ahmed in his publication “*Shari'ah compliant: a user's guide to hacking Islamic law*” (2018).

Authenticity: A Debate on Substance for the Islamic Finance Industry

Supporters of a reformist approach have sought ways to reach beyond form to substance, lamenting the fastidious attention paid towards formal aspects of *Shari'ah* in the Islamic Finance industry, which has practically turned into the *halal* equivalent of its Western counterpart without showing significant differences in the way capital is being financed. As they claim, in order to tackle substantive aspects of Islamic Finance, the industry should be grounded in the wisdom revealed by *Shari'ah* and its objectives, a concept known as *Maqasid al Shari'ah*.

The best definition of the objectives of *Shariah* was provided by a prominent XII century theologian, philosopher and jurist of Islam: “The very objective of the *Shari'ah* is to promote the well-being of the people, which lies in safeguarding their faith (*deen*), their lives (*nafs*), their intellect (*naql*), their posterity (*nasl*) and their wealth (*mal*).

Les établissements de crédit conventionnels peuvent être définis par le transfert de risque qu'elles réalisent. Bien que bénéficiant depuis plusieurs années de régimes fiscaux avantageux, les banques occidentales ont toujours cherché des moyens de minimiser leur exposition au risque au détriment de la clientèle, en exigeant une garantie en échange d'un crédit, ainsi qu'au détriment des contribuables en cas de nécessité d'un renflouement gouvernemental. Dans un paysage où les profits sont certains et les pertes presque toujours compensées par des garanties ou des fonds publics, il n'est pas étonnant que les institutions financières laïques aient franchi tant de limites.

Whatever ensures the safeguarding of these five serves the public interest and is desirable, and whatever hurts them is against the public interest and its removal is desirable.“ (Abu Hamid al-Ghazali d.1111 CE) Models of financing based on participatory exposure to risk in the Profit and Loss Sharing (PLS) model, via means of equity-based instruments, have been endorsed as truest to the principles of Islamic faith, drawing from the renewed interest in *Maqasid al Shari'ah* and linking it to the fundamental principle of 'no risk, no gain' underlying Islamic transactions.

The most commonly used contracts in the form of Profit and Loss Sharing are:

1. *Mudaraba*: an investment partnership whereby the *Rab ul Mal* (investor) provides capital to the *Mudarib* (entrepreneur) in order to undertake a business activity. While profits are shared on a pre-agreed ratio, loss of investment is borne by the investor only and the *Mudarib* loses its share of the expected income and the time/ work invested in the commercial project.
2. *Musharaka*: a joint enterprise or partnership structure in which partners share in both the profit and losses of an enterprise. This contract allows for the financier to achieve a return in the form of a portion of the actual profits earned according to a pre-determined ratio.

Mudaraba and *Musharaka* are seen as structures that are truly compliant with the Islamic principle of risk sharing, in that only the ratio for profit is guaranteed. However, revenues mainly depend on the performance of the business which cannot be known in advance. These models should represent the major source of capital financing according to Muslim reformists. Nonetheless, studies have shown how PLS has gradually declined in use to 6.34% of total financing, down from 17.34% in 1994-6 (Khan M. Mansoor & M. Ishaq Bhatti).

There are obvious reasons why PLS contracts have proved hard to implement compared with debt products. Firstly, in order to allow a wide distribution and usage of these modes, Islamic banks have to turn into venture capital platforms and apply specialised accounting and reporting skills that are typical of private equity firms. Such processes are notably costlier and time-consuming compared with debt-based instruments.

Secondly, PLS structures cannot effectively meet industry demands for project financing, home financing, liquidity management and consumer credit. Last but not least, due to information asymmetry between the financier and the entrepreneur, the moral hazard shifts onto the latter, who may report less profit to the bank than they have actually earned in order to keep a greater revenue stream for themselves.

When Things Go Bad: Testing the Ethical Resilience of Islamic Finance

A detailed analysis of the arguments provided by both Islamic traditionalists, who support the issuance of debt-based instruments, and by Islamic reformists, who endorse models of financing based on the participatory exposure to risk via means of equity-based products, leads to the conclusion that the ethicality of the industry is located in the structuring phase of a deal: what I call the Moralisation of Contracts. In that sense, I maintain that both approaches are inherently formalistic and do not provide sufficient grounds for the elucidation of moral action.

Just as the financial resilience of banks is scrutinised by stress-tests, an effective way to prove the ethical resilience of this model would be to test it against distressed circumstances. If *Shari'ah*-based financial institutions were able to provide a better response in critical circumstances than their conventional counterparts, then a case could be built that Islamic Finance principles and practice are more solid than secular ones.

Dana Gas: A Case Study on *Shari'ah* Risk and the Moral Uncertainty of Default Procedures in Islamic Finance

The case of Dana Gas, a natural gas company in the Middle East with a public listing on the Abu

Dhabi Securities Exchange (ADX), is emblematic of the debate about morality and trust in Islamic Finance. The company issued a convertible *sukuk* in the form of a *Mudarabah* contract in 2007 for a total of \$1 billion, with maturity in 2012 offering a profit rate of 7.5%. When approaching maturity, following a period of distressed circumstances, the company defaulted in October 2012 and in November 2012 announced it had reached a restructuring agreement with *sukuk* holders. Despite the restructuring agreement, the company faced a number of other critical challenges after 2012 that prevented it from fully overcoming its financial problems. Fearing that it might not be able to fulfil its payment obligations, Dana started discussions with holders about a possible second restructuring of the *sukuk* in May 2017. The terms of a second restructuring seemed less favourable for the *sukuk* holders who were less willing to let it pass without further negotiations. However, after preliminary discussions among parties and their legal representatives in the second week of June 2017, Dana Gas announced that the *sukuk* was no longer *Shari'ah*-compliant in the UAE due to changes in the interpretation of *Shari'ah*. In consequence, it would not distribute upcoming payments due to the unlawful nature of the *sukuk*.

This led to a conflict of jurisdiction in that the *Mudarabah* agreement underlying the *sukuk* structure was regulated by UAE law,

La finance islamique joue le rôle d'un agent de moralisation dans la prise en charge du risque. Une exposition au risque plus équilibrée se traduira par une plus grande considération morale et de meilleurs résultats, comme indiqué dans la maxime juridique *Al-ghurm bil ghunm*, ou «Il n'y a pas de récompense sans risque.»

De la même manière que la résilience financière des banques est examinée au moyen de tests de résistance, un moyen efficace de prouver la résilience éthique de la finance islamique serait de la tester lors de circonstances difficiles. S'il était avéré que les institutions financières basées sur la Charia sont en mesure de fournir une meilleure résistance aux circonstances critiques que leurs homologues conventionnelles, on pourrait alors affirmer que les principes et les pratiques de la finance islamique sont plus solides que les principes laïques.

whereas the Purchase Undertaking, the part of the *sukuk* contract, was governed by English law (Zada & Muhammad, 2018). Regardless of which law will eventually prevail, this case elucidates the meaning of *Shar'iah* Risk and sets a precedent with no shortage of moral concerns:

1. On the one hand, there are no clear guidelines defining retroactivity in *Shari'ah*. Fairness of retroactivity in law is perhaps one of the most controversial matters in all jurisdictions and has been formally addressed by Western cultures in the legal maxim *Nullum crimen, nulla poena sine lege* (there is neither crime nor penalty without a law). If a new interpretation of *Shari'ah* enters into force, should this affect the previously agreed terms and conditions of a deal? In order for Islamic Finance to be trusted by a larger spectrum of potential investors and its own community, the question of retroactivity should be tackled by both governmental and religious authorities.
2. The sudden change of behaviour by Dana Gas Management, which switched from negotiating with *sukuk* holders to claiming nullification of its payment obligation by virtue of *Shari'ah* non-compliance, raises concerns about whether the decision was made out of zealous observation of the law rather than convenience.

Islamic faith does not encourage judgement about human intentions; to safeguard the unity of the Islamic community, it is desirable not to ruminate on suspicious thoughts about other believers, as elucidated in a passage of the *Qur'an*: "Oh you who have faith! Avoid much suspicion. Indeed some suspicions are sins" (Surah Hujurat 49:12).

Other passages in the *Qur'an* openly suggest that ultimately, the judgement of human intentions is mandated to Allah. Now, if we allow questionable behaviour to go morally unchecked, inasmuch as they are governed by a legal and religious framework, we incur the formalistic risk of equating legality with justice, which eventually leads to moral self-licensing. This represents a dangerous slippery slope for moral consciousness and a very tangible one, as witnessed during the Holocaust. When confronted with war crimes allegations in Israel, Otto Adolf Eichmann, the Nazi operative responsible for organising the transportation of millions of Jews to concentration camps, based the legitimacy of his deeds on the grounds of an authoritarian system made of hierarchies and commands to which he was subordinated and therefore unable to take any moral stance on the genocide he was helping to perpetrate. His position was analysed in *Eichmann in Jerusalem: A Report on the Banality of Evil* (Arendt, 1963).

Shari'ah non-compliance risk presents a unique problem for the Islamic Finance industry as it cannot be measured by statistical modelling in the same way that one can calculate market or credit risk. The unpredictability of *Shari'ah* rulings may have consequences at a systemic level.

In 2008 the *Shari'ah* board of AAOIFI ruled that 85% of the *sukuk* under issue around the world were not compliant with *Shari'ah* (Maurer, 2010). The main reason behind that statement was that most *sukuk* were asset-based rather than asset-backed, meaning there was no legal transfer of ownership of the underlying assets to holders who would not have recourse to liquidate them in the event of a default. As in the case of Dana Gas, it is not hard to imagine what would happen if 85% of *sukuk* issuers were to nullify their payment obligations at the same moment, due to *Shari'ah* non-compliance rulings. This would have consequences as dramatic as the GFC for financial stability in Islamic Finance countries.

Innovation and other Challenges for Islamic Finance Institutions

In his recent publication "Beyond Debt: Islamic Experiments In Global Finance", Professor Daromir Rudnycky (2018) eloquently unfolds the experimental ethos of Islamic Finance practitioners and scholars who join forces to create authentic financial devices that meet the religious requirement imposed by *Shari'ah*.

One key aspect of innovation for Islamic Finance is the implementation of standards to allow the use of derivatives for hedging. Use of derivatives would improve its overall credit-worthiness, as it is most actively used in real estate and energy markets.

On the other hand, a 2015 study by the IMF detected a number of regulatory issues which raised concerns about the soundness of the Islamic Finance industry. To name a few:

1. An important challenge is to ensure that profit-sharing investment accounts (PSIA) at Islamic banks are treated in a manner that is consistent with financial stability. Many regulators treat them as deposits, which undermines their loss and liquidity absorbency features.
2. Islamic banks appear well-capitalised, but there are challenges with the implementation of the Basel III Accord, due to the scarcity of *Shari'ah*-compliant high-quality liquid assets.
3. Islamic Finance raises a number of taxation issues. These include tax incentives for debt over equity, the tax treatment of sales, and additional layers of transactions in some instruments. Moreover, differences in the treatment of Islamic and conventional finance, if unchecked, can create cross-border spill-overs and encourage international tax arbitrage.

Le risque de non-conformité à la Charia constitue un problème fondamental pour la finance islamique, car il ne peut être modélisé statistiquement comme on le fait pour calculer le risque de marché ou de crédit. Le caractère imprévisible du verdict de la Charia peut avoir des conséquences au niveau systémique. En 2008, le comité Charia de AAIOFI a statué que 85% des sukuk concernés dans le monde n'étaient pas conformes à la Charia (Maurer 2010). La principale raison qui a conduit à cette affirmation est que la plupart des sukuk étaient basés sur des actifs plutôt que garantis par des actifs, ce qui signifie qu'il n'existait aucun transfert légal de propriété des actifs sous-jacents à des détenteurs qui donc n'auraient aucun moyen pour les liquider en cas de défaillance.

More generally, the IMF study pointed out the need for greater regulatory harmonisation in Islamic Finance, especially for cross-border operations. Some even argued that standardisation of *Shari'ah* interpretation is desirable. The author disagrees. By its nature, a textual interpretation is in the intellectual domain and should be kept free from restrictions. Besides, it would prove hard to implement, due to the many schools of thought regarding *Shari'ah* and *fiqh*.

Instead, a global agreement on how to manage the effects of *Shari'ah* non-compliance must be reached that minimises the risk of financial loss for investors. In this regard, the AAIOFI should play a major role in strengthening its powers, encouraging greater adoption of its standards by member countries.

At present, out of 45 AAIOFI member countries, only 12 have adopted its standards as mandatory regulatory requirements. Regardless of such adoption, the AAIOFI does not have the financial sanctioning powers of a regulatory agency due to its status as a standard-setting organisation. The same applies to the Islamic Financial Services Board (IFSB).

The author believes that the establishment of a Supranational Authority with sanctioning powers over the conduct of IFIs is desirable and would confer greater accountability and trust on the industry. Although this change will not come overnight, it should

be addressed and endorsed by the Organisation of Islamic Cooperation in its OIC-2025 action plan.

Conclusions

The Islamic model for capital financing cannot alone ensure that the morality of agents will follow from the morality of contracts, in the same way that the rules of a sport cannot prevent the occurrence of a foul. This is despite taking into account the debate among practitioners and *Shari'ah* scholars whose unprecedented input and recognised status in financial services represents an additional layer of prudential oversight for the industry, alongside regulators; one that is very positive, in light of ethical reflections on the authenticity of Islamic Finance.

Claims that Islamic Finance principles would have prevented the Global Financial Crisis of 2008 are only justified in terms of correlation. Yet correlation does not prove a direct causality and, even if it could, it has been shown that a systemic failure of this model could be triggered by the very nature of *Shari'ah* risk.

However impressive the figures on Islamic Finance assets may seem at first sight, with an estimated \$2.2 trillion managed worldwide, this total does not even surpass the total assets under management (AUM) of one major global bank alone such as HSBC, which had an estimated \$2.5 trillion in AUM in 2018.

The Islamic Finance industry is still relatively small compared with its Western counterpart and has

yet to prove it can represent a real alternative to mainstream finance, rather than a niche market. To do so, its business model needs to reach scales of at least 25% of global AUM, which are estimated to hit \$100 trillion by 2020, according to a PWC report (PWC). Due to the practical limitations imposed by *Shari'ah*, it is hard to imagine Islamic Finance will reach such levels without compromising the integrity of its business model.

If a connection can be established that links the limited market share,

size and growth of an industry or a country with greater levels of integrity in business conduct, then this paper can conclude with an open question which sounds more like a moral dilemma: should we, as Western societies, aim at lowering our growth figures to the level of Islamic Finance in order to account for better integrity, thereby giving up both the benefits and systemic risks such wealth creates? Regardless of the choice, the author believes that an answer to this question can only be reached by political means. •

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Beyond the Code of Ethics- Measuring Corporate Culture

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* The views expressed herein are those of the author and do not necessarily reflect those of the Organization he is affiliated with or of the Jury.

An ethical corporate culture is not created by a code of ethics any more than telling a child not to eat sweets gives them healthy teeth. Culture is more than documents and processes; it is made of perceptions, of feelings and the sense of “how things are done around here”. Take any recent scandal: they were not created by individual employees, but by a corporate culture which allowed and even encouraged people to behave unethically.

There was the rationalisation of the fraud; in other words, the attitude that “everyone else is doing it, so it must be ok”, the winning at all costs mentality, and the sidelining of those who tried to blow the whistle. So how can that culture have been fostered, and conversely, how can the leaders of tomorrow get assurance that the culture they

want and think they have created is actually in place? How can something as intangible as corporate culture be measured?

In the first part of this essay, we will consider three case studies of recent scandals to identify some of the tell-tale signs of a poor corporate culture. It is important to note that all three examples had a mature compliance system with an external whistle-blower hotline, a code of conduct and an internal audit department. So what went wrong?

Case studies Volkswagen

The first case study of how a poor culture can prevail through an organisation is Volkswagen. To re-cap what happened, in 2015 Volkswagen admitted equipping 11 million cars with software to detect when the car

La culture, c'est plus que des documents et des processus, elle est faite de perceptions, de sentiments et de la «façon dont les choses sont faites ici». Les scandales ne sont pas le fait d'employés individuels, mais d'une culture d'entreprise qui permet aux gens de se comporter de façon contraire à l'éthique. Alors, comment une culture déficiente peut-elle se mettre en place et comment les dirigeants de demain pourraient-ils faire pour être assurés que la culture qu'ils veulent, qu'ils pensent avoir créée est réellement en place? Comment pourrions-nous le mesurer?

Nous allons d'abord examiner trois cas: En 2015, Volkswagen a admis avoir doté 11 millions de voitures d'un logiciel permettant de détecter quand la voiture était soumise à des tests réglementaires, et alors de la faire passer en mode de faibles émissions. Ce que nous savons à propos de Volkswagen, c'est qu'il existait chez Volkswagen une culture autoritaire féroce.

was being subjected to regulatory testing. The vehicle would then enter a low emissions mode, releasing 40 times less nitrogen oxide compared with real-world driving. The original finding was made by the Californian Air Resources Board, which investigated emissions discrepancies between European and US models of the same vehicles.

The Volkswagen board, CEO, and senior management were undoubtedly accountable for this scandal. However, they did not design, test or install the software, which was down to the engineers. So what was the environment that convinced teams of engineers to develop software they knew was unethical and illegal and then for nobody to report them?

Media reports suggest there was a ruthless, authoritarian culture at Volkswagen. The New York Times interviewed an unnamed executive who said: "They only know one way of management... Be aggressive at all times". Furthermore, "the firm is controlled by a tight-knit troika of a billionaire family (Ferdinand Porsche's descendants), a German state government (Lower Saxony) and powerful labour unions. The corporate jet is not just any jet, but a full-size Airbus". (Ewing & Bowley 2015).

"The terrible mistakes of a few people"

When news of the scandal broke, the CEO Martin Winterkorn said the problem was down to "the terrible

mistakes of a few people". Board member Olaf Lies said that "the people who allowed this to happen, or who made the decision to install this software acted criminally, and must be held personally accountable". He also said the board only found out about the problems "shortly before the media did".

Matters did not improve once the scandal was full-blown public knowledge. A whistleblower stepped forward. A former Volkswagen employee filed a lawsuit for wrongful dismissal in March 2014 in the US state of Michigan. The plaintiff alleged that co-workers illegally deleted electronic data for three days after the US government accused Volkswagen of cheating on its emissions test. He was fired for reasons unrelated to the emissions scandal, although he alleged that it was because he refused to take part in an illegal act which would obstruct the course of justice (Ewing 2016).

So what was the culture that allowed this to happen? As can be seen by the responses in the months after the scandal emerged, there was a closed-off leadership at Volkswagen which passed the blame onto a handful of engineers instead of looking at the culture that made it possible. There was a culture of fear at Volkswagen, where employees were unlikely to question the orders given to them and only good news such as "we can meet the emissions targets" was passed on to management, regardless of how that

Comme on peut le constater dans les réponses dans les mois qui ont suivi le scandale, les dirigeants étaient en vase clos et cherchaient à se protéger. Ils ont accusé une poignée d'ingénieurs, convaincus qu'ils ne pouvaient pas être tenus responsables eux-mêmes, au lieu d'examiner la culture qui a permis que cela arrive.

A la Danske Bank, entre 2007 et 2015, plus de 200 milliards d'euros de transactions suspectes ont été dirigées vers des comptes à haut risque de «non-résidents» (principalement de nationalité russe). La Danske Bank a indiqué que la succursale estonienne disposait d'un système informatique différent et que les documents étaient rédigés en estonien ou en russe. On pensait également que les procédures Anti-Money Laundering (AML) appropriées atténuaient les risques élevés.

objective was achieved. Potential whistle-blowers were likely to be too scared of retribution to speak up.

Danske Bank

Our second case study concerns Danske Bank and one of the biggest money laundering scandals of recent times. Between 2007 and 2015 more than €200 billion of suspicious transactions were channelled through high risk “non-resident” (largely Russian) accounts. In 2018 Danske Bank put the root cause down to its Estonia-based branch having a different IT system where documents were written in Estonian or Russian. (Bruun & Hjejle, 2018). The bank noted: “...it was believed within [the] Group that the high risk represented by non-resident customers in the Estonian branch was mitigated by appropriate AML procedures... In early 2014, following a whistle-blower and new reporting from Group Internal Audit, Danske Bank Group realised that there had been a historical misconception.”

The bank called it a “historical misconception” but a whistle-blower appeared to disagree: Howard Wilkinson, the head of Danske Bank's Baltic trading unit until 2014. In May 2012, he became suspicious of some of the trading he saw and decided to investigate. One of Danske's clients, Lantana Trade LLP, based in London, had moved \$480 million through the branch in the space of five months.

Wilkinson paid £1 to download their company accounts, which mentioned the company's net assets as £0.00. This was reported to Danske's compliance team, who responded that it was probably an administrative error and Lantana would be contacted to update their records. Eighteen months later, Wilkinson downloaded the same report and found their assets listed as £15,689, while Lantana's account with Danske Bank had close to \$1 million. The next day Wilkinson wrote a letter to Danske bank in Copenhagen: “The bank may itself have committed a criminal offence.... There has been a near total process failure”. Two days later he received a reply: “Thanks for drawing our attention to this. It must be investigated asap” (Hope, Hinshaw & Kowsmann, 2018).

It took until the middle of 2014 for the bank's internal audit department to investigate some of the evidence. The report mentioned two findings: The Estonia branch's head of international banking had said that employees were not recording the true owners of the companies because “it could cause problems for clients if Russian authorities request information”. It also mentioned that the Estonia branch was not able to identify the true source of funds and “therefore acts against [anti-money-laundering] legislative principles” (Hope, Hinshaw & Kowsmann, 2018).

L'enquête disculpait la direction et faisait retomber la responsabilité sur les employés des niveaux inférieurs. Il y avait un manque de supervision de la part de la direction du groupe, qui ne s'intéressait qu'à l'argent que rapportait la succursale. La culture ainsi instaurée qui privilégiait les résultats au détriment de l'éthique; la culture créée permettait à la direction de la succursale de donner une explication / raison à la fraude qui du coup devenait acceptable.

En septembre 2016, on a constaté que Wells Fargo ouvrait des comptes d'épargne, des cartes de crédit et des polices d'assurance sans le consentement des clients. Cela s'est produit parce que Wells Fargo avait fixé à ses employés des objectifs élevés en matière de vente croisée de produits.

“The acts, which lasted for years, were systematic, coordinated and targeted, always targeted on making money”

Despite this conclusion, a full investigation only started in 2017, three years after the audit report. The investigation largely exonerated Danske's top management, including the then CEO Thomas Borgen. It did, however, note that 42 employees and agents “have been deemed to have been involved in some suspicious activity” and reported to the regulator (Bruun & Hjejle 2018). Since December 2018, 10 Estonian employees have been arrested, with Estonia's head of criminal police saying: “The acts, which lasted for years, were systematic, coordinated and targeted, always targeted on making money” (Tallinn 2018).

What we can see is a lack of oversight by Danske's group management, as if their only interest was the money the branch was bringing in. Yet not knowing about the fraud, while ignoring the warnings and reaping the benefits, does not excuse them, given the whistle-blower accusations, internal audit report and the fact that a small branch had a turnover higher than Estonia's entire GDP. Danske's management had set a culture which prioritised balance sheets over ethics and allowed executives to rationalise the fraud as acceptable practice.

Wells Fargo

Continuing with the financial services theme, in September 2016 the US bank Wells Fargo was fined \$185 million by the Consumer Financial Protection Bureau (Wikipedia 1), for opening savings accounts, credit cards and insurance policies without customers' consent.

Wells Fargo set employees high targets to cross-sell products; for instance, if someone applied for a current account, employees were expected as well to try and sell the applicant a credit card or a loan. The strategy aimed to persuade customers to open extra accounts which would generate more revenue. However, in pursuit of the strategy, employees fraudulently opened accounts which ended up dormant. Approximately 95% of these accounts were unfunded and thus brought in no revenue, while the remaining 5% brought in about \$2.4 million. This was small change for a bank of Wells Fargo's size, and considerably less than the fines that would come.

So it appears that Wells Fargo had a poorly thought out incentives programme and a decentralised structure with poor oversight of its separate entities.

The board's independent directors investigated, and reported on the issue in April 2017. They summarised the culture well:

“The root cause of sales practice failures was the distortion of the Community Bank's sales culture and performance management

Les administrateurs indépendants ont enquêté et sont arrivés à la conclusion que la culture exerçait une pression agressive sur les employés pour qu'ils atteignent leurs objectifs. La seule façon dont les employés pouvaient y parvenir et donc conserver leur travail, était de les créer frauduleusement.

Ainsi, dans nos trois cas, nous trouvons des thèmes communs. Peur, objectifs irréalistes, programmes d'incitation insuffisants, rationalisation de la fraude et surveillance insuffisante des petites succursales.

system, which, when combined with aggressive sales, management created pressure on employees to sell unwanted or unneeded products to customers and, in some cases, to open unauthorized accounts. Wells Fargo's decentralized corporate structure gave too much autonomy to the Community Bank's senior leadership, who were unwilling to change the sales model or even recognize it as the root cause of the problem. Community Bank leadership resisted and impeded outside scrutiny or oversight and, when forced to report, minimized the scale and nature of the problem...Many employees felt that failing to meet sales goals could (and sometimes did) result in termination or career-hindering criticism by their supervisors. Employees who engaged in misconduct most frequently associated their behaviour with sales pressure, rather than compensation incentives" (Independent Directors of the Board of Wells Fargo, 2017).

In other words the culture was created by an aggressive management who instilled fear in their employees to meet arbitrary, and in some cases, harmful sales targets. They felt the only measure of success was the amount of accounts that were opened per day. The only way employees could satisfy this measure and not be fired was to create fraudulent accounts. Any new employee was exposed to a culture where "everyone else is doing it so it must be ok, or at least, better than losing my job"

The signs of poor corporate culture

Using our three case studies, what are the signs of a poor corporate culture? Some themes stand out:

Fear: Senior management not being willing to listen to internal or external feedback; employees not being able to raise their concerns; management not leading by example, but getting employees to follow orders through fear.

Targets: Management setting unrealistic targets, and sticking rigidly to performance metrics which do not help to achieve the organisation's goals.

Incentives: Remuneration that has a high degree of uncertainty, with a large variable element in bonuses or commission.

Rationalisation: Lower level employees do not realise the consequences of their actions. Senior managers see that unethical behaviour is tolerated if objectives are met or that they are not accountable if they turn a blind eye. The culture becomes self-perpetuating.

Poor oversight: Small subsidiaries or branches may not need the same oversight as larger functions in an organisation. Yet they should still be investigated where red flags are spotted, such as when a small entity generates disproportionate revenue.

We now know what a bad corporate culture can look like and with hindsight it is easy to identify what went wrong. The challenge is

Les auditeurs internes jouent un rôle clé dans la transmission d'informations sur la culture de l'entreprise au conseil d'administration et à la direction. Nous pouvons apprendre des techniques qu'ils utilisent. L'Institut des Auditeurs Internes propose trois techniques. Une analyse des causes profondes des problèmes d'audit précédemment soulevés, des sondages auprès des employés, des entretiens structurés et l'utilisation de mesures préexistantes pouvant refléter la culture.

looking forward: How can the leaders of tomorrow measure corporate culture in the workplace? And what metrics are already out there to help them?

Internal auditors

Internal auditors have a key role in passing information on company culture up to the board and senior management. They have a unique, independent view across all levels of the organisation. Through their audits, they speak to everyone from CEOs to managers to the most junior employees who are just starting in the company. The internal audit profession is increasingly looking at questions of ethics, culture and tone at the top, beyond simply ticking boxes and checking signatures. So if we want to learn about measuring culture and ethics, it is important to see how internal audit teams can feed into our assessment.

Of course what we can obtain from an internal audit team depends on its maturity its mission as set by the board. But they could, for example, include culture as a reported part of each audit, or they could perform a specific enterprise-wide culture audit. We could use the results of this work in our culture measurement programme, and as the internal audit profession already focus on these areas, we could also use some of the same techniques.

Fortunately, the Institute of Internal Auditors provides guidance on precisely this issue and suggests four techniques (Roth 2017):

The first is root cause analysis of previously raised issues. Under close scrutiny, the root cause of an issue is often cultural. For example, if procedures are not being followed due to management overriding controls, this could be due to a “win-at-all-costs” culture where managers do what it takes to get the job done; or to an authoritarian regime where management’s say is final. This could be an isolated case, where one manager’s aggressive subculture does not match the company’s culture. Or it could be pervasive, connecting the dots between numerous issues that shed light on a defective corporate culture.

Using interviews and questionnaires

The second and third techniques are structured interviews and employee questionnaires. The two techniques have similar aims but different approaches: to ask employees specific questions to obtain their version of the company’s culture. The idea of a structured interview is to ask the same set of questions to as large a sample of employees as is practical.

Being a face-to-face interaction, it requires good interviewing techniques; for example, it should start with some questions to put the candidate at ease, such as “do you feel the company’s values are lived through the organisation?” The interviewer can then move on to more pointed questions, like “have you ever been asked to do anything

Les entretiens structurés et les enquêtes auprès des employés ont des objectifs similaires: poser les mêmes questions à un groupe de personnes, mais selon une approche différente. D'autres indicateurs peuvent apporter des preuves objectives de problèmes de culture. Nous pourrions utiliser des mesures telles que les résultats des enquêtes auprès des clients, le nombre et la tendance des plaintes de clients, les statistiques de rotation du personnel, les incidents opérationnels, etc.

that violates the companies code of conduct?"

This approach does have disadvantages, however. As mentioned, it takes a skilled interviewer to be able to ask the right questions in the right way, and interpret the results correctly; for example, to detect when an employee is not being completely open, and thus ask the right follow-up questions. Due to the time needed, sample sizes cannot be as large as employee questionnaires.

Questionnaires take a similar approach by asking a sample of employees a specific set of questions. They can, however, reach a far larger number than interviews. Such questionnaires are often composed of a series of statements followed by a question asking whether the interviewee strongly agrees, agrees, disagrees or strongly disagrees. A well-constructed questionnaire can provide specific objective data on the company culture, so long as employees believe their anonymity is protected. On the other hand, they lack the human touch and the possibility for the interviewer to ask follow-up questions or seek a clarification from the interviewee.

The fourth technique is to leverage metrics which can reflect culture. Using these metrics along with the above techniques can bring objective evidence of any cultural issues. Relevant metrics could include customer survey results, the number and trend of customer complaints, employee turnover

statistics and operational incidents. The selection of the statistics used will depend on the industry and the company itself. It is also possible to monitor them regularly and produce a monthly dashboard which can act as an early warning indicator. Yet statistics alone will not give an overview of a company's culture. They must be used in conjunction with other techniques.

Now we understand some of the techniques auditors can use, what other theories and techniques are available?

Using formal surveys

As discussed above, one of the most obvious ways to measure culture is by asking people. However, to obtain consistent, measurable answers requires a structured approach, and to get results from the whole company, we will need to use a questionnaire. There are plenty of consultancy companies which sell different types of employee questionnaires to help you create your own. Let us consider some of the psychological information and logic behind these surveys.

In his book *Ethicability* Roger Steare identifies three types of ethics (Steare, 2013): the ethics of obedience, care and reason. These relate to the decisions you make and the reason you take them. For example, if you have a job that you love, but one day your boss verbally abuses a colleague, reducing them to tears, do you decide to report this incident:

Si vous souhaitez utiliser des sondages, il est important d'examiner certaines des informations psychologiques qui les étayent: selon Roger Steare, il existe trois types d'éthique. L'éthique de l'obéissance, du soin/ de l'attention et de la raison. Roger Steare a créé son enquête pour mesurer la prévalence de ces types d'éthique, ainsi que 10 principes d'intégrité. À savoir la sagesse, l'équité, le courage, la maîtrise de soi, la confiance, l'espoir, l'amour, l'honnêteté, l'humilité et l'excellence. Ses résultats montrent que l'éthique de la raison et de l'obéissance sont inversement corrélées. À mesure que nous grandissons, notre éthique de la raison augmente et notre éthique de l'obéissance diminue.

- a) because there are HR procedures that are there to deal with such incidents;
- b) because others may suffer if you don't take action;
- c) because you would rather risk your job than allow that type of behaviour?

Answer A relates to the ethics of obedience. It does not ask us to decide what is right or wrong; it tells us. Answer B relates to the ethics of care; what decision will benefit the most people and what are the consequences of our actions on others? Lastly, answer C relates to our ethic of reason. We do what is right because it is the wise or moderate thing to do. None of these answers is more correct than the others, but they show us how we shape our decisions of what is right and wrong.

Steare created his own survey to measure the prevalence of these types of ethics, along with 10 principles for integrity: wisdom, fairness, courage, self-control, trust, hope, love, honesty, humility and excellence. This survey has been completed more than 80,000 times globally, and gives us an insight into ethics and culture across industries. The most striking point to note from these results is that the ethics of reason and obedience are inversely correlated. As we mature, our ethics of reason increases and our ethics of obedience decreases. So the more we develop our ethics of reason the less we need to comply with the ethics

of obedience. That is consistent with Kohlberg's theory of moral development (Wikipedia 3); namely, the more rules we have, the less we will think about what is right.

Are fewer rules better?

In the case studies above, people did not go astray because of a shortage of rules. On the contrary, there were plenty. A good analogy is that of a roundabout. In Europe, it has been demonstrated that the roundabouts are safer and more efficient at regulating vehicle flows than traffic lights. The latter are the equivalent of a rule: Go or do not go. The roundabout pushes the driver to exercise judgment about when it is safe to go. Think how many times you have entered a junction at a traffic light, and not been able to exit the other side. Would you have done that if the traffic light had not been there?

This does not mean that the key to good ethics is throwing out the rule book. But does giving people the freedom to think what is right or wrong within a given set of parameters improve people's ability to make good decisions? The evidence seems to support this hypothesis..

In *Organizational culture and leadership*, Edgar Schein wrote that there are three levels of culture (Schein, 1992). Like peeling an onion, it becomes harder to change a culture the deeper one penetrates. The first layer is "artefactual", meaning things like the visible signs,

Edgard Schein a écrit à propos de trois niveaux de culture, «artefactuel», «épousé» et «sous-jacent». Les valeurs artefactuelles sont ce que nous pouvons voir, et peuvent donc facilement être mesurées. Les enquêtes et les entretiens peuvent être utilisés pour mesurer les valeurs épousées. Les hypothèses sous-jacentes peuvent cependant être plus difficiles à mesurer, mais nous pouvons utiliser d'autres mesures telles que le filtrage des communications des employés ou leurs évaluations.

Pour compléter les résultats d'une enquête et obtenir des données plus régulières, nous devons également utiliser certains indicateurs. Ceux-ci devraient être similaires aux KPI (Key Indicator Performance - Indicateur de Performance Clé) existants. Gardons en mémoire que les KPI peuvent toujours être manipulés. Misons davantage sur les «mesures attendues» que sur la fixation d'objectifs spécifiques.

the company logos, buildings and dress codes. The second, “espoused values”, refers to what people say and believe. The last layer refers to “underlying assumptions” regarding our core beliefs and the way we see the world.

Artefactual values are fairly easy to measure, as things we can see. It is likely that metrics exist for such values. Surveys and interviews can be used to measure espoused values which can help reveal employees' attitudes towards risk and, a company's leadership and priorities. However, cultural areas which cover underlying assumptions can be harder to measure.

Take “integrity” as an example. Unethical behaviours can become normalised so they are accepted or not even noticed, and therefore not reported. Here we need to think of some alternative ways to obtain insight.

Dr Alex Gillespie and Dr Tom Reader from the London School of Economics suggest one uses “unobtrusive indicators of organisational culture”. These analyse data from already available sources (Gillespie and Reader 2017). Examples include Glassdoor.com reviews by employees, where they can anonymously leave reviews on issues such as salary, management, and the work-life balance; response time to customer calls to measure how customer-centric employees are or if they are being pushed to take calls outside working hours; and linguistic analysis of emails between

employees, searching for data such as high levels of aggressive language in a particular area.

Metrics

As mentioned already, we need metrics to complement the results of our survey and provide regular data. These metrics will be similar to existing KPIs and this will help with the implementation. So it is worth highlighting some of the best practices and pitfalls with KPIs.

Firstly, keep it simple. Implementing a culture measuring programme will not work if it merely burdens business units with more data collection. Try to use what is already available.

Secondly, any KPI can be manipulated, however well designed. As the Wells Fargo fraud demonstrates, KPIs are indicators, not fool-proof measures, and any insights from KPIs should bear this in mind. There is no point calculating complicated formulas that give your team a culture score of 75.6 and a yearly target of 77. The KPIs will be manipulated and you will lose all insight into the data.

Furthermore, some metrics also resist precise target scores. Take the number of times the whistleblowing hotline is called. This is a good indicator of culture and of course having a lot of calls is a bad sign. But so is having no calls; it means the hotline is not known or it is not at the front of employees' minds. Ideally, the target should be somewhere between “no calls”, and “lots of calls”. Setting

Une fois que les ces résultats ont dépassé les limites attendues, nous devrions utiliser le jugement humain pour approfondir nos recherches.

Nous devrions combiner les outils susmentionnés: commentaires des employés, métriques/paramètres globales de l'entreprise et métriques/paramètres de l'unité opérationnelle pour donner une vision globale de la culture de l'entreprise, mais aussi pour indiquer les domaines dans lesquels il faut peut-être creuser plus profondément en cas de préoccupations. Pour les commentaires des employés, nous devrions utiliser un questionnaire bien conçu pour les employés. Ils sont coûteux à gérer, mais s'ils sont bien faits, ils constituent la pierre angulaire de notre programme de mesure de la culture. Ensuite, nous devrions utiliser l'équipe d'audit/de vérification interne d'une entreprise pour donner un aperçu.

an arbitrary target of ten calls a year is easily manipulated and reveals nothing. Instead, it is much better to have an expected measure of between five and 15 calls a year. This is not a target but an indicator of where there might be hotspots of poor culture. Once they are identified, you need to use human judgement, go to the area in question, talk to people, and find the story behind the figures.

What to measure?

We now know the techniques we want to use, so let us drill down to the details of implementation in an organisation. First, though, an organisation needs to define what culture it wants. This can relate to values or the company's mission, but it has to be honest. If you want a culture where employees come first, and work-life balance, support and mentorship are all important, you are unlikely to be ruthlessly efficient at the same time.

Having defined the desired culture, there are three main areas of focus during implementation:

- employee feedback
- companywide metrics
- business unit metrics

These can then be combined to give an overall view of company culture, but also to identify areas where there may be a need to dig deeper to uncover concerns. To be clear, the following is not meant to be an exhaustive list of all measurement techniques. There is no one-size-fits-all; instead they are ideas, to spark thinking about implementation in your company.

Employee feedback

Here we can focus on two areas: “asking people”, and “asking people who ask people”. The first, “asking people” has already been discussed at length. The specifics of what to ask, how to ask it and how to interpret the results are the subject of much study. The drawback to surveys is that they are usually conducted annually and are expensive to perform. However, a well-designed survey can be the cornerstone of any measurement programme.

The second area is to ask people who ask people. Here we can use a company's internal audit department to provide the insights we need. They can dig deeper in specific areas and have the skills and resources to use interview techniques. The feedback will depend on the internal audit department's mission. The department could simply provide highlights of audit reports for you to analyse for areas of attention. Alternatively, it could provide specific information, such as the results of a root cause analysis of issues raised by the audit, to find common culture-related themes. Lastly, it could include a cultural element, providing statistics in areas such as audit report clearance times or the time elapsed for management to close issues identified by audits.

Company-wide metrics

These are statistics that are generic across all business lines. With the same statistics across the

Les indicateurs à l'échelle de l'entreprise sont des statistiques génériques dans tous les secteurs d'activité. Ils incluent des éléments tels que les taux de rotation du personnel et les informations des entretiens de départ des employés. Avec les mêmes statistiques dans toute l'entreprise, il devient facile de faire des comparaisons. Nous pouvons analyser Glassdoor pour les avis négatifs ou utiliser la technologie pour analyser les communications des employés. Les métriques/paramètres des unités commerciales essaient d'utiliser leurs propres KPI. Ceux-ci varient énormément d'une unité opérationnelle à l'autre et d'une organisation à l'autre. La direction devra définir cela, éventuellement avec l'aide d'équipes de conformité et d'éthique. Ceux-ci pourraient inclure des exemples tels que le ratio de marge bénéficiaire ou le nombre de clients ayant obtenu un crédit maintenant en retard.

company it becomes easy to make comparisons. We can include some traditional statistics such as:

- number of calls to a whistleblower hotline
- employee turnover and dismissal rates
- negative employee exit interviews
- employee overtime rates
- risk/compliance training attendance
- remuneration statistics, such as the difference between executive and employee pay, or the percentage of salaries paid in bonuses or commissions

We can also add some more contemporary measures. We can scan Glassdoor.com (the website where employees leave confidential reviews on their employers) for negative reviews. One interesting technical measurement is linguistic scanning of employee communication such as emails or chat messages for specific types of language.

KeenCorp (KeenCorp.com) has developed software which anonymises employee communication, scans it and measures employee engagement through “language analysis and tension detection” based on how people write. It then reports back with a heat map of potentially problematic areas, with the data anonymised and in compliance with European GDPR legislation.

Business Unit Metrics

This tries to use the business units own KPIs, which can vary wildly across other business units and organisations. You will need to rely on the division management to define their own KPIs and their level of tolerance. They can be guided by teams such as Compliance and Ethics, but the ownership must lie specifically with the relevant business unit. Some generic examples could be:

- profit margin ratio
- number of client complaints
- number of clients granted credit now in arrears
- number of management-accepted risks
- maturity of continuous improvement initiatives (which often have employee feedback to management at the heart)
- number of management-approved exceptions to procedures
- number of procedures

Conclusion

So can we measure corporate culture? I would argue no. “Measure” is the wrong word, because it implies that we can arrive at precise, measurable figures and create management reporting that receives and assesses indisputable facts. If we measure, we get statistics and targets. Our reports might say “we have a turnover of \$10 million and a culture score of 72. The following year we

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intend to increase these by 10%". Metrics would be manipulated, surveys answered "correctly" and any insight lost.

What we can do, however, is create cultural indicators. We investigate if metrics fall outside expected boundaries. We do not set arbitrary targets. We try to understand the story behind the figures, which might point to evidence of poor culture. On the other hand, perhaps the fluctuations are for perfectly acceptable reasons.

It is up to you how to implement a cultural indication programme. This paper has offered some insights and concrete examples, but the specifics will depend on each organisation and industry. My best advice is to not over-complicate or burden the

business lines; use what is already available. It will not be a fail-safe way to avoid any type of fraud in the future, but hopefully it can detect problem areas and allow action to be taken to prevent a culture where fraud is considered acceptable.

Instead, the goal is to create a culture driven by the ethics of care and ethics of reason, where profit is not the only motive and we seek to help the communities we serve. Only then can we look to improve the image of an industry that since the financial crisis has ranked among the least trustworthy, along with politicians, journalists and estate agents. That alone should be sufficient motive to take action. •

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Part III

**Can/should ethics
be monitored ?**

E

ffects of Product Complexity on Ethical Behaviour

Ethics & Trust in Finance
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Finalist

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* The views expressed herein are those of the author and do not necessarily reflect those of the Organization she is affiliated with or of the Jury.

*"Integrity has no need of rules" –
Albert Camus*

The decade following the global financial crisis has been damaging for the financial services industry. Not only has revenue suffered due to the precarious position of global capital, but the industry has been dogged by ethical dilemmas that have further damaged its position. In order for the industry to rehabilitate itself over the next decade, the sector needs to answer two questions: Why is it so vulnerable to ethical issues? And what can be done about it?

This paper will argue that ethical issues seem to occur to a greater extent in financial services due to the complexity of the products it deals in. This complexity leads to a differential in knowledge between institutions and their customers, which places the former in a position

of power: over their customers but also over their employees. The power of institutions to drive their employees to increase revenue creates substantial pressure to leverage the position of power they have over their customers, which in turn provides a greater opportunity for ethical dilemmas to arise..

In order to address the problem regulators, legislators and the industry need to take a more holistic and proactive position than they currently hold. By understanding how the portion of agreed knowledge, brought about by product complexity, can lead to imbalances in power, these groups can leverage a wider range of approaches, alongside existing regulation, to develop more potent initiatives against unethical behaviour. The industry as a whole can develop solutions that are far

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more potent and sustainable than regulation alone can provide, by strengthening financial education for both adults and children, increasing the clarity of information about financial products and conducting deeper analysis of the factors that squeeze margins,

However, before these solutions can be developed it is essential to understand the nature of power and how the degree of agreed knowledge each party holds, due to product complexity, shapes buyer-supplier relationships.

The role of capitalism

To understand this interplay between consumer knowledge and unethical conduct, one needs to look at the central ideas of capitalism: the trade of goods and services (Wallerstien, 1975). Prices are set broadly by demand from the buyer, or the utility they attribute to an item, and the supply of this item by the seller (White, 1991). This principle creates a dialectic relationship between buyer and seller (Dampérat & Jolibert, 2009). Sellers try to achieve the highest prices for their goods, whereas buyers are trying to get the best deal (Inderst & Wey, 2007). This basic standard facilitates, in one way or another, our lives and the institutions we interact with (North, 1991). In healthy economies, where there is consumer demand, marketplaces are created with multiple vendors to facilitate provision of this service (Taylor, 2001). It is therefore in a supplier's

interest to offer a competitive price because a customer can get the service from another supplier (Porter, 1979).

It is this competitive pressure, however, that forms the basis for unethical behaviour in business. A key assumption underpinning capitalism is that consumers have knowledge and oversight of the whole market, and can pick the best deal from the range of suppliers (Ratchford, 2001). Yet what happens if the consumer does not have oversight of the market or cannot understand the complex variables that make up the price of a service? Knowledge of these complexities is the unique selling point of service organisations. So how can consumers judge the best deal if they are not knowledgeable about the products? How can buyers have the ability to switch suppliers, if they are unable to differentiate effectively between products? It is this imbalance which gives financial institutions the upper hand over their customers. It creates an inequitable relationship between buyer and seller, with the power to price a good in the hands of the seller (Porter, 1979).

In order to demonstrate this notion, let us consider consumer behaviour regarding some of the simplest and most recognisable financial products: current (checking) account switching rates in the UK. If supplier and buyer power were more equitable, we would expect to see similar switching rates to other services.

Le déséquilibre entre le consommateur et le fournisseur est très prononcé dans les services financiers en raison de la complexité des produits financiers. En bref, plus le produit est complexe, plus il faut de connaissances spécialisées pour le comprendre. Cela crée un plus grand déséquilibre entre le fournisseur et le consommateur, ce qui offre une grande possibilité au comportement contraire à l'éthique. Il est donc essentiel de comprendre les racines de ce pouvoir et la façon dont il se manifeste sur le marché financier.

Yet in 2015 only 3% of customers in the UK switched their current account, compared with 12% who switched their gas and electricity supplier (Hartfree et al., 2016). Furthermore, the argument cannot be made that banking customers are more satisfied with the service they receive. Substantial evidence shows that banking customers do not switch even when dissatisfied with their bank (Bansal et al., 2005).

The nature of the products and services that financial institutions sell means that the balance of power between supplier and buyer is skewed towards the supplier. This in turn makes it is easier to take advantage of buyers and thus create an ethical dilemma.

The balance of power

Why does this disparity in knowledge give so much licence for financial organisations to act unethically? In order to answer this question, it is imperative to investigate what is power, and how it is formed and maintained between suppliers and buyers.

The degree of complexity of a financial product has a profound impact on the relationship between financial institutions and their customers. This is because the more complex the product, the more expert knowledge is required to understand it. This mismatch in knowledge between the supplier (the financial institution) and the buyer (the consumer) has a significant impact on the degree of

power each party holds. The more knowledge one party possesses, the greater its portion of power, as noted above. It is the disparity in power in the supplier-buyer relationship that increases the opportunity for unethical behaviour.

To understand this concept it is necessary to investigate notions of power. Classically, power was defined as being wielded by individuals or small groups, by way of “episodic” or “sovereign” acts of domination or coercion (Rabinow, 1991). However, this can be seen as a simple definition, only representing one manifestation of power. Classical definitions missed the power relationships that exist between individuals on a day-to-day basis. In this way, more modern discourse defines two forms of power: repressive power and normalising power (Foucault, 1980).

Repressive power

The first form of power, repressive power, incorporates traditional definitions of power. In this perspective, power is presented as a dichotomy; the capacity of an agent to impose its will on the powerless. Power is thus defined as a possession which is owned by those in power, to the detriment of those who do not possess it (Mills, 2003). For example, repressive power is evident when a judge orders a criminal to be sentenced, or a manager threatens employees to do what they are told, or be fired. In essence, it is the suppression of an undesirable act

Le pouvoir répressif est la définition traditionnelle du pouvoir. Le pouvoir est la position qu'une partie peut exercer contre une autre, par exemple un monarque contre ses sujets. C'est également l'approche traditionnelle de la réglementation des marchés financiers, les régulateurs ayant le pouvoir par le biais de la législation d'appliquer des mesures punitives pour lutter contre les comportements non éthiques. Cependant, cette forme de pouvoir est réactive, elle est souvent utilisée à la suite d'un comportement contraire à l'éthique, ce qui signifie qu'elle doit être considérée comme un pouvoir de second ordre.

by another agent through the use of force to get someone to do his or her bidding (Foucault, 1980). In the examples above, a judge is using repressive power to imprison a criminal for a crime, which in this case is the undesirable behaviour. Similarly, a manager is forcing his employees to do his bidding under the threat of being fired.

Two problems can be identified with using this definition of power alone. Firstly, repressive power is secondary power (Gore, 1995a). That is to say, the need to use repressive power implies a failure has already occurred; an undesirable act has already taken place. So, regarding the examples just mentioned, the state only needs to lock up criminals if its laws have been broken, and a manager who has to threaten employees is not fully in control of them. If an agent were truly powerful, then they would not have to use repressive power.

Secondly, by suggesting power is repressive intrinsically defines power as oppressive; it stops the powerless from doing what they want, bringing them in line with the wishes of those in power. This can be seen in classical interpretations of power such as Marxism, where individuals are puppets in the hands of powerful institutions (Althusser, 1984). This is an over-simplified explanation of power. As already explored, repressive power is a reaction to undesirable behaviour, which it aims to repress; yet it also enables resistant behaviour.

If a state passes an unpopular law then resistant behaviour will result (Foucault, 1976). For example, when the United States passed prohibition laws in 1920, there was a boom in underground drinking dens and organised criminal activity to supply them (Lyman, 1997). This demonstrates that repressive power is inefficient because it can produce the opposite effect to its purpose. Instead of being an oppressive force, it can be a productive one.

This use of repressive power can be seen in the current approach to regulating the conduct of financial institutions. Much of the cornerstone pieces of regulation for financial services have been reactions to previous unethical behaviour; the legislation is reactive rather than proactive. A perfect example was the introduction of the US Sarbanes-Oxley Act 2002, in reaction to the collapse of Enron (Li et al., 2008). Although the act took great steps to outlaw the unethical behaviour seen at Enron, it did not stop it happening in the first place. This example illustrates the secondary nature of regulation; it will always lag behind those wishing to behave unethically who are not covered by particular legislation.

In addition, the introduction of further regulation elicits a response from those in financial institutions. Previously profitable activity is now inhibited, and as such, new types of behaviour have to be found to gain a competitive advantage. Consider in his context the implementation of

Il y a pouvoir normalisant lorsque nous interagissons avec d'autres êtres humains. Le pouvoir répressif, en revanche, n'est en action qu'à certains moments, lorsqu'un comportement contraire à l'éthique a eu lieu. Le pouvoir normalisant est donc le pouvoir qui décrète ce qu'est un comportement normal, ou quelles sont les normes sociales auxquelles nous devons obéir. Cela signifie que c'est une source de pouvoir plus puissante que le pouvoir répressif car ses fondements reposent sur les normes sociales qui régissent nos vies, plutôt que sur le paysage réglementaire et législatif en perpétuel changement. En d'autres termes, s'opposer au pouvoir normalisant, c'est s'opposer à l'ensemble de la communauté dans laquelle vous vivez, et non à quelques individus puissants.

Basel II regulations. Banks gamified these rules, finding loopholes and attributing capital to areas where the legislation was unclear or poorly drafted (Peston, 2013). This misallocation of capital had a major effect when this capital was required during the global financial crisis. This gamification was the fate of Basel I, which required the drafting of Basel II, and in the end this was also the fate of Basel II, which required the drafting of Basel III. In its current state, legislation is inefficient at regulating the ethical behaviour of financial institutions.

Normalising power

What of the second form of power: normalising power? Foucault (1980) says that our lives are only shaped by repressive power on rare occasions. For example, only a small number of people are sent to prison. Only a small number of people within financial services engage in unethical conduct. Further to this, we do not walk around with the insatiable urge to break the law; we do not walk around a shop, for example, with only the threat of prison stopping us from shoplifting. There has to be, therefore, something more profound at play.

This is the difference between repressive and normalising power. Repressive power makes us do something we do not want to; normalising power, on the other hand, enables us to do what we want to do anyway (Gore, 1995b). Put another way, normalising power

is the power that decrees what is normal behaviour or what are the social norms that we must subscribe to.

One can already see the supremacy of normalising over repressive power. Think of the public backlash when a social norm is broken. Even if an action is not illegal, there can still be a public outcry. This is evident from the backlash against unethical behaviour in finance. Often this behaviour does not contravene any laws, but the actions are held to a higher ethical standard. It is this power that Foucault identifies as normalising power, which enables people to do automatically what society desires, by codifying these desired behaviours into social norms.

Foucault thereby dismisses the idea that there is a real individual beneath the baggage of social convention; rather, without these social norms, one would not be a person at all (Foucault, 1980). Desired behaviour, in this case ethical decision-making, is an integral part of who we are as individuals. To go against this is not just to resist a select few who possess power; it is to resist the standards that the community sets. Again, this highlights the reactive nature of repressive power, which seeks to solve a problem that should not exist. In an ideal world, individuals would engage in desired behaviour because they believed it was the right thing to do. Repressive power is in the hands of a select few; normalising power is everywhere.

If normalising power is everywhere, how are ethical issues allowed to arise? How can regulators harness this power? And how can one empower financial organisations to behave in an ethical way? In order to answer these questions, it is critical to look at the way in which relationships are formed through normalising power.

Power/Knowledge

For normalised power relationships, the level of power held by each party depends on how much agreed knowledge each party possesses (Foucault, 1980). The term “Power/Knowledge” is used to signify that power is constituted through accepted forms of knowledge, understanding and “truth”:

“Truth is a thing of this world: it is produced only by virtue of multiple forms of constraint. And it induces regular effects of power. Each society has its régime of truth, its ‘general politics’ of truth: that is, the types of discourse which it accepts and makes function as true; the mechanisms and instances which enable one to distinguish true and false statements, the means by which each is sanctioned, the techniques and procedures accorded value in the acquisition of truth; the status of those who are charged with saying what counts as true” (Foucault, 1980, 131).

Thus, those who have more knowledge of accepted forms of truth have more power than those

who have limited knowledge. One example is the power doctors have over your own body. Through their knowledge of medicine, doctors have the power to declare you fit or healthy. We therefore trade the norm of self-determination over our bodies to a doctor, based on their knowledge of medicine. Furthermore, we hold doctors to a higher standard to advise us appropriately on our health. This power, therefore, is not standalone; it is in the context of other social relationships. The power of a doctor is stronger than a random person on the street, because they have demonstrable medical knowledge.

The same is the case for the behaviour of financial institutions, which have power over managing their clients’ financial risk. They hold this position because they have knowledge of the economic and mathematical levers through which this risk can be managed. In return, clients expect institutions to act in their best interests (Zacharias, 1995) and hold them to higher standards accordingly.

The problem in business occurs because employees are also tied to the norms between themselves and their employers. Employers delegate the ability to generate revenue to their staff who in turn let their employers take responsibility for their career progression and compensation (McDowell, 1990). If this power relationship between employee and employer did not exist, then businesses would give

En ce qui concerne les relations de pouvoir normalisées, le niveau de pouvoir détenu par chaque partie dépend du degré de connaissance reconnue détenue par chaque partie détient. Ainsi, plus un individu est au courant des formes de vérité acceptées, plus il a de pouvoir sur les autres avec moins de connaissances. Cela se voit dans la relation déséquilibrée entre les institutions financières et leurs clients. Les institutions financières ont le pouvoir de gérer le risque financier de leurs clients car elles connaissent les leviers économiques et mathématiques grâce auxquels ce risque peut être géré. Cette position de pouvoir ouvre alors la porte à un comportement contraire à l'éthique.

away their products for free, as this would be the best outcome for the customer. This division of power between employer, employee and customer comes back to the dialectic nature of capitalism noted above. Ethical issues occur, therefore, when the power of the employer to generate revenue (and the reward employers bestow on employees for this generation) is greater than the power of the client to hold organisations to account.

This disparity in power comes from the knowledge of a product. An employer can hold their employees to account over reduced revenue generation. Employers often have clear oversight of the products they sell, the revenue they generate and who is generating this revenue. Businesses fail when this oversight is not present; for example, during the build-up to the global financial crisis banks loaded their balance sheets with complex derivative products which they did not fully understand (Choudhry, 2010).

In the case of the power relationship between employer and individual employees, the power sits with the employer, because they have oversight of all sales and can promote those which generate the most revenue. Put simply, employers have knowledge of overall business performance which an individual employee does not possess. This is the case in all organisations (not just financial services) where employees are empowered to behave in a way that generates as much revenue

as possible. The difference comes in areas with complex products or services, as it is more difficult for customers to hold suppliers to account. In other sectors, such as grocery shopping, customers are able to compare the best deal for vegetables and hold unfair suppliers to account by shopping elsewhere. As we have already seen, this accountability is difficult to enforce even with the most vanilla financial products (Hartfree et al., 2016). Customers have limited knowledge of financial products and often have an opaque view of what represents a fair deal. Power, consequently, sits with the institution. Ethical problems thus occur when the power of revenue generation is greater than the power of customers to hold organisations to account.

This discourse is not unique to financial services; rather it is a factor which influences all ethical decision-making in organisations and is amplified by product complexity. The more complex the product, the weaker the position of the consumer compared to the supplier and so the larger the window for unethical behaviour. Consider an example from outside financial services. The pharmaceutical industry is another sector which deals in complex products and has been dogged by ethical issues – notably by raising the price of life-saving drugs by hundreds of times (Haque, De Freitas et al., 2013). As with banking, the customer has very limited power to hold the pharmaceutical companies

Le déséquilibre dans les connaissances spécialisées concernant les services financiers est très accentué parce que la complexité des produits financiers, de par leur nature, est très forte. Il est donc essentiel d'explorer les comportements qui se sont manifestés pour identifier des recommandations pouvant améliorer le niveau éthique des décisions prises.

to account, because they are often prescribed the medicines by their doctors and depend on the drug to live. The power to generate revenue far outstrips the ability of the customer to deprive the company by switching to another supplier. As such, pharmaceutical companies have the ability to act in whatever way drives the best revenue growth, rather than in the best interests of the customer.

One can see, therefore, that the current reactive approach of regulators to tackling unethical behaviour is inefficient. The power that financial institutions hold over their customers is more profound and intrinsic than any regulation can remedy. As such, more nuanced approaches need to be taken in order to combat unethical behaviour.

A unique challenge to financial services

This holistic recognition of normalised power relationships between buyer and supplier in turn produces a unique challenge for financial services. How can the balance of power be redressed between financial institutions and their customers if the products and services that are sold are inherently complex (Howcroft et al., 2012)? Financial services differentiate themselves based on the complexity of managing financial risk. As already highlighted, the problem occurs because of the dialectic relationship that exists at the heart of capitalism. An abstract way of

solving the problem would be to solve this contradiction within capitalism. This is the solution reached by many 19th and 20th century ideologies; that capitalism is inherently flawed, and as such, a new basis for social institutions has to be found (Godelier, 1967). This is not a position which this paper accepts or seeks to engage. As mentioned, the central nature of capitalism to our institutions means the outcome of these abstract discussions have far wider social impacts (Tormey, 2012) than those of ethical decision-making in financial institutions. Financial institutions must therefore be allowed to generate revenue and differentiate their product-offering like all businesses.

How can strategies be implemented to improve ethical behaviour within financial services if abstract arguments do not efficiently redress the balance of power between financial organisations and their clients? The answer can be found by exploring real-life examples of unethical behaviour within the sector and understanding where the gaps are present.

Examples of unethical behaviour in financial services

Two scandals in the UK show how these power relationships can turn into ethical issues. These scandals are the mis-selling of payment protection insurance (PPI) and the mis-selling of interest rate swaps.

Au Royaume-Uni, deux scandales montrent que ces relations de pouvoir peuvent se transformer en problèmes éthiques. Ces scandales sont : la vente abusive d'une assurance de protection des paiements (PPI) et la vente abusive de swaps de taux d'intérêt.

The PPI mis-selling scandal occurred when credit providers built high-margin, low-coverage insurance products into loans in order to increase profits. Put in context, for every £100 that insurers received on car insurance, they paid £78 in claims; for PPI, they paid out just £15 for every £100 of policy income (de Meza et al., 2007). Financial organisations were able to do this because customers were not knowledgeable about the terms of the loan agreements (De Pascalis, 2018), or what constituted good insurance. As a result, credit providers were able to add insurance with little coverage for loans, safe in the knowledge that claims would not be made against it. Credit providers abused their position of power by exploiting their knowledge of the products to generate profit for their organisation.

One can see the power relationships at play in this example. Salespeople within financial organisations were placed under great pressure to increase margins for their employers. In response, products were developed for the sole purpose of generating revenue at the expense of customers. This example demonstrates how inequity of power between customers and organisations, and employees and employers, played out in the production of unethical financial products.

In a similar way, the interest rates swap scandal took place within the capital markets divisions of global banks, when they used their knowledge of interest rate trends

and the swaps market to sell unfair interest rate swaps to their business clients. Rate swaps were initially set up to protect customer loans against interest rate rises. If interest rates rose then the bank would pay the customer compensation, but if they fell then the customer was liable for the cost. Some of the world's biggest banks sold these swaps to their customers at times of falling interest rates, almost guaranteeing increased customer expense. Banks were also accused of failing to mention the "break costs" of exiting the swap should a customer wish to terminate the agreement, telling clients the protection was "zero cost". The level of compensation paid by banks' client was so heavy in some cases that businesses were forced to go out of business (Popper, 2012).

Financial organisations, in this case the banks, used their knowledge of macro-economic trends to sell one-sided products where customers had no knowledge of the market, or access to it. The lack of customer knowledge of how swaps worked - in particular, that compensation can be paid both ways - delivered guaranteed margins for the banks. Once again, it can be seen from this example how banks took advantage of their power over customers to generate profit for themselves.

Strategies to address ethical issues

Lack of customer knowledge causes a power imbalance between customer and financial organisations

that can be exploited for increased profits. The social norm among these institutions is to drive for increased revenue, due to the balance of power being in their favour. What, then, are efficient strategies to address future unethical behaviour, given that regulation draws on repressive power, which we have seen is an ineffective approach?

Firstly, we need to address the fundamental knowledge differential in society, namely, a lack of knowledge of finance and economics generally. In its simplest form, this means focussing resources on improving financial education across the board. For example, it involves carving out an increased portion of the curriculum in schools for financial education in matters like how to budget, the time value of money, what is a bank and its function and what products do they sell. It also requires an increased focus in schools on economics and financial mathematics. At a higher level, more advanced education should be made available to adults about how to manage their own financial risk, including the best approaches to follow.

By increasing financial education we can address the knowledge gap between those on the inside and the outside of financial institutions. For instance, if customers had more awareness of the basic components of a swap product, they would have had a better grasp of the risks involved when their bank tries to sell them interest rate protection products. In particular, they would have been

better placed to realise that what they were being sold was not “zero cost”.

Secondly, if financial institutions are serious about addressing unethical behaviour, they need to make the components of their products, and thus the related risks, easier to understand. This means not hiding risks in small print and instead bringing them to the fore of product descriptions. This would give customers knowledge of the key points of the product they are considering whether to buy, free of financial jargon, and of any potential consequences of engaging in such an arrangement, thereby balancing the scales of agreed knowledge on which normative power is based. In this context, few customers would have purchased PPI, if they had had a clear view of what was being added to their loan agreements and an understanding of what this insurance covered.

Lastly, regulators need to be more proactive in assessing and identifying which market trends are likely to cause ethical dilemmas. For example, regulators should be considering where there are high levels of product saturation, or squeezes on margins, in order to understand where organisations could be motivated to use unethical practices to hit revenue targets. These warning signs were present with both PPI and interest rate swaps and could have been identified well before mis-selling actually took place. Regulators could have seen that falling or stagnant interest rates might provide an opportunity

Afin de réduire les comportements contraires à l'éthique, un certain nombre de stratégies efficaces doivent être mises en œuvre. Premièrement, il faut identifier et réduire les lacunes dans les connaissances spécialisées. Deuxièmement, si les institutions financières veulent sérieusement lutter contre les comportements non éthiques, elles doivent faciliter la compréhension des composants de leurs produits, et donc des risques associés. Enfin, les régulateurs doivent être plus proactifs pour évaluer les tendances du marché et identifier lesquelles de ces tendances sont susceptibles de causer des dilemmes éthiques.

for investment banks to make use of one-side swap deals to boost profit margins, targeted especially at business customers, with larger loan agreements but little insight into the swaps markets.

Strategies to address unethical behaviour, therefore, are much more efficient if regulators and legislators are able to identify where there is a significant mismatch between customers and financial institutions. It is this mismatch that forms the base of normalised power relationships and provides the opportunity for unethical behaviour to occur. Efficient strategies are needed to close this gap and thus reduce the window of opportunity in which unethical behaviour can take place.

Conclusion

The complexity of financial products leads to a greater window for unethical behaviour to occur. To address unethical behaviour in financial services it is necessary to understand the normalised power relationships between institutions and their customers and between institutions and their employees. This is because normalising power enables us to behave in a way that is deemed correct by a social group.

The balance of power in these relationships is set by the amount of agreed knowledge one party has over the other. In the case of financial services, institutions hold power over their clients, who are consumers of financial products with limited knowledge of what they are buying.

In this case, self-regulation through notions of supply and demand is flawed because buyers are unable to shop around in an informed manner in order to get the best deal.

Additionally, one must assess the relationship between financial institutions as employers and their individual employees. Financial institutions in this relationship exercise power over their employees to generate revenue for the organisation. As such, employees of financial institutions may be motivated to generate revenue for their organisation at the expense of their customers.

This power differential is present in all capitalist relationships between buyer and seller. The unique challenge faced by the financial services sector is that financial products are inherently complex. Without this fact, financial services would not exist in their present form, raising the question: How can all customers have a more equitable relationship with financial institutions if the products they are sold can only be fully understood with expert knowledge?

By considering the UK's PPI and interest rate swaps mis-selling scandals, one can see how financial institutions can tend to exploit their superior knowledge of financial products to the detriment of their customers, with revenue generation prioritised over customer benefits. In the case of financial institutions, social norms tend towards increased revenue generation rather than customer welfare, based on the

normalised power that institutions hold over consumers.

How can this misbalance of power be addressed? Firstly, governments and educators need to promote financial education. This can start at school with more financial and economic mathematics being included in the curriculum, and lead to more advanced education on managing risk for adults. Secondly, if financial institutions are serious about addressing unethical behaviour, they need to state clearly and simply the key components of

the product and the related risks, in an easily digestible manner. Finally, regulators need to be more proactive in identifying potential problem areas, such as where high product saturation or squeezes on margins occurs.

By developing a greater understanding of the normalised power relationships at play within the provision of financial services, we can begin to acquire a better appreciation of the factors that produce unethical behaviours, and implement initiatives to combat them. •

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Conduct Capital Buffer

Ethics & Trust in Finance
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Finalist

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* The views expressed herein are those of the author and do not necessarily reflect those of the Organization she is affiliated with or of the Jury.

The aim of this essay is to propose a regulatory instrument rewarding ethical behaviour in the banking sector.

It is divided into the following parts:

- i) Rationale for a regulatory-driven incentive for banks to behave more ethically;
- ii) Key findings in literature about conduct and ethics in finance and how I define them in relation to banking;
- iii) Proposal of a measure to evaluate the conduct of banks;
- iv) Discussion of how to promote conduct effectively by regulatory stimulus;
- v) Proposal of a Conduct Capital Buffer;
- vi) Brief discussion on credit risk related concerns of the Conduct Capital Buffer.

I mostly used the example of the Poland for illustration purposes while developing the concept of the Conduct Capital Buffer. The key findings and ideas seem to be universal in nature and should be applicable to most countries with a developed rule of law.

The unethical world we live in

The issue of ethics in banks is quite complex. As demonstrated during the last global financial crisis, the conduct of banks significantly deviated from the desired ethical standards. This was a key point of interest for a number of newspaper articles (Irwin, 2014; Wild & Glover, 2018), books (McCormick & Stears, 2018; Koslowski, 2011; Villa, 2015; Aragon, 2010; Carboni, 2011), films (Wolf of Wall Street, 2013; The Big Short, 2015; Inside

La question de l'éthique dans les banques est complexe. Comme l'a démontré la dernière crise financière mondiale et les amendes élevées que les plus grandes banques du monde doivent payer à cause des comportements contraires à l'éthique. La gestion des banques s'est considérablement écartée des normes éthiques souhaitées. Dans le même temps, il semble que l'absence actuelle de règles de conduite au sens strict n'ait pas d'impact (direct) suffisant sur les opérations réelles des banques et que les autorités de contrôle manquent d'instruments pour obliger les institutions financières à adopter un comportement plus éthique.

Job, 2010) and even Master's theses (Turner, 2010) and Ph.D. dissertations (Tischer, 2013).

The behaviour of banks in recent years significantly deviated from the desired ethical standards. The scale of financial fees imposed on financial institutions has also been growing. In Poland, the lack of research devoted to conduct makes the assessment of the level of compliance impossible, especially since it would be too superficial to link this assessment of individual banks solely to fines imposed by the Polish Financial Supervision Authority (PFSA). At the same time, it seems that the current lack of conduct regulations in the narrow sense does not have a sufficient, direct impact on the actual operations of banks and supervisors lack the competence to force financial institutions to behave more ethically.

In the United Kingdom, for several years now, an innovative study has been conducted to measure the level of conduct compliance in credit institutions. For the mechanism for awarding ethical behaviour to be effective, it must motivate the actions of the bank's shareholders rather than its employees.

A comprehensive study by the Conduct Costs Project Research Foundation (CCPRF) has revealed distortions that show how the banking sector diverged from the common standards of morality¹. In the period 2012-2016, the 20 largest banks in the

world, employing a total of 2.3 million people paid £300 billion in fines for misconduct, equivalent to about 70% of Poland's GDP. Contrary to popular belief, misconduct consisted mostly of faulty internal processes and procedures, not deliberate frauds by individuals in cases that were often covered by the media, such as that of the Credit Suisse employee, Patrice Lescaudron. The majority of fines resulted not from fraud or market abuse (which only accounted for 6% of all fines, including the LIBOR scandal), but from banks' persistence in virulent practices towards their customers, due to their focus on profit and vulnerability to moral hazard. Thus mis-selling issues, based on misleading customers, was the root cause of the majority (85%) of cases.

Pure market forces fail to promote ethics in banking

Perhaps the most significant fact is not the size of the fines related to misconduct but the impression that top management at banks do not fully appreciate the negative impact of misconduct on the financial performance of their institutions. Costs incurred to repay fines and redress or remediation of misconduct amounted to an average of 10% of all expenses incurred by banks between 2012 and 2016. If the analysed banks had not been compelled to pay fines, their profits would have been on average 21% higher, with annual Return on Equity (ROE) increased by 3 percentage points.

¹ Conduct, Culture and People Research Foundation: www.ccpresearchfoundation.com/index, (accessed 14 January 2019).

Il est intéressant de noter que ce n'est pas le niveau des amendes qui est le problème, mais le fait que les dirigeants des banques ne semblent pas pleinement prendre conscience de l'impact négatif d'une telle conduite sur la performance financière de leurs institutions. Une explication possible réside dans la mentalité à court terme des actionnaires et des dirigeants de la banque : les résultats trimestriels sont beaucoup plus importants que les conséquences à long terme d'une stratégie donnée. Cette observation suggère que les forces «pures» du marché ne poussent pas les banques à adopter un comportement plus éthique. Cela m'amène donc à plaider en faveur d'une solution réglementaire.

Reputational cost, another hidden cost of misconduct, is also worth highlighting. Armour et al. (2010) estimated that this type of cost could be almost nine times the size of fines. Given this finding, one might suppose that managing a bank in an ethical way would be promoted by market forces – in particular, by shareholder pressure and pressure on bank management to minimise costs and maintain a good corporate image. A potential explanation for why this is not the case is the short-term mindset of shareholders and senior bank management, as noted by Rappaport & Bogle (2011), Dallas (2012), Milbradt & Oehmke (2015) and Repenning & Henderson (2010).

This observation, as well as the review of the literature, suggests that the market is not driving banks' behaviour in a more ethical direction, as desired by customers and regulators. This leads me to argue in favour of a new regulatory solution, aimed at rewarding the ethical behaviour of banks. It would consist of a six-month assessment of the ethics of banks in Poland, conducted on the basis of a survey and a qualitative study which would be an extended version of the cited study from the UK. Based on the results of such a study, the PFSA could reduce or increase the soft capital requirement by one percentage point.

Step 1: Defining an ethical bank

Over the years, many academics (Murdoch, 2015; Perezts, 2015; Koslowski, 2011) have attempted

to produce a definition of the term conduct or ethics in banking, with reference to ethical standards devised by ancient philosophers and applied to today's financial world. However, no universal agreement has been achieved on what ethical behaviour in banking or what banking conduct really mean. Even the Banking Standards Board, the Conduct Costs Project Research Foundation (CCPRF) and Reuters in its Culture and Conduct Risk report, fail to provide a clear definition or set of benchmark requirements. Instead, they focus on policy and management guidance.

In addition, in most (if not all) jurisdictions, information on conduct and ethics in finance is significantly dispersed in the current regulatory environment, without a single point of focus in a dedicated legal act, regulation or recommendation². The lack of a harmonised approach or even a basic, agreed definition makes it all the more difficult for markets to implement and value ethical standards.

However, there is a consensus that,

² The current Polish examples of recommendations containing conduct-related provisions are: i) the Code of Banking Ethics (PBA); ii) Recommendations of the Banking Ethics Committee of the Polish Bank Association (PBA for older customer service (PBA); iii) to a certain extent, Corporate Governance rules for supervised institutions (PFSA). At a European level, conduct-related provisions can also be found in many EU secondary laws, including: i) MIFID; ii) CRR/CRDIV; iii) EMIR; iv) guidelines and standards originating from EU agencies such as EBA and ESMA).

Au fil des ans, de nombreux universitaires ont tenté de définir le terme «conduite» ou «éthique» dans le secteur bancaire, en se référant aux normes éthiques élaborées par les philosophes anciens et en appliquant leur raisonnement au monde financier actuel. Cependant, aucun accord universel n'a été trouvé sur ce que signifie réellement un comportement éthique dans le secteur ou la gestion bancaire. L'absence d'approche harmonisée et même d'une définition de base compliquent d'autant plus la tâche des marchés pour la mise en œuvre, la valorisation et l'exécution de normes éthiques. Cependant, il existe un consensus sur le fait que, en raison de leur rôle social, l'attitude des banques en matière de comportement privilégie les intérêts des clients avant leurs propres profits. Dans cet essai, je propose d'examiner le comportement dans les banques de la façon suivante: à travers le comportement éthique (compris comme faisant ce qu'il convient de faire conformément à ce que Plante (2004) a suggéré) à l'égard de trois groupes distincts de parties prenantes: i) les clients, ii) les employés et iii) les actionnaires.

due to their social role, banks' attitudes to conduct should put the customers' interest before their own profits. There is a rich literature on whether ethical behaviour has a financial impact on banks. Marlene (2015), Halamka & Teply (2017) and Herrera et al. (2016) used econometric tools to analyse differences in financial performance between ethical and standard or non-ethical banks. They came to the same two conclusions.

First, conventional banks show higher profits in the short term, which is aligned with the problem of short termism. However, in the long term this difference from ethical banks becomes smaller. Second, ethical banks tend to be less risky and more stable with ROE volatility lower than their standard peers. Similar conclusions were drawn by Mascu (2010) and Climent (2018) in their case studies on selected banks.

In this essay, I propose the following way of looking at conduct in banks. It is ethical behaviour as understood by doing the right thing towards three distinct groups of stakeholders: clients, employees and shareholders. This is in line with what Plante (2004) suggested.³

Step 2: Assessing if a bank is ethical

Since 2015, the UK's Banking Standards Board (BSB) has conducted an annual survey of

³ Professor Thomas G. Plante, Stanford University School of Medicine, author of *Do the right thing: Living ethically in an unethical world* (New Harbinger Publications, US, 2004). There is not space in this paper for full analysis of Plante's definition.

UK banks⁴ to assess awareness and compliance with corporate conduct. The BSB undertakes a general survey of bank employees, qualitative, in-depth analysis of focus groups, and interviews with management and supervisory boards. The aggregated research results are highly publicised in the UK. Many organisations refer to them, including the Financial Conduct Authority (FCA), the Bank of England (BOE) and the UK government.

While the results are not binding for banks and do not require them to take any regulatory actions, I am aware from my own professional experience that they are discussed in detail during bank management meetings. They form the basis for taking internal steps to improve banking processes. In addition, the BSB results initiate analysis, including whether current incentive models for employees are appropriate and whether the institution generally behaves in an ethical manner.

Therefore, drawing on the BSB surveys, I would suggest a wider-ranging assessment of banks' conduct based on three similar tests for the three stakeholder groups that I identified above: clients, employees and shareholders. The principles of the present proposal are universal and should be applicable to any

⁴ The public version of the report, containing aggregated results, is published online: <https://www.bankingstandardsboard.org.uk/annual-review-2017-2018/>. However, the BSB does not disclose data for individual banks participating in the survey.

country or region. The assessment would take place every six months and would be carried out by the local Financial Supervision Authority (FSA). The questionnaire would grade bank's internal culture, procedures and policies, business priorities, suitability of products and services provided, and customer service⁵.

The costs of the survey would be covered by banks participating in the study, subject to the principle of proportionality⁶. The results and the ranking of banks' performance in terms of conduct would be publicly available and all cases of misconduct would have regulatory implications.

In order for banks to be motivated to act ethically, all stakeholders should share a common purpose: bank employees, who respond to their managers, who in turn at the most senior levels respond to their superiors or principals, namely the shareholders. This interpretation of a corporation, where the ultimate

purpose is to maximise shareholders' wealth, is known as *shareholder primacy*.

Step 3: Designing the regulatory stimulus

I therefore argue that in order for a regulatory stimulus to be effective in promoting ethical behaviours in banks, the regulations should incentivise the top management via shareholders.

Return on Equity (ROE) is the key indicator for shareholders, as noted by Damodaran (2008), Maverick (2019) and repeatedly by the investor Warren Buffet since 1987. It is considered to be a measure of how effectively management is using the company's assets to generate profits. The ROE consists of profit (numerator) and equity (denominator). The higher the ROE, the more attractive a company is for investors. To obtain a higher ROE, institutions can increase profits or reduce the equity. The detailed breakdown of ROE is provided below.

For banks the equity part is driven by the regulator. In

En se basant sur les enquêtes du Banking Standard Board, je suggérerais de faire une évaluation plus large du comportement des banques basée sur trois tests similaires pour toutes les parties prenantes: i) les clients, ii) les employés et iii) les actionnaires. Le questionnaire évaluerait la culture interne de la banque, ses procédures et sa politique, ses priorités commerciales, l'adéquation des produits et services fournis ainsi que son service à la clientèle. Les coûts de l'enquête seraient pris en charge par les banques participant à l'étude, en respectant le principe de proportionnalité.

⁵ In particular, processing complaints, fair and clear communication with customers, remediation and redress.

⁶ Options may include the number of customers, size of the bank or share in the market.

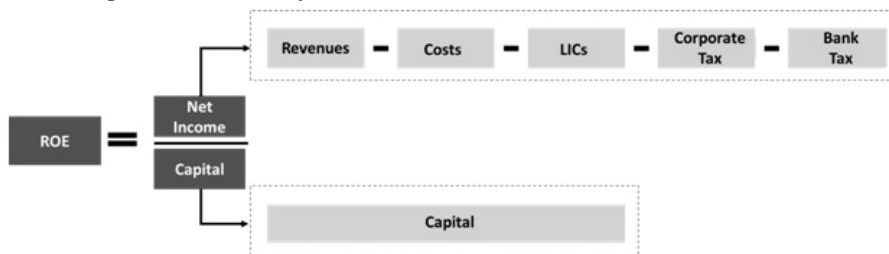
Figure 1. Shareholder primacy



Source: Author's presentation.

Pour que les mesures de stimulation réglementaires soient efficaces à promouvoir un comportement éthique des banques, elles doivent stimuler la direction à travers ses actionnaires. Je soutiens donc que la réglementation devrait d'une certaine façon avoir une incidence sur l'indicateur financier le plus important utilisé par les investisseurs, à savoir le ROE (« Return On Equity » ou rendement des fonds propres). Pour obtenir un ROE plus élevé, les institutions peuvent augmenter leurs bénéfices ou réduire leurs fonds propres. Basé sur la décomposition du ROE, deux « endroïtes » ont été identifiés, qui méritent d'être pris en compte pour l'introduction d'une incitation réglementaire afin de stimuler les comportements éthiques souhaités: i) l'impact réglementaire sur les bénéfices (numérateur) ou ii) le capital (dénominateur du ROE). La revue de la littérature suggère que le changement le plus efficace consisterait à modifier les exigences de fonds propres (réduction), ce qui renforcerait l'incitation dans la mesure où les actionnaires auraient quelque chose à rechercher (des exigences de fonds propres plus faibles entraînent plus de bénéfices à distribuer) plutôt que quelque chose à éviter (prélèvement).

Figure 2. ROE analysis



LICs are Loan Impairment Charges. In Poland, banks also pay bank levies.

Source: Author's presentation.

simplified terms, these are assets or capital that the bank must retain in case a crisis occurs. However, the structure of indebtedness, which is reflected in banking, also includes risk-weighted assets (RWA), which allows a risk weight to be assigned to specific groups of assets. The aim of this indicator is to emphasise that not every bank loan is equally risky. The level of capital required depends on the level of RWA.

For the largest banks⁷, the required capital can be up to 18%. However, for most banks globally, the requirement varies between 12-13%. Some analysts and bankers suggest that current capital requirements are already too high and render business unprofitable. However, research suggests that banks would be able to remain profitable and generate value for shareholders if their combined capital requirements

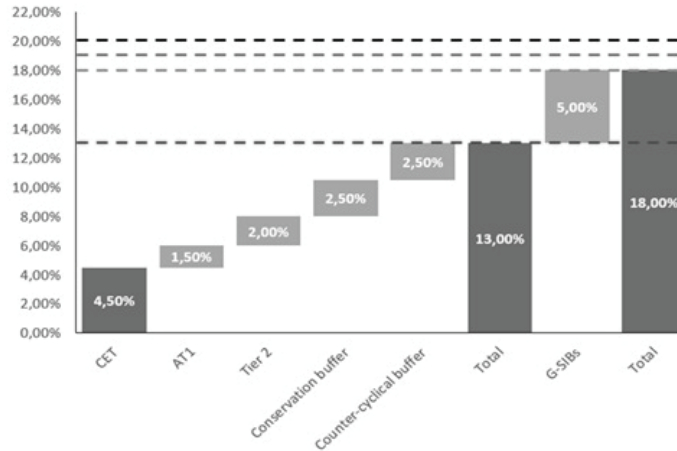
were 18% (International Monetary Fund, 2013), 19% (Bank of England, 2011) or even 20% (Bank of International Settlements, 2010). This indicates that there is room for potential additional capital surcharges on banks.

Based on the ROE breakdown, two “spots” have been identified which are worth considering for the introduction of a regulatory stimulus to drive desired ethical behaviours: either the regulatory impact on profits (numerator), or capital (denominator).

First, I discuss profits. The obvious idea for a regulatory impact would be an additional levy on banks' profits which depended on the degree to which a bank had acted unethically. However, the disadvantage of this solution is that it would be an inherently negative stimulus. In order for a regulatory impact to be effective, it should not be a punishment, but a reward for banks with a high level of good conduct. Such

⁷ Defined by the international Financial Stability Board as Globally Systemically Important Banks (G-SIBs).

Figure 3. Capital Requirements – an overview



Lowest line: Requirement for most banks

Third line: Requirement for largest banks at maximum level at which banks would be profitable according to the International Monetary Fund (IMF)

The two top lines: Maximum level at which banks would be profitable according to BOE and Bank of International Settlements (BIS).

Source: Author's presentation.

an approach is supported by Coglianese & Mendelson (2010), who emphasise that effectiveness and compliance with regulations are heavily dependent upon incentives and rewards.

The second area is capital. Here, the suggestion would be a change in capital requirements (reduction) which allows for a more positive stimulus. Such a measure would give shareholders a goal to pursue (lower capital requirements result in more profits for distribution to investors) rather than a penalty to avoid (bank levy).

Step 4. Putting pieces

together

Based on the above considerations, I propose that a Capital Conduct Buffer (CCB) tool is introduced. It would be a regulatory solution modelled on the own funds requirements under the EU's Capital Requirements Regulation (CRR) and Capital Requirements Directive IV (CRDIV). An additional capital requirement of 1% of risk-weighted assets (RWA) would be imposed automatically on all banks in a jurisdiction. For the purpose of demonstration, I will focus on Poland as an example but the below are universal and could be applicable in most, if not all countries.

Compte tenu de ce qui précède, je propose l'introduction d'un outil Capital Conduct Buffer. Il s'agirait d'une solution réglementaire élaborée par analogie avec les exigences du fonds propre selon le Capital Requirements Regulation et Capital Requirements Directive. Sur la base d'enquêtes de la BSB (Burgundy School of Business), je suggère une évaluation plus large du comportement des banques basée sur trois tests similaires pour toutes les parties prenantes: i) les clients, ii) les employés et iii) les actionnaires. Puis, à la suite des analyses effectuées et basées sur l'enquête réalisée, selon la qualité de son comportement, la banque pourrait bénéficier d'une diminution ou au contraire subir une augmentation des fonds affectés au Concut Buffer.

Based on BSB surveys, I suggest a broader evaluation of bank behaviour based on three similar tests for all three stakeholder groups: customers, employees and shareholders. The evaluation would be conducted every six months by the local financial supervision authority. The survey would assess a bank's internal culture, procedures and policies, business priorities, the adequacy of products and services, and customer service. As discussed earlier, the cost of the survey would be covered by banks participating in the survey, subject to the principle of proportionality. The results and ranking of banks in terms of conduct would be available to the public, and all cases of misconduct would have legal effects⁸.

Based on the survey results regarding the bank's conduct, it could enjoy a reduced additional capital requirement, as a reward for

⁸ The UK survey is not public, as it is a bottom-up initiative of banks themselves. In the proposed solution, CCB would be a regulatory requirement and would ensure banking sector transparency. It is noteworthy that since 2018 the UK's Financial Conduct Authority (FCA) and Competition and Markets Authority (CMA), have obliged banks under the BCBS7 regulations to publish Service Quality Indicators and FCA Metrics. These measures disclose the quality and speed of rendering individual services such as issuing or blocking bank cards and drawing down credit facilities. UK banks must also publish the results of survey questions for bank customers in several basic categories: for example, "Would you recommend this bank to your business partners/family members?" Banks must display the results in a visible place at each branch and publish them on their websites.

high ethical standards; or suffer an increased requirement, as a penalty for low standards. This solution would enable banks to be ranked in three categories:

1. **Ethical banks:** Institutions with top 10% scores. These institutions would have a reduced CCB value, which would earn them a reward for ethical behaviour.
2. **Conventional banks:** Institutions without any outstandingly ethical behaviour but not pursuing bad practices either. They would not be rewarded for good conduct, but as they do not violate the law, they would not suffer any penalties or costs for misconduct.
3. **Unethical banks:** Institutions subject to judicial or administrative proceedings, or which have otherwise displayed misconduct. This category would suffer a double penalty. Their CCB score would be increased and, additionally, they would be obliged to pay penalties and be liable to judicial or administrative sanctions.

An incentive designed in this manner would have a significant impact on ROE and would therefore motivate shareholders to put pressure on management to develop strategies that would make banks behave more ethically. While the inspiration for such survey is taken from the UK's BSB, the suggested assessment would feature the following differences:

Je suggère que l'enquête soit élaborée sur la base de consultations de l'industrie (qui devraient inclure dans le cas de la Pologne: les banques polonaises, l'Association des banques polonaises, la Banque centrale polonaise et l'Autorité de surveillance financière polonaise). En raison de la nature de l'institution, je suggère que le responsable de la conception de l'enquête soit le Bureau de la concurrence et de la protection des consommateurs (qui est l'organe le plus proche de la Financial Conduct Authority du Royaume-Uni en Pologne). L'enquête elle-même auprès des banques serait réalisée par l'Association des banques polonaises. Sur la base des résultats de l'enquête, l'Autorité de surveillance financière polonaise déciderait tous les 6 mois d'augmenter ou de réduire le capital minimal requis de 1% sur le capital requis total imposé à une banque.

- It would be carried out once every six months
- The full results would be available to the public i.e. the banks' ranking in terms of conduct
- It would be carried out among both bank employees and customers
- It would have regulatory implications

CCB: How it would work

I suggest that in Poland the survey should be developed following industry consultations with banks, the PBA,⁹ the central National Bank of Poland and the PFSA. . The leader of the survey design should be the Polish Competition and Consumer Protection Office (CCPO),¹⁰ the body which most closely compares with the UK's FCA. The survey among banks would be carried out by the PBA. Based on the results of the survey, the PFSA would decide every six months whether to raise or lower the soft capital requirement by one percentage point on the total capital requirement imposed

9 The PBA already conducts surveys examining the quality of services. However, they are not comprehensive or binding.

10 The CCPO and the Consumer Ombudsman also undertake similar activities in fields such as unfair market practices, as defined by law. However, they are not specialised regulators of the financial market and lack the analytical competence, information resources and financial sector data to detect and prevent banking risks...

on a bank¹¹.

Such a procedural design would ensure the cooperation and mutual control of all communities concerned, making the most of experience, knowledge and different perspectives on particular cases. This is important, given the lack of clear guidelines or an agreed, tight definition of conduct.

The choice of the supervision body for the banking market as the ultimate decision-maker is dictated by its knowledge, access to information, competence and mandate to regulate capital requirements. The risk of a non-objective approach and excessive arbitrariness must be noted. However, it should be emphasised that over the years, institutions such as banking supervision authorities, especially in developed countries, have employed highly qualified personnel and displayed strong resistance to external influence, regardless of whether they are a separate institution or integrated with the central bank (Barth et al., 2006). Nonetheless, in order to ensure the maximum level of objectivity, this paper proposes the involvement of the banking industry through the PBA and the CCPO, which, as a separate institution, could balance any potential bias by the PFSA.

11 The author does not propose detailed questions or a design for translating survey results into an increase or a reduction of the requirements. These elements are beyond the scope of this study and would need to be clarified following several months of industry consultations.

One possible objection to the proposed solution is that it provides for the simultaneous introduction of conduct measurement, publication of results and implementation of penalties and rewards. Such a workload would be very difficult for banks to manage in a short period of time. An alternative solution could be to stagger the approach, starting with measuring and publishing the conduct level in banks' reports and statements, with an expectation on investors and customers to respond first.

However, as noted above, the current experience indicates that the market does not measure the level of conduct effectively. I therefore doubt the real impact of the requirement to publish a bank's conduct level on the actual decisions of investors, on the bank's market capitalisation and then on its operations. It is also rare that a bank's customers read its financial statements, so this information would in fact not be visible to them.

CCB would not make banks riskier

The concept of reducing capital requirements based on non-financial features is already discussed in relation to green finance. It was suggested by the European Banking Federation in 2017 and is being considered by the European Commission (2018) and the FCA (2018). Some commentators such as Matikainen (2017), suggest that such a solution might lead to additional risk-taking by banks. I accept

Matikainen's point that capital is for loss absorption and that lowering its level to promote specific investments like *green finance* can threaten a bank's financial sustainability. Yet I believe that the CCB approach can avoid this risk.

First, as noted before, empirical studies show that ethical banks – the desired outcome of the CCB – are more financially stable. Second, my proposed surveys would only evaluate ethical behaviour. They would not target specific financial activity, such as promoting credit to people or institutions based on purely non-financial features like gender, locations, or types of activities. •

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Central Rating Index for Ethics and Trust in Finance

Ethics & Trust in Finance Global edition 2018-2019

Finalist

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The views expressed herein are those of the author and do not necessarily reflect those of the Organization he is affiliated with or of the Jury.

It is both worrying and reassuring that young people working in finance are encouraged to write about ethics and trust in finance today – “worrying” because it means there is a systemic issue, but “reassuring” because action is being taken to improve the situation. What is even more reassuring is that young people are not obliged to write about this topic but rather encouraged to – this point is central to this essay. Ethics must be guided by one’s own understanding and urge to do the right thing. It is practised as a set of cultural circumstances and cannot be rigidly imposed as a set of rules or regulations but should rather be debated and constantly challenged, with ideals changed positively.

In *Ideas and Opinions*, one of the greatest moral philosophers of the twentieth century wrote: “A man’s

ethical behaviour should be based effectually on sympathy, education, and social ties and needs; no religious basis is necessary” (Einstein, 2010). In a financial context, the “religious basis” can be taken as the fear of retribution and hope of reward for acting ethically. This should not be the driving force for ethics because people tend to find loopholes and use this as a measure for behaving ethically when they are instead merely acting in accordance with a set of rules.

Challenging the *status quo*

The current ethical foundation of most worldwide financial enterprise is embedded in a set of official rules and regulations which must be adhered to. Ethical behaviour cannot be fully ensured

La position éthique de la plupart des entreprises financières du monde est ancrée dans un ensemble de règles et de réglementations officielles, mais ils ne peuvent pas seuls assurer pleinement le comportement éthique. Se comporter de manière éthique n'est pas aussi simple que de cocher une case. Par conséquent, une définition rudimentaire de l'éthique est nécessaire, elle pourrait être la suivante : «agir de manière à promouvoir et renforcer la confiance dans les relations mutuelles». Il s'agit de gérer des désirs personnels contradictoires avec ceux de parties prenantes internes et externes correspondantes. L'objectif de cet essai est simple: proposer un nouveau système, complémentaires à la législation et aux directives en matière d'éthique en vigueur, afin de créer un index ou un «spectre» d'éthique. Il est évident que les consommateurs exigent que l'éthique soit prise au sérieux et c'est la raison pour laquelle cela fonctionnera mieux que toute réglementation.

by rules and regulations alone. What is incorrect about our current thinking regarding ethics in finance is that it can be kept in check by either following regulation or by not following regulation. Behaving ethically should not be considered as a box-ticking exercise. This is what is fundamentally amiss with our application of ethics in finance.

If ethics is not as simple as following an ascribed ethos, then a basic definition to start with is needed. Most will assume it is the difference between right and wrong but the inherent difficulty with this is that most people have different definitions about what is right and what is wrong. Instead, describing it in a utilitarian manner would help define it better; in other words, “acting in a way that promotes and strengthens trust and confidence in mutual relations” (Osesik, 2013). It is about managing conflicting personal desires with those of related internal and external stakeholder groups. Every action in finance must consider whether the effect of that action will be beneficial to all parties involved or only to some.

The purpose of the essay is simple: to propose a new system that will work alongside current ethical legislation and guidelines. Given that ethics is complex, and that any action can be beneficial for some related parties and not for others, there is a need to create an index or “spectrum” of ethics. If consumers and investors are becoming increasingly conscientious

about how companies behave, then there is a demand for commercial organisations to be scored on their ethical behaviour.

In an age where fines and penalties are no longer seen as the deterrent they should be, affording consumers and investors the choice to know how ethically an entity behaves will be far more revolutionary. This paper will discuss how such a significant change in thinking will be implemented and will also give reasons and evidence as to why it will work.

Who decides what is ethical?

Currently, many investors are unaware of how ethical a company truly is. Many investors do not even know they are investors. Take, for example, the huge number of UK employees contributing towards the national pension scheme in which they are automatically enrolled; many will not know how their contributions are being invested. If we are operating on the basis that people wish to invest ethically, then it should be their right to know this information, especially if they are “defaulted” into this position. Furthermore, if pension companies are aware of their contributors’ lack of investment knowledge then it creates an impetus to ignore the ethics of their actions and instead simply invest in the company with the greatest returns.

While this is not entirely the reality - thanks in part to the increase

À l'heure actuelle, chaque caisse de pension décide elle-même ce qu'elle considère comme «éthique». Cela serait sans importance, si ce n'est le fait que de nombreuses retraites britanniques sont financées par des employés automatiquement affiliés à ces mêmes caisses. Une caisse de retraite a décrit son fonds éthique comme étant «destiné aux personnes souhaitant investir conformément à des préoccupations éthiques ou morales spécifiques, par exemple dans des domaines tels que les droits de l'homme et le commerce équitable». Cette caisses ne fait pas qu'exclure les entreprises qui nuisent au monde, à ses habitants ou à l'environnement, elle investit également de manière proactive dans des organisations qui apportent une contribution positive à la société »mais ne fournit aucune documentation sur ce que cela signifie au juste.

in demand for ethical investment - most of these pension schemes provide an “Ethical Fund” which one can choose to contribute to. NEST is one of these providers and it is interesting to note that while its default “Retirement Fund” and “Higher Risk Fund” [first quarter, 2019] consist of investments in Alphabet Inc, Facebook Inc, Johnson & Johnson, Samsung Electronics, Exxon Mobil Corp. and Nestlé SA (Fawcett, 2019), their Ethical Fund does not consider these companies at all.

Given the negative press encircling some of these companies it is not surprising that they have been cut as a consideration from the Ethical Fund of NEST, but there are certain things wrong with this situation:

- (i) the default fund should be the Ethical Fund (most people stay with the default option (Kahneman, 2017)), and surely the principle behind the Ethical Fund is diminished if it is also part of an entity that invests in unethical companies;
- (ii) the decision to deem one shareholding as ethical or unethical is ambiguous here. No reason is given for the exclusion of certain companies from the Ethical Fund;
- (iii) the need to know on what factors the decision of exclusion based, which is important because it would make for an interesting debate.

This interesting debate begins with NEST's description of the Ethical Fund, which is “for people who want to invest in line with specific ethical or moral concerns, for example, in areas such as human rights and fair trade”. It does not just exclude companies that harm the world, its people or the environment; the fund also proactively invests in organisations that make a positive contribution to society (Fawcett, 2019). The even more interesting aspect is that, since launch, the annualised total return of the Ethical Fund has been 10.3%, while the default Retirement Fund has only returned 8.8% over its life. This would suggest that there is no direct benefit to acting unethically as an entity. In fact, we might be witnessing a shift towards making it beneficial to invest in conscientious companies.

How too many rules can cloud our moral compass

This last paragraph suggests that we are already shifting our attitude to a more integral and holistic approach towards what can be deemed ethical. This is in contrast with the last 10 years of post-financial crisis fallout of strict external regulation, which has not been successful in achieving the systemic stability it promised. Kaptein argued that there could be an “optimum number of rules after which an organization becomes riddled with them” (Kaptein, 2012). Beyond this optimum amount of

Il existe un nombre optimal de règles au-delà duquel une organisation est saturée et toute réglementation supplémentaire ne ferait que nuire, car l'effort de plus sera déployé pour se conformer aux règles au détriment d'un comportement éthique. Par exemple, si une réglementation officielle doit être suffisamment détaillée pour prendre en compte chaque infraction possible, alors elle prive la personne de sa capacité de penser de manière indépendante et la poussera plutôt à chercher un moyen de contourner les règles. Trop de réglementation réduit la capacité des personnes à réfléchir de manière critique à leurs propres actions, ce qui conduit de nombreuses entreprises à confondre le comportement éthique avec le respect de la loi. Suivre aveuglément les mesures et les procédures sape l'esprit éthique que l'on essaie d'obtenir.

rules, extra regulation will only be damaging, as more effort is put into abiding by the rules at the expense of operational effectiveness and ethical behaviour (Osesik, 2013). Too much regulation only leads to complexity and ambiguity, rather than raising the level of morality: "Modern finance is complex, perhaps too complex. Regulation of modern finance is complex, almost certainly too complex ... As you do not fight fire with fire, you do not fight complexity with complexity" (Haldane & Madouros, 2012). This is proved by the actual size of published regulation, which is supposed to guide our morality, the first and most famous of which being the Ten Commandments, which have survived more than two thousand years. Compare this with a more recent example: the 1933 Glass-Steagall Act, written and designed as a response to the Great Depression, which at 37 pages has been perused with economic stability for over 70 years; or even the US Bill of Rights, that most influential and long-standing of modern constitutional documents, which fits on a page of A4. Contrast this with the latest financial crisis, bringing a remedy of some 849 pages and more than 27,270 new regulatory restrictions (Zuluaga, 2018).

If an official regulation needs to be so detailed as to take every single possible infringement into account, then it robs the person of their ability to think independently and morally. Furthermore, it causes them instead to look for ways around

the rules, which will then be justified as "moral". Following rules while searching for ways to exploit an opportunity is still unethical, but it is ever more difficult to illustrate as such if they can be seen to be acting within the law. Ethics should always return to self-criticism and inner-reflection: "is the action I am about to take going to be beneficial to myself only and damage others or is it mutually beneficial?" More regulation actually reduces people's ability to think critically about their own actions (Osesik, 2013).

Ethics in finance is currently limited mostly to two things: our own cultural upbringing, and multiple pages of regulation. In certain professions, such as accountancy, there is an emphasis on following a code of ethics, but unfortunately this does not apply to all financial professions. This leads to many companies confusing acting ethically with legal compliance. They simply follow measures and procedures imposed on them which undermine the ethical spirit trying to be achieved, as people will just consult legislation rather than their own conscience when judging what is right and wrong (Osesik, 2013). Ethical decisions should be guided by one's inner moral compass, built over years of cultural experience, and challenged. It is an all-inclusive debate which can only be upheld if its principles are constantly disputed and consequently bettered. To accept the *status quo* is to deny personal agency.

The link between morality and free will

Une approche utilitariste l'éthique est la «maximisation» du bonheur pour toutes les parties concernées. Plus le nombre de personnes bénéficiant de nos actions est élevé, plus ces dernières sont considérées comme éthiques et créent un cadre de moralité qui peut être amélioré davantage qu'un ensemble rigide de directives. Woo et Einstein croient tous deux que le libre-arbitre est illusoire et que tout est l'effet d'une cause (c'est-à-dire que vous avez fait un «choix» mais il s'agit en réalité de la conséquence des circonstances prédéterminées, et non par volonté d'être «bon» ou «mauvais»). Ainsi, même si le libre-arbitre est illusoire, il est important de croire que nous contrôlons nos propres actions. L'abandon de l'idée du libre-arbitre nous conduit à ne plus nous considérer comme blâmables pour nos actions et à commencer à céder à nos pires instincts.

We think of ethics as a constant set of formal standards and rules to religiously follow in order to remain safe. As previously explored, it is possible to both follow rules and act unethically. Ching-Hung Woo argues that Einstein believed morality should be treated as a secular matter of bringing dignity and happiness, as much as possible, to all people (Woo, 2015). This “maximisation” of happiness is essential to having a guiding hand in ethics and morality. The more people who benefit from any action we take, the more utilitarian it is and the more ethical it is perceived as being. All of this creates a framework for morality which can be enhanced more than a rigid set of guidelines. Woo also highlights that we have no free will when it comes to ethics; in other words, the decision has already been made by the set of circumstances that made the decision come about in the first place: “Now in the scientific framework favored [sic] by Einstein, where events unfold by deterministic laws, once an initial state of the world is completely specified, all subsequent phenomena are determined. Hence when a person faces multiple alternatives and makes a choice, the will of the decision-maker at the moment of decision was actually already fixed from the beginning of the universe. Hence the feeling of having a choice is only an illusion” (Woo, 2015). In other words, there was only one actual choice made at that point, and it was dictated by prior causes.

This is of course dangerous thinking and can condone behaviour with disregard for other parties. However, it does also make sense and is worthy of discussion. Would, for instance, the Ethics & Trust Prize have been established had the financial crisis of 2007-8 not happened? This paper has been written as a causal effect from this crisis. Given these points, it is easy to see why distinguishing between good and bad is not as easy as writing an 849-page dossier. It is better to conceptualise ethics, which is the true key to its perpetuation and lasting impact.

Even if free will is illusory, it is still important to believe that we are in control of our own actions. One experiment conducted by Vohs found that, when the control group's belief in free will was undermined, they took more opportunity to pilfer envelopes of \$1 coins. It seems that when people stop believing they are free agents, they stop seeing themselves as blameworthy for their actions. Consequently, they act less responsibly and give in to their baser instincts (Caves, 2016). It is important here to reiterate that this essay argues that a disbelief in free will, and hence ethics, is as bad as rigidly following a set of rules which form legal compliance, rather than a notion of morality. A happy middle-ground lies in the space that allows the individual to constantly distinguish “doing good” from “doing bad”.

Même Association of Chartered Certified Accountants (ACCA) a abandonné une compréhension erronée de l'éthique selon laquelle cette dernière pouvait être rapidement assimilée grâce à un manuel, préférant maintenant la notion de «bon comportement» plutôt qu'un «code d'éthique». En termes simples, «se comporter de manière éthique» signifie faire «la bonne chose». Cela va au-delà du respect de la loi - le respect des normes et réglementations en vigueur fait également partie du comportement éthique, mais implique surtout d'agir dans l'intérêt général.

“Good” behaviour as a starting point

Even the Association of Chartered Certified Accountants (ACCA) has shifted from the flawed notion that ethics can be gathered quickly from a handbook, preferring instead to now market it as “Good Behaviour”¹ rather than a “Code of Ethics”. Accountants from this organisation are still expected to follow the guidelines: “Most professionals are required to comply with an ethical code – in the case of ACCA, you will be required to comply by ACCA’s Code of Ethics and Conduct”. However, this is stated as a bare minimum and is intended to provide the accountant with a framework upon which to build. ACCA stresses that “these principles provide a framework to guide the professional accountant” but not to “ignore your personal values when at work” (Waters, 2011).

The best definition on this webpage asks “what does it mean to behave and work ethically” and it is from this description that a professional can begin an independent ideology of what encompasses ethics in finance: “simply put, it means doing ‘the right thing’”. This goes beyond compliance with the law; compliance with relevant standards and regulations is also part of ethical behaviour...It also means *acting in the public interest*

¹ See, for example, the ACCA webpage on Ethics: <https://www.accaglobal.com/an/en/student/sa/features/good-behaviour.html>

[emphasis added]” (Waters, 2011). The key parts of this last statement are in finding out what doing “the right thing” encompasses and how best to act “in the public interest”.

Of course, the ACCA is most interested in ethics where it specifically involves trust in the workplace, and not necessarily the other arm of ethics in finance relating to ethical investment. Therefore, when the ACCA speaks of ethics, it is really speaking of trust. The ACCA instils this trait and reinforces its importance because it has essentially given the professional accountant the power to decide how money is accounted for within an organisation, which can lead to conflicts of interest further down the line. It would be a futile exercise to deliver someone this power if they had no intention of using it correctly, circling us back to the ancient question of whether it is worse to be merely incompetent as a professional, or rather competent but evil.

The nature of trust in finance

Geoffrey Whittington writes of trust in finance:

“[It is] an essential ingredient in facilitating financial transactions. The financial reporting process helps to create trust, but it, in turn, must be trusted. Auditing and professional standards have been the traditional means by which trust in financial reporting has been fostered. Recently, these institutions have been put under great pressure

La confiance dans la finance est un ingrédient essentiel pour la conduite des transactions financières. Par exemple, les maisons de disques sont essentiellement des fonds d'investissement – la maison donne à l'artiste une avance en échange des bénéfices futurs sur les ventes de la musique enregistrée. L'élément de confiance est liée au fonctionnement interne de la maison car tous les flux de revenus sont comptabilisés en premier par le label, et non par l'artiste. De plus, alors que nous entrons dans une ère de plus en plus numérique, les flux de revenus comptés numériquement signifient que nous devons faire confiance aux ordinateurs qui nous fournissent les informations correctes. Il est nécessaire de s'assurer ici que les données sont là pour faciliter l'art, pas pour le menacer.

by changes in the size and scope of financial markets. The consequence is likely to be a continuing change in the nature of trust and the means by which it is supported. In the future, personal trust is likely to be substituted increasingly by trust in systems supported by regulatory bodies. This does not mean that trust is no longer important, but rather that the form which it takes has changed. The importance of trust needs to be recognised by those engaged in shaping the future of financial reporting, if they are to meet the needs of users of financial information” (Whittington, 1999).

A good example of trust in both people and systems can be observed within the recorded music industry. One such record label, Warp Records, goes as far as to refer jocularly to itself using an acronym: We Are Reasonable People (WARP). Record labels are essentially investment funds: the label gives the artist an advance of cash in exchange for future profits realised on contracted supplies of recorded music. Sometimes it is profitable, upon which, after recouping the said advance, any profits are usually split on a fifty-fifty basis. If it is not profitable then the investment is simply written-off (as with any other investment). The trust element comes from within, however, as all revenue streams are accounted by the label first, and not by the artist, as would be typical with any other supplier-customer arrangements. In the recorded music industry,

the label (customer) tells the artist (supplier) how much money has been generated from sales of their music (this is repeated all the way up the supply chain). As can be seen, trust will play a major role here, as the artist is fully dependent on the royalty accountant for giving a fair and accurate report of all profit the artist is entitled to. Of course, it is written into any contract that they have the right to audit this report. Yet most artists choose to trust that the statements are materially correct.

The second issue is, as we enter an increasingly digital age, most music revenue streams are made up of micro-penny transactions multiplied million-fold. This creates the need to trust a computer system that counts and ensures precision within accounted revenue and expenditure. There is a need to ensure here that data is here to facilitate art, not threaten it (Bussinger, 2016).

In conclusion the fabric of ethics must come from within the organisation. Even if employees are determined to maintain high ethical standards, they become less ethical when corporate management adopts a profit-oriented approach compared with when it values integrity, or when no corporate values are professed (Ghosh, 2008). There is ample experimental evidence from 1979 that suggests that employees working in companies where work-life balance was emphasised and where CEOs or people in leadership positions encouraged ethical behaviour were found to accept

Il y a clairement une nécessité de créer un tableau de bord de l'éthique pour que les gens l'utilisent et fassent des investissements éthiques, mais il n'existe actuellement sous aucune forme définie. Les investisseurs prennent simplement des décisions éthiques fondées sur ce qui est disponible dans les médias, ce qui pose deux problèmes: les médias sont malheureusement souvent biaisés ou mal informés, et ensuite, cela donne aux entreprises peu d'élan pour essayer de s'améliorer à l'avenir.

Actuellement, il existe peu de systèmes de notation qui se concentrent sur certaines catégories, telles que les caractéristiques des conseils d'administration, la structure de propriété, les régimes de rémunération, les dispositifs anti-OPA, les informations financières, les contrôles internes et la formation des administrateurs.

kick-backs less than employees who worked at profit-driven corporations (Hegarty & Sims, 1979). Therefore, we must empower financial sector employees to think critically about their ethics, instead of limiting their thinking by a set of rules.

Proposal for the introduction of an “Ethical Spectrum”

Clearly there is a need to create a scorecard of ethics for people to utilise and make ethical investments, but it does not currently exist in any defined form. Investors simply make ethical decisions based on what is available in the media, which holds two problems: the media is unfortunately often biased or misinformed, and secondly, it affords companies little incentive to try and better themselves in future. Given that the public's interest in ethical governance and ethical leadership has grown, it is necessary to enhance the importance and clarity of ethics over and above the typical response: governments tend to respond to scandal with regulations, without considering that it is the “obedience culture” which often fails in the first place (Financial Conduct Authority, 2014).

Conversely, can any financial firm be considered ethical given that its primary function is to create positive returns for its investors? Some would argue that it cannot, but the key point is that an ethical position should be considered both externally as well as internally. There should be

a strict separation between financial regulators and professionals in finance. While an exchange of ideas should be encouraged, fraternisation as well as a change in employment across the divide should not. The relationship between judges and lawyers could serve as a guide (Bieber & Viehoff, 2017). This would limit any conflict of interest that could arise when making important decisions regarding an entity's ethos.

Sub-sections of Ethics & Trust Scoring

There are two main fields which this scoring can be broken down to, each with a valid motive:

- (i) Trust in Corporate Governance Ratings, giving users of the scores the ability to see how well-run and well-managed an entity is;
- (ii) Social & Environmental Responsibility Ratings, giving users corporate insight into how ethical an investment might be.

The value of subdividing the scoring system into two sections like this is to highlight the way in which these scores will be affected. Corporate Governance, for instance, depends on directors and employees within an entity acting selflessly and in the best interest of the related stakeholders, while Social & Environmental Responsibility will examine how the entity regards its day-to-day trade as ethical. In other words, one is internal and the other is broadly external.

Scoring Index: Trust in Corporate Governance Ratings

Toutes les sociétés cotées en bourse devraient participer à la promotion d'un sens de l'éthique sur les marchés financiers. Le Tableau de Bord de la Gouvernance d'Entreprise aurait donc pour principal objectif de faciliter le travail des analystes; permettre aux entreprises d'évaluer facilement la qualité de leur propre situation de gouvernance; permettre aux investisseurs d'établir des niveaux minima dans le cadre des politiques générales d'investissement; permettre des comparaisons entre industries et entre pays et être facilement accessible à toutes les parties intéressées. Les critères d'évaluation prendront en compte trois domaines principaux: la composition du conseil d'administration, l'approche de l'audit externe et l'effet des indicateurs clés de performance sur les normes d'éthique.

Once the two categories are identified, we can begin scoring the entity using an index. While there have been many attempts to measure governance from a compliance perspective, there are currently no global benchmarks with which to measure Corporate Governance standards. As a starting point, there are currently a few ratings systems which concentrate on certain categories, such as board compositions, ownership structures, compensation plans, anti-takeover devices, financial disclosures, internal controls and directors' educational backgrounds.²

In recent years there has been demand for ratings agencies to introduce these systems as a means of assessing the very real risk factor that a board of directors can have on an investment. The aim would not be to be merely compliant, but to be guided by the "spirit" of the ratings system. Every publicly-listed company should be part of bringing this about, in order not only to "level the playing field" but also to trickle this sense of ethics into the private sector.

The main goals of the Corporate Governance scorecard would therefore be:

² Examples include: Governance Metrics International (GMI) Ratings, the Corporate Governance Quotient (CGQ), the Corporate Governance Score (CGS) of Standard & Poor's and the Board Effectiveness Rating (BER) of the Corporate Library (TCL).

- (a) To facilitate the work of analysts and investors through a systematic and easy overview of all relevant issues of good governance. It is vitally important that the users of these reports understand the information contained within them.
- (b) To enable companies to easily assess the quality of their governance situation. There is a need to give executive boards the impetus to succeed at becoming ethical.
- (c) To allow the setting of minimum scores by investors for governance as part of general investment policies. External parties should be given the right to affect the score if they can justify the means for doing so. Internal parties can either accept this change and try to improve their situation, or challenge the verdict.
- (d) To enable comparisons across industries and across countries, because we can only really assess progress when using comparative information.
- (e) To be readily available to all interested parties via the internet. This can be via a paid subscription; it does not necessarily have to be free. The results should also come with a description of how they formed their rating and what the index was based against (Bhasin, 2009).

Cet index explique comment une entité se comporte dans l'environnement dans lequel elle opère. La demande en investissement responsable a explosé ces dernières années, les investisseurs ordinaires devenant de plus en plus conscients de la nécessité de protéger la planète sur laquelle ils vivent. À l'heure actuelle, deux agences ont pour objectif d'évaluer les grandes marques en fonction de leur impact environnemental et social: Ethical Consumer et Good on You. Ils basent leurs faits sur le degré de transparence d'une société concernant sa chaîne d'approvisionnement, si la société a pris plusieurs initiatives positives importantes, si elles ont été conçues pour être éthiques dès le départ et si elles possèdent une accréditation ou une certification appropriée.

The assessment criteria will be fluid, but will broadly consider three main areas:

- Composition of the Board of Directors: the Board's structure and related-party disclosures; the size of the board and its attendance at meetings; level of executive share ownership; the independence of its members; and the emphasis on communication of the company's ethos.
- Approach to External Audit: the presence of an audit committee; which audit firm is used, and if subsidiaries are "split out" to different firms; what percentage of revenue the audit represents; what are the standards for audit in the given territory.
- Effect of Key Performance Indicators on Ethics Standards: most importantly, a measure of how effective being ethical really is to the company.

This last point is important as it is vital to highlight that behaving ethically through responsible corporate governance can pay dividends in the long run, perhaps to the extent of preventing another crisis.

Scoring Index: Social & Environmental Responsibility Ratings

The next index discusses not the internal governance of an entity but rather how that entity behaves within the environment it operates. The demand for responsible investment

has boomed in recent years, with ordinary investors becoming more aware of their need to protect the planet they live on. There is also a realisation that growth can only occur sustainably when there are limited resources available.

Currently, there are two agencies which have made it their goal to assess large brands based on their environmental and social impact: Ethical Consumer and Good on You³. There is also an index for listed companies called FTSE4Good. However, it has received criticism (ironically creating an unethical situation by trying to be perceived as being ethical) because it lists some fossil fuel companies as environmental, which merely serves to "greenwash the reputations of major polluters" (Jolly, 2019). This has led to a situation where environmentally-conscious investors are unaware that they are essentially funding fossil-fuel extraction. The FTSE4Good is owned by the London Stock Exchange which further signals a conflict of interest. It is good that the London Stock Exchange is addressing its need to be environmental, but ratings should look at clear facts with the inclusion of all related stakeholders.

In contrast, Good on You is an independent ratings agency, and its model for rating is quite straightforward. The model is based on how transparent a company is

³ See, for example, Ethical Consumer: <https://www.ethicalconsumer.org> and Good on You: <https://goodonyou.eco>

Le but de cet article était de souligner que l'approche actuelle en matière d'éthique fonctionne jusqu'à un certain point, mais il y a des risques de s'effondrer suite à une dégénérescence cachée. Il n'est pas nécessaire d'éliminer le cadre actuel, mais il faut le centraliser et le renforcer au moyen de mesures qui encourageront un débat libéral. Le problème clé est que notre enracinement actuel dans l'éthique repose sur le respect de règles plutôt que sur la compréhension de l'essence même de ce que signifie être éthique. La confiance ne doit pas être considérée comme acquise et c'est avec cette proposition que je souhaite ne pas garder les entreprises sous contrôle, mais tenir toutes les parties prenantes connectées et informées, et savoir comment elles peuvent apporter un réel changement avec les bonnes informations.

regarding its supply chain; whether the company has taken several significant positive initiatives (often as leaders on one or more key issues); whether it is designed to be ethical from the ground up; and whether it has relevant accreditation or certification.⁴

Ethical Consumer uses the following method: "We score each company out of 14 and each product out of 20. We use a negative based scoring system where a company starts with 14 and then gets marks taken away if it gets criticised in one or more of our categories. There is one exception to this. Companies can score a positive mark under company ethos if they commit to certain things (e.g. Fairtrade) across their whole company group."⁵ Ethical Consumer also awards points for accreditation.

Conclusion

It is obvious that environmental and social awareness is consumer-driven rather than investor-driven. Steps should be taken to include the foundations of ethics that companies have used to successfully drive

campaigns that result in either a company changing the way it trades, or by a product being boycotted or shunned. Investors take notice of market demand and this is how real change can occur. Compounded with the addition of a centralised ethical ratings system, there is a genuine hope that ethics and trust can be restored in finance.

The aim of this paper has been to highlight that the current approach to ethics works to a degree but is prone to collapse through hidden deterioration. It is not necessary to get rid of the current framework but there is a need to centralise and enhance it through measures which will bring about free debate. The key issue is that our current ethical grounding is based on following rules rather than grasping the spirit of the essence of what it means to be ethical. Trust should not be taken for granted. With this proposal, I hope not to keep corporations "in check" but to keep all connected stakeholders informed about how they can bring about real change with the right information. •

⁴ <https://goodonyou.eco/how-we-rate/>

⁵ <https://www.ethicalconsumer.org/about-us/our-ethical-ratings>

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Part IV

Ethical dilemmas

Ethical Aspects of Bank Resolution

Ethics & Trust in Finance
Global edition 2018-2019

Finalist

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* The views expressed herein are those of the author and do not necessarily reflect those of the Organization he is affiliated with or of the Jury.

To encumber other stakeholders besides shareholders and taxpayers with the absorption of bank losses has a strong ethical underpinning. A new legal instrument in the hands of supervisory bodies, known as resolution, will allow a fairer distribution of bank losses among various entities. At the same time, it raises new questions at the interface of finance, law, and ethics. It is therefore of fundamental importance to define the notion of “public interest” as a prerequisite for the initiation of a resolution action. This question needs to be addressed with reference to basic ethical standards. Otherwise, resolution will only be regarded as endorsing state aid to failing banks.

A bail-out too far

In the spring of 2013, riots that hit the streets of Nicosia, Cyprus, made the world aware of the need to revisit the concept of “privatising profits and socialising losses” which became notorious in the aftermath of the 2008-09 financial crisis. This method of functioning in the financial sector went much further than “just” the so-called real economy¹ and affected the public finance systems of Ireland, Portugal, Italy, Spain, Greece, and Cyprus.

The angry crowds protested against being the ultimate fall guys for the recapitalisation of banks. In the meantime, it had been noted

¹ According to (Stiglitz, 2001) “...failures in the banking system have strong spillovers, or externalities, that reach well beyond the individuals and firms directly involved.”

La crise financière de 2008-2009 a donné lieu à une aide massive des États aux banques. Ceci, à son tour, a conduit à une crise fiscale dans de nombreux États membres de l'UE. Cette aide de l'État (ou «bail-out») a favorisé un comportement irresponsable et contraire à l'éthique des patrons de banque. En même temps, elle obligeait les contribuables à payer la facture. Aussi, les dirigeants mondiaux ont donc été obligés d'introduire d'autres instruments pour préserver la stabilité du système financier. La résolution (ou «bail-in», renflouement interne) vise à rendre la faillite d'une banque moins dommageable pour l'ensemble du système bancaire, sans que des fonds publics soient engagés. Au printemps 2013, cet outil a été utilisé pendant la crise chypriote.

that there was an extensive group of entities that had earned a huge income from banking activities. They had weathered the crisis almost intact, without accepting any burden of the losses, unlike taxpayers. That group was the supplier of financing for banks; that is, investors purchasing bank debt in the form of bonds. During the financial crisis of 2008-2009, it was the fear of turbulence on global debt markets that led governments to embark on socially unpopular programmes that extended state aid to banks. That situation was seen as socially unfair and resulted in further accusations of unethical conduct by both banks and politicians.

During the Cyprus crisis, it was done differently. The burden of bank losses was shifted to bondholders and depositors who held deposits exceeding the covered €100,000. Consequently, instead of traditional state aid, known as a “bail-out”, part of the banks' debt was written down as a so-called “bail-in”. By distributing the burden of losses among a larger number of investors, including both shareholders and bondholders, it was possible to protect the interests of the least experienced providers of financing for banks: namely, depositors whose funds were covered up to €100,000.

As a result, a fairer and ethically acceptable solution was proposed. Interest collected by bondholders in the form of a coupon payment was nothing more than a margin for the issuer's credit risk that they bore.

Therefore, if these investors accepted such a risk for compensation, they could not expect their investment to be risk-free; that would have been the case if Cypriot banks had received state aid. It is common knowledge that there is no such a thing as a free lunch; someone must always pay for it. In this case, it would have been the state or taxpayers.

No risk, no risk premium

Acceptance of the issuer's loss not only by shareholders but also by creditors in the form of bondholders and depositors therefore has a strong ethical underpinning which is additionally supported by company law. According to the widespread theory of nexus of contracts, a company is a combination of contracts between various stakeholders: shareholders, managers, creditors, contractors, employees, and so on. Based on that theory, shareholders are perceived not so much as the “economic owners” of the company but as one of the capital providers. Shareholders, as equity providers, are one of the categories of company stakeholders next to debt providers (debt capital) and human capital in the form of employees.

The situation of equity providers is specific, given the order of settling claims made by providers of various forms of corporate financing. Shareholders occupy the last place in the hierarchy of creditors: their claim is subordinated (“junior”)

Diverses entités mettent des facteurs de production à disposition de l'entreprise. Ainsi, chaque entreprise constitue un «nœud» de contrats entre ces contributeurs (actionnaires, dirigeants, créanciers, employés, etc.). Toutes ces parties prenantes assument des risques en cas de faillite de l'entreprise. Le niveau de chaque risque est en ligne avec l'implication dans l'entreprise et détermine la rémunération correspondante. En conséquence, ceux qui supportent le risque résiduel de l'entreprise ont droit à une prime de risque plus élevée que ceux dont la créance est fixe. Pour atténuer leur risque, les actionnaires, qui supportent le risque résiduel de performance, disposent également du de vote dans certaines décisions de l'entreprise.

to all debt claimants. In other words, shareholders are the most subordinated creditors, who are only entitled to the final, “residual” claim against the property of a dissolved or liquidated company. The claim is settled only after fixed claims by other entities have been satisfied.

This means that shareholders, who are in a sense “internal creditors”, can seek settlement of their “residual” claims only from the assets remaining after satisfying the “real” creditors. It follows that shareholders bear the final, “residual” risk which is much greater than that faced by the “real” creditors of the company. A correlative for greater risk is the increased risk premium manifested in the entitlement to have a share in the entire net profit earned by the company.² A means to mitigate this risk is a constraint imposed on the management board that other corporate bodies must give their consent for specific company operations to be effective.³

2 This does not change the fact that the payment of a dividend is not certain; provisions in force enumerate the financial resources (balance sheet items) that can serve dividend purposes. See Article 348 § 1 of the Code of Commercial Companies and Partnerships, § 233 AktG (Mäntysaari, 2010).
3 (Mäntysaari, 2009) found that “in other words, the fact that shareholders are holders of certain subordinated claims makes them residual claimants. The company may have received equity capital from some shareholders. It does not follow that this would make shareholders the true masters of the company.”

Am I my debtor's keeper?

At the same time, the company's supervisory board is supposed to take care of the long-term interest of the company as a product of the collective interests of particular stakeholder groups, rather than the short-term interest of shareholders. Therefore, if such protection, previously afforded to the company's shareholders, is extended to cover other groups of stakeholders, it should also be fair for some of these stakeholders to carry the burden of absorbing company's losses. This conclusion seems justified in relation to some bank creditors, especially buyers of uncollateralised debt, given the character and significance of banks for the economy. Such entities, mainly institutional investors, provide banks with debt financing on a massive scale while not being able to exercise the right to vote at general meetings.

For many years, attempts have been made to reduce the extent of the so-called rational apathy of institutional investors purchasing stock in public companies. These investors, in particular index funds, provide capital financing to public companies. However, they usually do not attend general meetings, due to their limited participation in the company's share capital. Such an attitude has been rightly criticized as unethical, since it involves profiting from investment without any thought given to the

La propriété dispersée de sociétés cotées en bourse dévalue le pouvoir réel d'un droit de vote. Les investisseurs institutionnels préfèrent simplement vendre leurs actions, plutôt que participer aux décisions de l'entreprise. Cette «apathie rationnelle» des investisseurs passifs a un impact négatif sur la gouvernance d'entreprise. Sans véritable contrôle de la part des actionnaires, la direction peut être incitée à prendre des décisions qui lui profitent à court terme. En conséquence, elle peut prendre des mesures contraires à l'éthique, aux dépens d'autres parties prenantes. Ces dernières années, l'engagement des investisseurs institutionnels s'est accru, à mesure que les entreprises cherchent à reconquérir leur réputation éthique et que la responsabilité sociale des entreprises gagne en importance.

decisions taken by the company or responsibility through active participation in general meetings. This passive attitude is popularly referred to as “foot voting”; if they do not approve of the board's activities, investors simply “quit investment” by disposing of their shares.

Similar objections involving unethical conduct are raised against institutional investors that provide debt financing by purchasing bonds. Hence, making these investors assume the risk of absorbing bank-issuer losses has a disciplinary effect aimed at prompting the buyers of debt to pay more attention to the issuer's operations. The investor-issuer relationship is at present completely anonymous due to the public nature of transactions. It could evolve towards a standard legal relationship between the creditor and the debtor. Facing the real risk of losing the granted loan, creditors would keep a more watchful eye on the debtor's business model and operations. If their assessment was negative, institutional investors might withdraw their investment in the issuer's financial instruments.

This assessment would also take account of the ethical dimension of the business. For many years, some investment funds have defined certain types of business sectors as unethical: for example, weapons, tobacco and gambling. Such sectors are therefore not considered for investment. In recent times, given the wave of concern about global warming and the natural

environment, some investment funds have stopped investing in coal companies: for example, Norway's global and national pension funds. .

Increased engagement in issuers' affairs by institutional investors, including bondholders as well as shareholders, fits the process of corporations reclaiming their ethical image and responding to rising pressure for corporate social responsibility.

No more bail-outs, unless...

None of the above changes the fact that the bail-in of the bonds of Cypriot banks in 2013 was a very innovative measure which to some extent was implemented *ad hoc* rather than because it was anchored in the existing legal framework. That framework, currently effective in the European Economic Area (EEA) through the bank recovery and resolution directive,⁴ was only in its infancy in 2013. Certain specific themes can be identified which underly the legal regime of the EU's Bank Recovery and Resolution Directive (BRRD) and which are somewhat excessively summarised as “no more bail-outs.” At the G20 meeting in Pittsburgh in 2009, as stressed by de Spiegeleer, van Hulle, and Schoutens (2014), the leaders of major global economies assumed an obligation “to create more powerful

4 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms.

Les dirigeants du G20 ont exigé des banques une plus grande responsabilité et une réduction de l'aléas moral dans le secteur bancaire. Les modalités de renflouement ont été identifiés comme un obstacle à cet égard. Cependant, l'objectif primaire de l'interdiction totale des renflouements n'a pas été remplacé par l'idée de la réduction maximale de ces derniers. En fait, l'objectif ultime du régime de résolution, énoncé dans la BRRD (Bank Recovery and Resolution Directive), est de préserver la stabilité du système financier et de limiter la propagation de la contagion financière. La discipline de marché doit être maintenue, mais un soutien financier public «extraordinaire» peut toujours être appliqué si certains critères sont remplis. Ces critères restent plutôt vagues et leur interprétation peut être poser problème.

tools to hold large global firms to account for the risk they take... and to develop resolution tools and frameworks for effective resolution of financial groups to help mitigate the disruption of financial institutions failures and reduce moral hazard in the future.”

Direct reference to moral hazard shows the ethical basis for bank resolution under the BRRD. World leaders clearly indicated that it was immoral or unethical for financial institutions to assume too high a risk and then collect premiums on that basis, while having recourse to state aid from taxpayers in the event of a crisis. However, the BRRD legal regime does not completely prohibit offering state aid to banks on the brink of failure or bankruptcy; instead, the BRRD narrows its application to exceptional cases.

A closer look at the provisions of the BRRD indicates that a resolution action has several objectives:

- 1) to ensure the continuance of critical functions;
- 2) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline;
- 3) to protect public funds by minimising reliance on extraordinary public financial support;
- 4) to protect depositors whose deposits do not exceed €100,000, meaning that they are covered;

- 5) to protect client funds and client assets.⁵

Of fundamental importance is the fact that a resolution action can only be initiated if it is in the public interest.⁶ If this condition is not met, then the normal insolvency procedure should take its course, as was the case with bankruptcy of Poland's Bank Spółdzielczy of Nadarzyn in 2016. The shareholders were the first to carry the burden of losses, followed by other financing providers, with the exception of depositors whose deposits did not exceed €100,000. These deposits were covered by Poland's Bank Guarantee Fund (BFG), which meant that normal insolvency proceedings would involve drawing from it.

No silver bullet

The adoption of the BRRD does not on its own solve the financial issues faced by European banks. The key question that remains is how to provide banks with an appropriate capital buffer to absorb losses. Admittedly, banks were required to accumulate adequate capital for a possible bail-in.⁷ However, such an extensive action is a long-term undertaking and the capital will have to be accumulated until 2023.

Meanwhile, dozens of banks are now in serious financial trouble disadvantages, in particular in

⁵ Cf. Article 31(2) BRRD.

⁶ Cf. Article 32(5) BRRD

⁷ The so-called MREL or Minimum Requirement on Eligible Liabilities and Own Funds.

Rien n'est gratuit, quelqu'un devra toujours payer lors de la faillite de la banque. À ce jour, de nombreuses banques n'ont pas été en mesure d'accumuler des fonds propres suffisants qui rendraient leur défaillance moins probable et moins dommageable pour le système financier. En attendant une telle situation, il n'est pas exclu que les décideurs soient encore confrontés un jour à une menace de faillite bancaire mettant en danger le système financier. Si tel est le cas, on ne devrait sous-estimer les conséquences d'une conduite contraire à l'éthique des banques et des décideurs. La décision finale peut être dictée par des facteurs politiques et la flexibilité de la BRRD en la matière augmente le risque des comportements contraires à l'éthique.

southern Europe. The political demand for urgent enactment of the BRRD, combined with the practical constraints discussed above, has finally led to the adoption of a flexible legal framework, especially with regard to the fundamental problem: When are the circumstances extraordinary enough to permit state aid to a bank?

In practice, the provisions of the BRRD appear to be so flexible that the risk of abuse and unethical conduct has not been stamped out at all. In this context, questions arise about the interpretation of the general clauses used by the BRRD:

- 1) How to interpret a ban on treating creditors in a way that would expose them to higher losses than in normal insolvency proceedings?⁸
- 2) When does the public interest actually become relevant, requiring a resolution action instead of an action under normal insolvency proceedings?
- 3) When do extraordinary circumstances occur that would still allow state aid to a bank on the brink of insolvency?

These clauses are general enough to create the risk of abuse and unethical conduct by banks seeking state aid), supervisory bodies and specialist resolution authorities. In particular, the latter bodies have been granted specific powers under the BRRD that allow interference

with the structure of banking organisations. Given the devastating economic and social consequences of bank collapses, there are concerns that political factors might influence the final shape of resolution proceedings in the wake of a financial crisis. The possibility cannot be dismissed that decision-makers will take advantage of the flexibility of the BRRD for their immediate needs. Such decisions may be lawful, but they will invite public resistance as unethical and ultimately aimed at extending state aid to banks. There are already instances of such an approach to the application of the BRRD.

Resolution in books...

A textbook example of the application of resolution proceedings is the takeover of the Spain's Banco Popular by Banco Santander. That "operation on a living organism", performed in June 2016, fully met the objectives of the BRRD outlined above: a bank of systemic importance was saved, losses were covered by shareholders and holders of hybrid instruments (including subordinated bonds), and no state funds were expended. However, the takeover provoked controversy because the holders of senior debt did not suffer any loss. On the contrary, the market valuation of these financial instruments increased when the news of the resolution of Banco Popular was released.

This increase outraged hybrid instrument holders who brought

⁸ The "no creditor worse off" or "NCWO" principle.

La prise de contrôle de la Banco Popular espagnole par Banco Santander est considérée comme un exemple classique d'action de résolution. La banque d'importance systémique a été sauvée, les pertes ont été couvertes par les actionnaires et les détenteurs d'instruments hybrides (y compris les obligations subordonnées), aucun fonds public n'a été dépensé. Dans le même temps, avec l'accord de la Commission européenne, le gouvernement italien a augmenté l'aide de l'Etat jusqu'à 12 milliards d'euros afin de réduire le risque de faillite de la plus ancienne banque italienne, Monte dei Paschi di Siena.

more than 50 legal actions against resolution authorities. Allegedly, the cancelled hybrid instruments were mainly held by foreign investors while the senior debt instruments were held by domestic ones. The situation prompted the resolution authority to cancel only hybrid instruments and, by extension, transfer the burden of Banco Popular's losses outside Spain's financial system. Whether or not the allegation was true, it should be noted that such a broad competence of the resolution authority undoubtedly created an ethical issue: the temptation to exploit the BRRD's flexibility in making decisions favouring domestic investors and thereby minimise public distress in the affected country.

There are even more troubling cases. With the European Commission's approval, Italy's government extended more than €12 billion in state aid to reduce the risk of bankruptcy at the country's oldest bank, Monte dei Paschi di Siena (MPS). The aid took the form of acquiring shares in place of cancelled stock and subordinated bonds (€4.785 billion), plus guarantees granted to another bank, Intesa Sanpaolo, to offset any losses due to the acquisition of MPS's assets. The admissibility of the aid was justified by the fact that it did not meet the criteria of "extraordinary public financial support" as defined by the BRRD. Such support can only be offered to an "institution that is failing or likely to fail;" yet in this case the aid was given to a "healthy" financial institution, Intesa Sanpaolo.

The principle "from the smaller to the greater" is one of the less robust forms of legal argument, but it seems fully applicable here. Since the BRRD confines state aid to failing institutions in extraordinary situations, it should naturally follow that such assistance cannot be offered to a financial institution in good shape.

...and resolution in action

In the case of two regional Venetian banks, Veneto Banca S.p.A. and Banca Popolare di Vicenza S.p.A., the justification for the eventual extension of state aid was the conclusion that the BRRD did not apply to those institutions. As indicated above, a prerequisite for instituting resolution proceedings is the existence of a public interest. In accordance with Article 32(5) of the BRRD, a resolution action is treated as in the public interest if it is necessary for the achievement of one or more of the resolution objectives and is proportionate to them. Under normal insolvency proceedings, the winding-up of a bank would not meet those resolution objectives to the same extent.

In the case of the Venetian banks, they were deemed too small to play a role in Italy's financial system, so their potential bankruptcy was not a threat to the system's stability. Furthermore, neither of these banks was acknowledged to perform "critical functions" because their lending, borrowing and payment services were available to a limited

Deux banques régionales vénitiennes au bord de l'insolvabilité ont également bénéficié d'une aide d'État, même si elles étaient trop petites pour constituer une menace pour le système financier italien. Cette fois, une législation *ad hoc* a été utilisée pour remplacer la liquidation standard par une procédure spéciale de renflouement. Les obligations subordonnées ayant été largement réparties entre les investisseurs individuels, la faillite de ces banques a été un défi politique. En effet, selon la BRRD les détenteurs de telles obligations devraient supporter une partie de la perte. Les autorités italiennes n'ont donc pas hésité à prendre des mesures clairement contraires à la loi visant à protéger les contribuables.

number of customers and could be taken over relatively quickly by another entity.

Therefore, the public interest criterion was not met, and no resolution action was needed in place of “normal” insolvency proceedings under Italy’s national laws. Yet insolvency proceedings were initiated which did not accord with the standard liquidation procedure but followed a special procedure laid down by the special Decree of the Minister of Economy and Finance No. 237/2016 (December 2016) and Act No. 15/2017 (February 2017). These instruments met the criteria of *ad hoc* interventions adopted only to remedy one specific situation. In particular, the measures sanctioned state aid to financial institutions whose bankruptcy would have caused economic turmoil in the Veneto region if the two banks had collapsed.

Once again, legal acrobatics were employed to burden taxpayers with the absorption of losses generated by banks on the brink of insolvency. Yet since the BRRD limits state aid to large, systemically important financial institutions, it should be even more demanding when granting such aid to small, relatively insignificant financial institutions. In this instance, the response of the Italian authorities provoked indignation from the EU’s Single Resolution Board; however, this did not cause the return of the received aid by the Venetian banks which would have led to their bankruptcy.

It was necessary to write down bonds as well as shares in order to extend state aid in the cases discussed above. This was extremely dubious in political terms, because the banks’ subordinated debt had previously been widely distributed among small investors and advertised as a secure investment; in retrospect, a clear example of unethical mis-selling.

In 2015, the write-down of such instruments issued by a small regional bank, Banca Etruria, which held the life savings of individual investors, proved politically unacceptable. There were even suicides that may have contributed to the fall of the pro-EU government of Mario Renzi. In the case of MPS, certain individual investors were granted the right to file mis-selling claims against the bank on the grounds selling financial instruments with an extremely high exposure to risk. According to MPS’s estimates, the claims cost the bank about €1.5 billion.

Appropriate product – but for whom?

Another fundamental question therefore arises: Who can acquire instruments which are subject to the bail-in mechanism? In other words, which investors should be considered sufficiently experienced at assessing the risk of a future resolution action and bail-in?

Both the Polish Financial Supervision Authority (PFSA) and Poland’s Bank Guarantee Fund took a hard-line approach to the problem: for the purpose of Tier II Capital and

Les détenteurs d'instruments subordonnés supportent le risque résiduel de performance de la banque. Par conséquent, il convient de veiller à ce que ces parties prenantes soient conscientes de la nature de ce risque. Les autorités de surveillance prennent des mesures pour limiter la distribution de tels instruments parmi les investisseurs individuels. Toutefois, s'il est interdit aux investisseurs individuels de participer à un investissement risqué, il est fort probable qu'ils en trouvent un autre. Dans le même temps, personne n'empêche les investisseurs individuels d'acheter des actions de la banque, qui restent l'instrument le plus exposé au risque.

MREL (minimum requirement for own funds and eligible liabilities) only subordinated bonds with a nominal value of at least PLN (Polish zloty) 400,000 should qualify.

It is clear that this stance was guided by the fear of selling such financial instruments to risk-unaware individual investors, as was the case in Italy. These concerns are well-founded, given the consequences discussed above and the assessment of such an action as unquestionably unethical. On the other hand, the solution adopted by the Polish authorities is also debatable. It seems to ignore European regulations and guidance which, in this context, recommend that the suitability of a specific financial instrument for a particular investor should “only” be examined. The possibility of covering bonds with the bail-in mechanism determines their complex nature, thus making it difficult for individual investors to understand their structure (ESMA, 2015).⁹ This means that “ordinary” senior bonds will also have such a complex character, because they may become subject to a bail-in.

Another issue is whether introducing such an additional requirement is ethical in itself. In fact, investment in subordinated bonds is not prohibited. Instead, the diversification of investment is made more demanding, which is the basis of investing, as outlined

in H. Markowitz's portfolio theory. An investor holding PLN 400,000 would still be able to invest in a subordinated bond but would not be in a position to build a diversified investment portfolio using this capital.

In practice, the implemented solution might curb the distribution of subordinated bonds among individual investors. Yet at the same time, it would significantly increase the risk for individual investors who decide to purchase such instruments anyway. This threat is real, in particular in the face of very low interest rates. The real interest rate on bank deposits pushes investors with cash surpluses towards looking for higher-interest opportunities which involve a higher risk.

Some recent experiences in the Polish bond market clearly show that the acquisition of senior bonds by a non-financial entity such as a debt purchase and collection firm can also be very risky. Limiting the availability of subordinated bonds for financial institutions would create a market void. The providers of financing would be forced to choose purely between investing in low-interest senior debt issued by financial institutions or in higher-interest senior debt issued by non-financial organisations, which is also risky. Yet there is another possibility: investing in shares. Nobody prevents individual investors from investing in bank shares, although this is a more uncertain instrument than subordinated bonds.

⁹ Guidelines on complex debt instruments and structures deposits, ESMA/2015/1787, 4 February 2016, p. 9.

Il est difficile de déterminer quand une procédure de résolution peut être entreprise dans l'intérêt public. Les autorités espagnoles ont pris des mesures audacieuses et ont déprécié les titres hybrides émis par une banque défaillante, ce qui a donné lieu à un certain nombre de poursuites judiciaires à leur encontre. Les décideurs italiens ont préféré exploiter la flexibilité du régime de la BRRD et fournir l'aide de l'Etat aux banques. Finalement, le prix qu'elles ont eu à payer est beaucoup plus élevé. Deux ans après l'adoption par le Parlement italien de la loi sur l'aide de l'Etat aux banques, les électeurs ont retiré leur confiance au gouvernement et au parlement ce qui a parmi aux partis populistes, y compris ceux favorables à la sortie de l'UE, ont obtenu un vote de confiance.

Pro publico bono?

The example of the Venetian banks also highlights a serious problem regarding a broad definition of acting in the public interest. This is perhaps the most serious interpretation challenge posed by the BRRD and the price to be paid for the exceptional flexibility of this legal instrument. The definition given elsewhere says that the initiation of a resolution action is justified as being taken in the public interest when it meets the objectives of the resolution to a greater extent than normal insolvency proceedings. However, there can be several objectives of a resolution, so possible conflicts between them are not impossible.

The question that should then be asked is whether the requirement of acting in the public interest is met when the initiation of a resolution action enables the achievement of one or more of the objectives to a greater extent than “normal” insolvency proceedings; but at the same time, the resolution has an undesirable effect on other objectives. In this case, the BRRD contains only one conflict rule: the “no creditor worse off” principle.

This principle underlines that the resolution authority will be able to initiate an action that would weaken creditors’ protection, even if its other objectives are met to a greater extent. No such rules are provided to cover other hypothetical conflicts. The resolution authority will thus have to be ready to provide a particularly ample and above all,

ethical justification for whether in specific circumstances the initiation of resolution proceedings is in the public interest.

Resolution will always lead to the burden of loss being imposed on some entities. As a result, decision-makers will be tempted to take action to cushion the domestic financial system and national investors (in particular, individual investors) against adverse effects; for such an attitude is unlikely to draw public opposition. Once again, it should be emphasised that there is no “free lunch” and if investors buy bank bonds then they must bear the risk, which charge a risk premium anyway. And yet, the senior debt of banks is not excluded from bail-in.

Based on the above examples, we arrive at another bitter conclusion: the use of BRRD mechanisms in Spain led to numerous lawsuits against the resolution authority while circumventing the same mechanisms in Italy did not. In other words, attempts to force investors to absorb losses proved more demanding than passing the burden to taxpayers.

Treating society as the weakest link in the economy is both unethical and has significant long-term adverse effects which should not be underestimated. Society is not defenceless because in a democratic state voters always has the power to elect a new government. Thus, in a general election, voters voice their opinion of the current legislators and decide whether they should continue to discharge their duties or not.

Le régime de résolution bancaire n'est pas un remède miracle qui permettrait de guérir le système bancaire européen en difficulté. Il vise à réduire l'aléas moral en préservant le rôle disciplinant de la dette. En même temps, cela crée toutefois un aléas moral, car les décideurs peuvent être tentés de faire supporter le poids des pertes aux investisseurs étrangers plutôt qu'aux investisseurs nationaux. L'effet le plus positif de la BRRD pourrait être d'obliger les investisseurs (créanciers) à être plus attentifs à la qualité et à la résistance du modèle économique du débiteur. Pour cette raison, il convient de faire tout son possible pour que la BRRD ne soit pas réduite à un instrument juridique justifiant le rationnement l'aide de l'État aux banques.

Cases of abuse also fuel populist movements, which were extremely successful in the last elections in Italy. Ultimately, two years after Italy's parliament passed the law on state aid to banks, voters sent the lawmakers away. At the same time, populist parties, including those that supported leaving the EU, were given a vote of trust.

Back to square one?

The BRRD was rapidly adopted in response to the Europe-wide displeasure incurred by state aid for banks. Formally, the directive has been made effective and is binding throughout the EU. Yet the rapid enactment of the new law has proved easier than the accumulation of capital or its surrogate to finance the application of the fundamental “no more bail-outs” principle.

There will be a risk of state support for banks in “extraordinary” circumstances as long as this capital is not accumulated, which on a case-by-case basis, may be limitless. Yet despite these imperfections, the mechanism of dividing the burden of loss among stakeholders should be considered a real and workable solution. As outlined above, the solution is entrenched in company

law and, moreover, accords with broader development of increasing corporate social responsibility. With reference to ethics, it is hard not to appreciate the disciplinary role of debt: state aid diminishes debt while the BRRD preserves it.

The most positive effect of the BRRD may be to require investors (creditors) to be more attentive to the quality and resilience of the issuer's (debtor's) business model. In today's financial world, involving algorithmic trading and blockchain technology, it is difficult to believe in any relationship between the debtor and the creditor that would last more than the time it takes to type “I SELL” on a keyboard. However, recent years have shown that a financial system thus organised is sooner or later doomed to turmoil and crisis.

Perhaps it is naïve to retain, confidence in the healing power of bail-ins, yet any instrument to combat financial crises is better than none at all. For this reason, utmost care should be exercised to prevent the BRRD from becoming a legal instrument that merely rations state aid to banks. Otherwise, the exorbitant costs incurred to implement this law will be wasted and the public will feel fooled again. •

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Voting With Your Wallet

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* The views expressed herein are those of the author and do not necessarily reflect those of the Organization he is affiliated with or of the Jury.

People Can Make a Difference

The Dakota Access Pipeline (DAPL) protests were one of the longest protests in recent US history. They began in early 2016 in reaction to an approved oil pipeline project in the northern United States. The pipeline, more than 1,800 km long, begins in the Bakken shale oil fields in northwest North Dakota and continues through South Dakota and Iowa, ending in Illinois. It sparked controversy among environmental activists across the US and Native Americans, because the pipeline was intended to cross both the Missouri and Mississippi Rivers and ancient burial grounds.

Interestingly, it was not just the oil companies that experienced a major public backlash, but this

time, the financiers suffered as well. In total, 17 major national and international banks were publicly identified as directly having financed the construction of the DAPL. These included major well-known banks such as *Wells Fargo*, *BNP Paribas*, *SunTrust*, *Mizuho Bank*, *Citibank*, *TD Bank* and *Bayern LB*, among others. By February 2017, more than 700,000 people had signed one of six petitions addressed to the banks that financed the pipeline. Individuals who signed the petitions collectively reported having more than \$2.3 billion invested in these banks through checking, mortgage, and credit card accounts. They threatened to divest their wealth and cut ties, if the banks continued financing DAPL. By then, thousands had already closed their accounts (BankTrack, 2017b). Major bank protests took place

Les manifestations contre le Dakota Access Pipeline (DAPL) ont été parmi les plus longues de l'histoire récente des États-Unis. Ce ne sont pas seulement les compagnies pétrolières qui ont été couvertes d'opprobre, mais également les acteurs financiers. 17 grandes banques nationales et internationales ont été publiquement pointés du doigt pour leur participation directe au financement de la construction du DAPL. Des manifestations contre ces banques ont eu lieu dans tout le pays. Le mouvement a montré que les gens ont commencé à voter avec leur portefeuille, et ont ainsi repris le contrôle de leurs finances.

Alors que le coût exact du mouvement contre le DAPL prend diverses formes qu'il est difficile de mesurer, il est très probable que ces mouvements ont affecté de manière significative les banques impliquées et ont eu une incidence sur leur comportement. Les conséquences ont eu lieu sur une échelle globale, toutefois, cela a-t-il été suffisant et pouvons-nous faire plus ?

across the world. In certain cases, individuals handcuffed themselves to bank branches, forcing them to close for the day. In others, hundreds of people came together in rural communities by protesting at multiple bank branches at the same time. In some cases, protesters climbed up to the top of a football stadium, namely *U.S. Bank Stadium*, during a live football game and hung large banners demanding that *U.S. Bank* divested from the pipeline. Other high-profile events followed suit, some of which even took place during the Superbowl.

Ultimately, the full consequences of these protests are hard to establish, but recent studies have shown that these banks lost between \$8-20 billion in deposits as a result of this specific movement, which has so far shown no signs of stopping (Homanen, 2018). Protests are taking place all over the world, including Canada, Australia and the UK.

Overall, the movement has shown that people have begun voting with their wallet, and are thereby, taking back control of their finances.

Did The Protests Work?

The exact cost of the DAPL movement to the targeted banks is hard to calculate, because it involves a variety of channels, such as lost deposits, loss of morale, brand value and more. However, it is very likely that these actions and associated reputational costs had a significant effect on the involved international

banks and their subsequent behavior. As an example, many banks were quick to make statements in reaction to the scandal and began publicly re-evaluating their commitments to the project. By March 2017, a major Dutch international bank, namely *ING*, sold its stake to the DAPL loan. Soon after, some banks from Norway and France sold their stakes. As time went on, municipal authorities began reacting as well. These included Seattle, Los Angeles and San Francisco, which began divesting their capital from the affiliated banks and oil companies. Furthermore, Norway's wealth fund stated its intention to drop fossil energy investments and numerous Norwegian pension funds and other Scandinavian asset managers divested from companies behind DAPL.

Overall, the consequences were global in scale, making DAPL a remarkable story that showcased the potential for people to use their personal finances to promote change. However, was it enough and can we do more?

The Problem

To this day, banks continue financing major coal and carbon-intensive projects, which undermine the Paris Agreement's aim of limiting global warming to 1.5°C above pre-industrial levels (Bank Track, 2017a). In addition, banks and other financial institutions have been identified as some of the major contributors to between \$21-32

A ce jour, les banques continuent de financer de grands projets à forte intensité de charbon et de carbone qui sapent l'objectif de l'Accord de Paris de limiter le réchauffement climatique à 1,5°C. De plus, les banques et d'autres institutions financières ont été identifiées comme quelques-uns des plus grands contributeurs de fortune financière privée investie sans payer d'impôt via plus de 80 juridictions offshore. Actuellement, la confiance des gens dans le secteur financier et dans l'environnement général des entreprises reste faible. Dans une récente enquête mondiale, 50 % des personnes interrogées considéraient que les sociétés financières sont «peu ou pas dignes de confiance» ou «indigne de confiance». Que devons-nous faire pour changer cet état de fait et pour reprendre le contrôle de nos marchés financiers de façon à les réaligner vers le futur que nous souhaitons ? Cet article propose deux solutions clés ; 1) La transparence et 2) La régulation.

trillion of private financial wealth that has been invested almost tax-free through more than 80 offshore secrecy jurisdictions (Henry, 2012). These financial institutions also pour billions of dollars into socially questionable and non-welfare optimizing enterprises that include everything from major tobacco companies to gun manufacturers.

It is no surprise that the public has lost its trust in the financial sector, given the extent of these widely considered undesirable activities and continuous reminders of how financial institutions were responsible for the recent financial crisis. Large corporations and financial institutions have become unimaginably large and often, it feels as if the public has no control over them. The 2011 Occupy Wall Street movement was a culmination of this sentiment and openly displayed people's frustration with the sector. To this day, people's trust in the financial sector and the overall business environment remains low. In a recent global survey, 50% of respondents considered financial companies as a "little trustworthy", "not trustworthy at all" or "untrustworthy" (Trustpilot, 2018).

What, therefore, must we do to change such perceptions? And how can we take back control of our financial markets in order to re-align them with the future we want to have?

This article proposes two key solutions: 1) **Transparency** and 2) **Regulation**. What happened

during the DAPL protests was a representation of the possible. Many of today's social challenges are partially caused by the lost connection between people and their investments. In the past, people had a better awareness of their ultimate assets. People invested in local firms and local banks, which in turn invested back in the local communities. Today, people are unaware of where their money is actually located and the resulting investments that they are driving. Are your deposits financing a coal mine on top of the coral reefs in Australia? Does your financial institution invest in companies that cause deforestation in Indonesia? Perhaps. DAPL represented our natural desire to re-establish those lost connections and with them, the collective means to re-invest our finances in building a socially and environmentally desirable future.

Knowing Where Your Money Goes

How do you begin tackling socially complex undesirable behaviour? As an example, tax evasion is one of society's most problematic issues to solve, because there are almost no natural market forces that can moderate it. As an illicit practice it is extremely difficult to tackle because of many obstacles, including lack of political will, unstable regulatory coordination and the absence of positive reinforcement mechanisms. Politicians have few incentives to adopt effective legislation, while

L'évasion fiscale est l'un des problèmes de société le plus difficile à résoudre, car il n'y a pratiquement pas de forces naturelles du marché qui puisse la modérer. Ces problèmes rappellent les autres problèmes de la finance, qu'il s'agisse du financement d'oléoducs et des centres de détention privés. Nous ne savons pas vraiment dans quoi nos banques ou nos institutions financières investissent.

DAPL a été un réveil capital pour de nombreux ménages, car c'est la première fois que les gens pouvaient concrètement visualiser les projets que leurs dépôts finançaient indirectement. Un pipeline qu'ils ne voulaient pas. La transparence sur ces questions est actuellement plutôt limitée, mais quelques cas notables existent. Globalement, plus nous plaçons pour de telles initiatives et plus nous demandons de transparence, mieux nous pourrions faciliter le mouvement des capitaux vers leur destination légitime.

we rarely applaud individuals or companies for paying their fair share of taxes, because it is something they should have done in the first place. The problems associated with tackling tax evasion are reminiscent of other problems in finance, such as investing in oil pipelines or private detention centres.

So what can be done? We rarely know what our banks or financial institutions are investing in. Therefore, the starting point is transparency. For many of these issues, **sunlight is the best medicine.**

The Banks

Few depositors know where their banks invest and which companies receive loans from those banks. That is why DAPL was a momentous awakening for many households, as it was the first time people could visualise in concrete terms the projects that their deposits were indirectly financing: specifically, a pipeline that they did not want. Transparency on these issues is currently rather limited, but a few notable cases exist. Rainforest Action Network publishes a “Banking on Climate Change – Fossil Fuel Finance Report Card” that documents the fossil fuel investments of some of the world's largest banks (Rainforest Action Network, 2019). A snapshot of their findings indicates that 33 of the largest global banks have financed an astounding \$1.9 trillion in fossil fuels since the Paris Agreement was adopted (2016–2018). These include

loans to projects on tar sands, Arctic oil and gas, ultra-deep-water oil and gas and fracked oil and gas. Such reports have created significant public awareness among investors, the public and the general banking community.

More such initiatives are needed and therefore, companies like MightyDeposits are an important next step forward. MightyDeposits is a US-based startup that utilises publicly disclosed data on banks to create awareness of the real characteristics of these institutions in local communities. Users who subscribe to the platform gain access to full information about banks beyond financial fundamentals such as balance sheets and income statements. For example, they receive information about what percentage of the bank's assets is invested in the user's local community and whether these assets are owned by particular minority groups such as African-Americans or Asian-Americans. The company reflects the continuous and increasing demand among households, which are trying to realign their social values with the appropriate financial institutions.

This demand is a driving force behind the creation of the Global Alliance for Banking on Values, a global network of banks which are committed to advancing positive change in the banking sector and the world in general. For many of these institutions, each loan that they advance must make the world a better place and they contribute

Les investisseurs individuels détiennent des positions importants dans d'autres produits financiers, y compris des fonds de pension et des fonds communs de placement. À titre d'exemple notable, lorsque les Néo-Zélandais ont découvert que leurs fonds de pension (ou KiwiSavers) finançaient des bombes à fragmentation et des mines anti-personnelles, ils se sont fâchés. Après avoir été décriées, diverses institutions financières ont commencé à adopter des stratégies d'exclusion. Fondamentalement, c'est le comportement que nous voulons promouvoir, que ce soit via les rapports des ONG ou les sociétés de services financiers, nous devons insister et continuer à exiger davantage d'informations sur les impacts réels de nos investissements.

significantly to socially relevant projects including renewable energy investments and cultural development initiatives. Without them, it is hard to imagine a world, where those investments would have been financed via existing, traditional banks.

Overall, consumers who invest in banks belonging to the Global Alliance network, are conscious of the impact their savings are making. These consumers are the reason for the existence of these new forms of socially conscious bank-based capital. Without the depositors, who put their money in these institutions, these banks would never have existed. They are a reminder that it is possible to make positive financial returns while also achieving positive societal impact. The more we push and the more transparency we demand, the better we can facilitate the movement of capital to its rightful destination.

Pensions and Mutual Funds

Banks are not the only institutions that matter in the household financial investment decision-making process. Individual investors have significant holdings in other financial products, including pension funds and mutual funds, to name a few. As with banks, there is growing awareness among retail investors in such funds about where their money is located. One notable example was the fury of New Zealanders when they discovered that their

pension funds (or KiwiSavers) were financing cluster bombs and land mines. The public outrage prompted a variety of financial institutions to adopt exclusion strategies; in other words, they divested their holdings in these companies. Similar stories can be found across the world. In The Netherlands, people reacted when they found out their pensions were helping to drive the creation of a world that they did not want to retire to.

Other traditional asset managers have also received comparable public attention. BlackRock, the world's largest investment management company, with over \$6.5 trillion in assets under management, has been publicly identified as the largest driver of climate destruction on the planet. As a huge asset manager, BlackRock's funds collectively hold a large proportion of the world's stocks in fossil fuel companies. This publicity and other forms of communication and transparency have raised awareness that if you invest in BlackRock's mutual funds, you are indirectly supporting these are types of companies.

Studies have further shown that when Morningstar, a global financial-services firm, began identifying funds based on their "greenness" (or fossil fuel exposure), investors began fleeing the fossil fuel intensive funds (Hartzmark & Sussman, 2018; Ceccarelli, Ramelli & Wagner, 2019). In other words, people reacted, when they were shown the full information about their investments.

Dans l'ensemble, diverses initiatives et organisations à travers le monde tentent de favoriser la transparence sur les marchés financiers. En Australie, la Responsible Investment Association Australasia fournit aux clients de détail une variété d'outils pour trouver des conseillers financiers éthiques et des produits d'investissement socialement responsables. Dès maintenant, nous devons redonner de la vigueur aux forces traditionnelles du marché pour accroître cette transparence. Nous pouvons le faire en devenant plus actifs sur nos marchés financiers et en exigeant davantage de nos prestataires financiers.

Les gestionnaires d'actifs ont l'obligation de représenter les intérêts de leurs clients. Lorsque les intérêts du client changent, les pratiques de gestion devraient également changer. Des études ont montré que les investisseurs institutionnels peuvent obtenir des effets signi-

Fundamentally, this is the behaviour we want to promote, whether via NGO reports or financial services firms. We need to continue demanding more information about the actual impact of our investments, whether they are deposits, pension holdings, mutual funds or other investments such as our corporate bond holdings, sovereign bond holdings and even the investments of our insurance providers. All our financial decisions have a similar context that resonates with the DAPL protests. All we have to do is demand to know where our money goes.

Tools for Retail Investors

Various initiatives and organisations around the world are trying to foster transparency within financial markets. In Australia, the Responsible Investment Association Australasia provides a range of tools for retail clients to find ethical financial advisers and socially responsible investment products. Similarly, the US Forum for Sustainable and Responsible Investment provides a useful document titled "Getting Started in Sustainable and Impact Investing – A Guide for Retail Investors". The document includes information for retail clients about how to align all areas of their financial portfolios with their social and financial aspirations (US Forum for Sustainable and Responsible Investment, 2017).

Such institutions can be found in nearly every country. Sometimes they are coordinated by investment organisations and sometimes by NGOs and charities. Overall, we need more tools like these that promote financial transparency in order to re-align capital markets with appropriate goals. Currently, we need to foster traditional market forces to increase this transparency, by becoming more active in financial markets and by demanding more from our financial providers.

Investment Stewardship

Investment stewardship is about making your financial institutions work for you. Asset managers have a fiduciary duty to represent the interests of their clients. When the client's interests change, stewardship practices such as active management should change as well. Why is this important? The reason is that the majority of global stocks are now owned by large institutional investors such as pension funds, asset managers and insurance companies, instead of being directly owned by ordinary households. Therefore, the balance of power has changed, and we need to think how to discipline markets, given the dominance of institutional investors.

Fortunately, studies have shown that institutional investors can exercise a significant influence on corporate behaviour, especially regarding environmental and social issues (Dimson, Karakaş & Li, 2015; Dyck, Lins, Roth and Wagner, 2019).

ficatifs sur le comportement des entreprises, en particulier dans les domaines liés aux questions environnementales et sociales. Comme pour ce qui est de savoir où se trouve votre argent, il est tout aussi important de savoir comment votre gestionnaire «gère» littéralement votre actif.

Les gens sont-ils concernés ? Réponse courte, oui. Globalement, à mesure que l'exigence d'information et de responsabilité augmente, les comportements vont finalement changer. Plus nous trouverons de moyens de rendre ces pratiques transparentes, plus les changements seront rapides.

Portfolio companies do in fact react when asset managers engage them successfully on socially challenging topics. In addition, institutional investors often vote in corporate AGMs on environmentally and socially relevant topics, acting on behalf of households, their ultimate clients. There will be votes on issues such as whether specific companies should disclose methane emissions or whether they should disclose their corporate lobbying expenditure.

Surprisingly, there are substantial differences of opinion among asset managers about how to vote on these issues. Some managers always vote “yes” on questions such as whether a company should disclose its emissions or whether it should have a strategy on how to approach a so-called “2°C climate scenario” where the earth’s average temperature increases by 2° Celsius. Meanwhile, other asset managers always vote “no” on the same questions. There is no obvious reason why institutions take different positions, yet that is the current reality.

As mentioned above, it is important that you know where your money is. Similarly, it is just as important to know how your asset manager is literally “managing” your assets. The relevant information is not always readily available, despite a range of disclosure laws around the world which address financial institutions’ active management strategies, such as proxy voting behaviour. In an ironic twist, there is actually a chance that your

investments in a socially responsible fund of the kind provided by some large asset managers might have a fund manager who votes in a completely different manner to your socially-minded expectations.

Changing Stewards

There is still a small, but growing awareness that people can have a choice on these matters, notwithstanding obstacles in the proxy voting landscape. Ceres, for example, is a sustainable nonprofit organisation which addresses these and other concerns, by publishing accessible, reader-friendly articles with titles such as “*Is Your Mutual Fund Company Taking Climate Change Seriously*” (Ceres, 2017). These useful metrics, which can also be obtained from other sources, reflect the growth of transparency regarding stewardship practices.

But do people care? The short answer is yes. In one notable case, 30,000 Americans called on Vanguard, an investment advisor with more than \$5.3 trillion in assets under management, to hold companies accountable on political engagement. Vanguard is entrusted with millions of people’s retirement savings and as savers, the 30,000 who joined the campaign were specifically demanding that Vanguard should actively manage their corporate portfolios in a socially desirable way. They told their pension provider to oblige portfolio companies to disclose their US political lobbying and therefore,

Le soutien de l'État est crucial. Heureusement, diverses propositions législatives en cours dans le monde tentent de réorienter le système financier vers un avenir responsable. Bien que les résolutions en matière de climat soient politiquement sensibles, il n'y a aucune raison pour que les ménages n'aient pas la possibilité d'investir dans un portefeuille vert. Il n'existe toujours pas de mécanisme réglementaire uniforme permettant aux investisseurs d'aligner leurs valeurs sociétales sur leurs préférences financières. L'adoption d'une loi qui imposerait ce type d'obligation d'information constituerait un important pas en avant.

how much money they were pouring money into the electoral process. Vanguard was thus perceived to play an enormous role in enabling secret corporate spending in US elections.

Overall, as the demand for information and accountability grows, behaviour will ultimately change. The more we find ways to bring transparency to these practices, the faster change will come. For example, Morningstar, the financial services company mentioned above, recently acquired FundVotes, a company specialising in fund-level ESG (environmental, social and governance) proxy voting data. The acquisition implies that that sooner rather than later, we will have even greater awareness about how our funds engage with their portfolio companies.

Regulation

Support from the state is crucial. While demanding societal change from our financial institutions is important, we must also continue to demand action from our politicians; not just via direct intervention, such as introducing carbon taxation to help combat climate change, but also through indirect initiatives to facilitate the alignment of our societal interests with appropriate forms of finance.

As an example, on 13 March 2019, US Representative Alexandria Ocasio-Cortez asked Wells Fargo's CEO at a House Financial Services Committee hearing whether his bank was involved in "caging children",

since the bank was involved in financing privately-run detention facilities. In addition, she asked, "if there was a leak from the Dakota Access Pipeline, why shouldn't Wells Fargo pay for the cleanup of it, since it paid for the construction of the pipeline itself?". Wells Fargo and other banks have been similarly questioned by Ocasio-Cortez for their involvement in financing gun manufacturers, thereby publicly connecting them as one of reason for rising gun violence in the US.

More is required, despite this vivid example of an elected representative voicing the specific concerns of her constituents about financial markets. The transparency that has been continuously demanded in earlier sections can be enhanced forcibly via legislation. As an example, the Technical Expert Group on Sustainable Finance at the European Commission has been set up to assist in developing the European Commission's legislative proposals on issues related to EU Green Bond Standards, EU climate benchmarks and guidance on corporate disclosure of climate-related information. Progress has already been made, but it will be just as important to enact legislation that requires investment advisors to disclose climate-specific information (and potentially, other socially relevant data) to retail investors.

The law requires fund managers to present investment opportunities to retail investors with appropriate details on risk profiles and expected

La transparence devrait être exigée par voie législative. En tant que citoyens, nous n'avons aucun moyen direct d'influencer le comportement de la Banque centrale. Cependant, il est juste que les citoyens demandent aux régulateurs de tenir compte des risques sociétaux croissants.

Les manifestations contre la DAPL auraient eu lieu de toute façon. Mais était-il évident que les banques seraient également visées? Non. Une fois que l'information a été communiquée au grand public, la désignation publique des banques impliquées dans le pipeline a permis de faire comprendre aux gens du monde entier qu'ils étaient partie-prenante aux événements, souvent au moyen de leurs propres cartes bancaires dans leurs portemonnaies.

performances. While climate resolutions are sometimes politically sensitive, there is no reason why households should not have the option to invest in a green portfolio or to divest from a fossil fuel-intensive stock. Ultimately, as far as our investments go, households should be allowed to execute any decision that could be characterised as moral in nature. In this context, it is never questioned that households have an independent right to install a smart meter in their homes. Therefore, why should they not be allowed to have a smart meter for their investments? In addition to knowing their energy expenditure, people should have the right to know the fossil fuel exposures of their financial portfolios. At present, there is still no uniform regulatory mechanism that allows investors to align their societal values with their financial preferences, even though there is clearly a growing demand and appetite. Adopting legislation that would force these types of disclosures would be a significant step forward.

Central Banks

Transparency is the first step that should be demanded as far as legislation is concerned. However, our political institutions have other means of exerting influence in the real economy. For example, central banks across the world have recently joined the Network for Greening the Financial System. The group's missions include helping

to strengthen "the global response required to meet the goals of the Paris Agreement and to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments in the broader context of environmentally sustainable development".

As citizens, we do not have any direct channels for influencing central bank behaviour. However, it is fair for citizens to ask that their regulators be aware of rising societal risks, such as climate change, and to make sure those risks are fully accounted for. Central banks should hire environmental economists, so that they can better forecast rising risks due to natural disasters and other climate-related risks that can have massive implications for our economies and financial stability. For example, in the UK, leading academics and representatives of civil society have publicly demanded that the next Governor of the Bank of England (the UK's central bank) should commit to serving the whole of society, and not just financial markets. This is another illustration of how people are demanding change from their financial institutions, including their central banks.

Conclusion

The DAPL protests would have happened anyway. People come together and act when their communities and livelihoods are threatened, people come together. But was it obvious that the banks would be targeted as well? No.

En tant qu'individus, nous devons exiger davantage de nos institutions financières. Si vous les quittez, ils perdent leur fonds de commerce, ce qui les forcera finalement à réagir. La force du marché qui en résulte incite à un changement positif et, pour lubrifier ces rouages, nous avons besoin d'une législation mise à jour afin de poursuivre notre effort collectif vers un avenir meilleur, durable et éthique.

Information was difficult to find. Publicly accessible data on corporate-level financing was only available through very specific corporate filings, and finding those documents required knowledge that they existed in the first place. In addition, those filings did not include the actual details about bank-level project financing. They were only available through an expensive financial data subscription, which required cross-continental collaboration among specific NGOs (Cook and MacMillan, 2019).

Transparency was essential to the story. The information about bank financing was made accessible to everyone through media, NGO campaigns, blogs, protests and journalistic reporting. First, the corporate-level financing was disclosed and afterwards, project-level financing information became available as well. This information spread beyond Indigenous digital media communication to the mainstream media after a notorious case was broadcast showing footage of private security guard dogs biting Native Americans at Standing Rock.

From then onwards, other crucial bank-level financing infographics were widely circulated amid the ongoing onsite violence: for example, the DAPL finance graphic released by Food & Water Watch. Once this information reached the wider public through a series of specific events, people worldwide felt they were involved – many of them through the bank cards in their wallets.

Today, we have many means to spread information, but surprisingly few opportunities to find it. As individuals, we need to demand more from our financial institutions and continuously remind them to disclose socially relevant information. Financial institutions need their capital providers, meaning you, the ordinary householder. If you leave them, they lose your business, ultimately forcing them to react. The resulting market force creates momentum towards positive change. To grease the wheels, we need updated legislation to continue our collective push towards a better, sustainable and ethical future. •

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Is Offshoring Ethical?

Ethics & Trust in Finance Global edition 2018-2019

Finalist

Christopher Stubbs

Ireland

*Procurement
Professional,
Pharmaceutical
Industry,
Basel (Switzerland)*



* The views expressed herein are those of the authors and do not necessarily reflect those of the Organization he is affiliated with or of the Jury.

In the post-Panama Papers world, there was much cause for optimism. The largest financial leak in history led to all kinds of encouraging soundbites and consensus appeared to be reached regarding what legislative steps were necessary to bring about meaningful change.

However, 2018 was a year that must have ravaged even the most ardent optimist's cheer. Notwithstanding another series of major financial scandals, including Danske Bank and 1MDB, it was also - most importantly - a year in which the capacity and willingness of monsters to lash out in the most deplorable fashion was publicly demonstrated, over and over and over again.

Eighty journalists and media workers were killed last year (RSF 2018, p.3). Among them were Ján Kuciak, a 27-year-old Slovak, who

was "shot dead in his home together with his fiancée, Martina Kusnirova, on 21 February", and Victoria Marinova, a 30-year-old Bulgarian broadcaster who "had been beaten, raped and strangled" (RSF 2018, p.11). Both murders were committed in the EU. Both victims were comfortably young enough to make submissions for the Ethics and Trust in Finance Prize.

This paper will make the following series of arguments:

- (i) Any discussion pertaining to ethics in finance needs to put the offshore system at its centre. Otherwise, the discussion is, in large part, a waste of time;
- (ii) The legislative solutions to produce better outcomes are already known and in the process of being implemented;

L'ambiguïté fait partie du monde de l'offshore. Le débat peut faire rage en ce qui concerne les termes et le langage utilisés (par exemple, un centre financier offshore, un paradis fiscal, etc.), les définitions et les avantages d'un tel système. Même s'il y a des aspects légitimes à l'offshore, toute analyse honnête doit conclure que les dommages qu'il provoque sont supérieurs aux avantages qu'il procure. Les chiffres cités dans le texte illustrent ce point. Même en laissant une marge d'erreur énorme et en accordant une grande crédibilité aux arguments des partisans de l'offshore, si l'on supposait que pour chaque chiffre cité, il s'agissait d'une surestimation grossière, les chiffres resteraient tout à fait ahurissants. En outre, le système offre une protection aux plus dangereux et aux plus impitoyables d'entre nous. Il ne s'agit donc pas d'une question purement économique, elle concerne le fondement de notre compréhension de la démocratie.

(iii) As a matter of the utmost urgency, much greater protections need to be offered to journalists and whistleblowers, who often expose the worst kinds of wrongdoing;

(iv) Incentives are key. At present, bad incentives are driving the behaviour of governments, corporate interests, media reporting and private citizens, with predictably unfortunate outcomes.

A brief commentary will conclude the paper.

The Ethics of Offshore Jurisdictions

The offshore system can be difficult to nail down. For the purposes of this paper, it refers to "jurisdictions that deliberately create legislation to ease transactions undertaken by people who are not resident in their domains, with a purpose of avoiding taxation and/or regulations, which they facilitate by providing a legally backed veil of secrecy to obscure the beneficiaries to those transactions" (Palan, Murphy & Chavagneux 2010, p.45).

Regardless of the scope of the above definition, it is appropriate to point out that there are legitimate reasons for actors to engage in such a system. For instance, an offshore jurisdiction may provide access to more developed and stable banking and legal institutions while companies may simply wish to shield expansion plans and property acquisitions from competitors.

In both instances, there is a good argument to be made for using offshore facilities.

A Brief History of Leaks and the Value of Offshore Jurisdictions

There have been numerous leaks over the last few years, including: the HSBC Suisse leak (2006); the UBS and LGT leaks (2008); Julius Baer (2008); Luxleaks (2012); the British offshore tax havens leaks (2013 & 2014); the Panama Papers (2014); and the Bahamas leak (2016) (Oei & Ring 2017, pp. 11-27). More recently, the Paradise Papers has resulted in a further increase in interest in offshore systems, as the industry's size and scope becomes clearer.

The figures involved are staggering. For example, the following are indicative of the stakes:

- "The European Union alone loses out on a thousand billion euros a year due to tax fraud and tax evasion." (Obermayer & Obermaier, 2016, p.312).
- "A 2008 US Senate staff report estimates that 'offshore tax abuses' result in an annual loss to the US Treasury of \$100 billion in tax revenue" (Omartian, 2016, p.1).
- There has been "a fivefold surge in tax related profit shifting in the last fifteen years alone, now costing governments \$300-650 billion per year" (Shaxson, 2018, p.246).
- With respect to revenues lost

Les solutions législatives pour contenir le phénomène sont connues. Elles sont doubles : l'échange mondial d'informations relatives aux comptes bancaires et un registre des entreprises transparent à l'échelle mondiale. Les choses deviennent de plus en plus compliquées, mais malgré de nombreuses raisons d'être pessimiste, les développements récents incitent à un peu d'optimisme. Par exemple, outre l'intensification de l'effort législatif des deux côtés de l'Atlantique, les résultats publiés par l'OCDE l'année dernière dans «Tax Transparency 2018: Report on Progress» étaient tout simplement sensationnels - 500'000 personnes ayant communiqué des informations sur leurs actifs offshore - et 93 milliards d'euros collectés à la suite de ces efforts législatifs.

to tax havens, the OECD “estimates such practices cost governments between \$100 billion and \$240 billion in lost revenue each year” (Trautman 2017, p.844).

- “Expert (but conservative) estimates of the amount of money parked in offshore tax avoidance schemes reach to at least 20-30 trillion dollars” (Dillon, 2016, p.56).
- Regarding the relationship between foreign aid to developing countries and financial flows from those countries to offshore jurisdictions, “for every dollar that we have been generously handing out across the top of the table, we in the West have been taking back some \$10 of illicit money under the table”. (Shaxson, 2011, p.27).

You get the picture. The ugly reality is that when “governments try to crack down on offshore tax secrecy, for instance, an army of (...) experts step up, targeting policy makers, denigrating the reformers, persuading offshore centres like the Caymans to write new laws to spike the reforms” (Shaxson 2018, p.179). It is thus clear that there can be a massive degree of complexity and pressure for governments to negotiate.

On ethics, Grayling (2003, p.184) warned against the use of “scholastic superfluities of intricate jargon and technical refinement of use to no

one but at best a few colleagues”. Following this line, it should be incumbent upon anyone with an interest in the topic to be clear. Accordingly, the system described above stinks. No amount of smart talk from well-paid advocates will change that fact.

In a rare intervention last year with respect to economic policy, The Holy See (2018, p.13) lamented that “it is not possible to ignore the fact that those *offshore* sites (...) have become usual places of recycling dirty money, which is the fruit of illicit income (thefts, frauds, corruption, criminal associations, mafia, war booties etc).” The implication is clear. The game of supranational regulatory arbitrage is offering protection to the worst kind of thugs: the kind that send men in the night to visit the most courageous of youngsters living outside Bratislava. Explicitly stated, “international mafias and weapons dealers actually depend on offshore centers, for it is through this option that they manage to launder revenues from illicit activities” (Ferreira & Madeira 2010, p.6).

In this context, I believe that offshore jurisdictions and the protections they offer (and to whom) must be the focus of any serious discussion about ethics in finance. To be clear, while corporate ethics training programmes are nice, they will not make a meaningful difference. The discussion needs to center on offshore jurisdictions.

Les efforts législatifs déployés sont impressionnants et leur intensification au cours des cinq dernières années est particulièrement remarquable. Ces efforts incluent l'adoption par l'UE du cadre OCDE/G20 Echange automatique d'informations (AEOI), du projet Erosion de la base d'imposition et transfert de bénéfices (BEPS) de l'OCDE et de l'accord du G5 pour un échange automatique d'informations. Le Département de la Justice (DOJ) et la Securities and Exchange Commission (SEC) des États-Unis sont particulièrement méritants de fiat de l'application d'instruments tels que la FATCA et la Kleptocracy Asset Recovery Initiative au cours des dernières années - qui a permis de collecter plus de 6,5 milliards de dollars, et a garanti des revenus en centaines de millions de dollars à la population de pays comme le Nigéria, le Kazakhstan, la Corée du Sud, le Pérou et le Nicaragua.

Green Shoots

Despite my gloom, there are reasons to be hopeful. The legislative solutions for tackling offshore jurisdictions are known and a consensus appears to be forming about their effectiveness. These measures have already reaped some encouraging results. Concisely, the “first big step would be to introduce an effective system for the global exchange of information about bank accounts”, with the second step being “a globally transparent register of companies”, where true beneficial owners could be readily identifiable, and the provision of false information made a criminal offence, with tough sentences for breaches (Obermayer & Obermaier 2016, p.305). The devil may be in the detail but that is as complicated as it gets.

As alluded to, there have been “significant developments in coordinated global action to increase cross border transparency and information exchange” (Oei & Ring 2017, p.4). For example:

- Ioannides (2016, p.35) notes that for the EU, “the implementation of the OECD/G20’s automatic exchange of information (AEOI) was adopted in December 2014”.
- Oei and Ring (2017, p.21) continue that following two special committees established by the EU in 2015 (i.e. TAXE 1 and TAXE 2), the “creation of a beneficial ownership register

and a proposed framework for whistleblower(s)” was recommended.

- “In October 2015, the OECD’s Base Erosion and Profit Sharing (BEPS) project published its final report, requiring companies to divulge where they earn their profits, carry out operations and pay tax” (Ioannides 2016, p.51).
- Further, the “G5 countries have agreed (...) to develop a global multinational multilateral system for an automatic exchange of beneficial ownership information” and “in 2016 the EC adopted a proposal for full public access to beneficial ownership registries for certain legal entities” (Oei & Ring 2017, p.25).
- The EU also adopted the Anti-Avoidance Directive in 2016 (Dillon 2016, p.23).

Jallow (2016, p.11) cites US legislative efforts such as FATCA (Foreign Account Tax Compliance Act), passed in 2010, which “primarily aims to prevent tax evasion by US taxpayers by using non-US financial institutions and offshore investment instruments”. The same author proceeds to make twelve broad recommendations, including: enhanced powers for tax authorities to gain access to bank data; establishment of an anti-global tax avoidance and evasion commission; coordinated information sharing between

tax administrations and central banks; and an institutionalised whistleblowing system, with laws that protect the identities of whistleblowers (pp. 13-14).

What are the results of this increased urgency? Are the efforts paying dividends? By any measure, the answer is a resounding yes. The OECD (2018, p.39) reports that, as of July 2017, “in response to disclosure initiatives and similar measures put in place prior to start of exchanges, approximately 500,000 individuals have already disclosed offshore assets worldwide, and some EUR 93 billion in additional tax revenue has been collected”. This equates to a massive investment fund for hospitals, schools, police forces, homeless shelters, drug rehabilitation programmes and other public spending projects which cash-strapped governments would otherwise have not been able to afford.

The figure includes the following publicly-reported tax revenues that were recovered (OECD 2018, pp. 40-41):

Brazil – approximately EUR 12 billion;

France - EUR 7.8 billion;

India - EUR 6 billion;

Indonesia - more than USD 10 billion;

Mexico – approximately EUR 826 million;

Burkina Faso – USD 2.4 million (from the first seven information requests).

In this context, even the most entrenched pessimist must admit that things are moving in the right direction.

Results on both sides of the Atlantic

Furthermore, Trautman (2017, pp. 851-855) reports that the US Department of Justice (DOJ) brought approximately 60 cases against individuals and more than 60 against corporations between 2009 and 2017, using the FATCA and other laws. This litigation led to the collection of more than \$4 billion in penalties. In the same period, the Securities and Exchange Commission (SEC) initiated proceedings against more than 85 companies and around 35 individuals, resulting in the collection of around \$2.5 billion. Lastly, the DOJ has helped recover hundreds of millions of dollars for the people of nations such as Nigeria, Kazakhstan, South Korea, Peru and Nicaragua, using the Kleptocracy Asset Recovery Initiative (2010).

This is just the beginning. The OECD reports that The Global Forum on Transparency and Exchange of Information for Tax Purposes (“The Global Forum”), increased its membership to 154 in 2018, with nine new jurisdictions joining last year, while “nearly 90 governments have begun automatically exchanging information on financial accounts of non-residents” (OECD 2018, p.4), partly motivated by the successes of the early adopters. It is also noteworthy that, in line with the

Des dizaines de meurtres, dont certains de nature simplement macabre, des détentions, des prises d'otages, des personnes portées disparues sont la terrifiante réalité à laquelle sont confrontés les journalistes qui effectuent un travail d'enquête sérieux. Les meurtres de Ján Kuciak et de Victoria Marinova démontrant que l'âge n'a aucune importance pour les plus impitoyables. Ce qui est choquant, c'est que ces cas se soient produits en Europe, en 2018, où la plupart des gens (y compris moi-même) auraient aimé croire que des institutions et des systèmes juridiques matures étaient en mesure de prévenir tels meurtres. Ces cas ont également mis en évidence le fait que quiconque a des principes et est cherché à apporter un changement positif est en danger. Cela aurait pu être toi. Ou moi. Ou un de vos fils ou de vos filles.

policy prescriptions cited earlier, “at the request of the G20, the Global Forum and the Financial Action Task Force (FATF) work together on the ways to improve the availability of beneficial ownership information and its international exchange” (OECD 2018, p.11).

The agenda for 2019 represents a heavy workload. It envisages the delivery of existing AEOI commitments; assessments of legal frameworks; expansion of support for developing countries; the publication of 30 reports; and an intensification of technical assistance, with a view to “a strong priority being placed on the availability of, and access to, beneficial ownership information” (OECD 2018, p.43). A cynical analysis of these developments might conclude that these are just more examples of bureaucracy. However, once this system of coordination matures, it may well have the capacity to hold the nefarious to account when future scandals occur, by depriving them access to the shadows in which they hide.

The Assassin's Veto: Terrifying Developments for A Free Press

“There are crooks everywhere you look now’, Daphne Galizia wrote. ‘The situation is desperate.’ Those were the last words she ever published. The 53-year-old journalist was killed when her car exploded later that day” (CPJ 2018, p.12). That particular horror unfolded in

a European capital on a dark day in October 2017.

Holding power to account is a dangerous business. Earlier, I cited a figure of 80 journalists killed in 2018, of whom 49 were deliberately targeted (RSF 2018, p.6). Regrettably, that does not reveal the full extent of the danger. Consider, for example, that in 2018 348 journalists were detained, 60 were held hostage, while a further three went missing (RSF 2018, p.3). It was a year “in which journalists are accused of terrorism on the basis of a single word or a single phone contact” (RSF 2018, p.15).

The figures for mortality and impunity rates during the past decade make for even grimmer reading. In a UNESCO-cited report, the IMS (International Media Support) notes that 827 journalists were killed in the last ten years. Frighteningly, with “only 8% of cases reported as resolved (63 out of 827), impunity for these crimes is alarmingly high. This impedes the free flow of information that is so vital for sustainable development, peace-building, and social welfare of humankind. This widespread impunity fuels and perpetuates a cycle of violence that silences media and stifles public debate” (IMS 2017, p.18).

Put yourself in a journalist's shoes. Is taking on serious topics and seeking to hold power to account wise, given this reality? Do these horrors not serve as a *de-facto* warning amounting to a borderline

Au sujet des lanceurs d'alerte, il y a une raison d'être optimiste. Chaque État peut choisir de ne pas poursuivre ceux qui rendent publiques des informations sensibles. Cependant, l'absence d'un mandat démocratique pour les lanceurs d'alerte pose des problèmes. Le fait que nos gouvernements, nos services de sécurité et nos services secrets soient mieux placés que Wikileaks pour déterminer quelles informations sont adaptées à une utilisation publique, n'a pas été contesté par un seul auteur. En dépit des meilleures intentions des lanceurs d'alerte et des organisations correspondantes, la possibilité de divulgations irresponsables et de conséquences inattendues reste de mise. Elle peut également mettre en danger des personnes bien intentionnées. L'auto-immunité des lanceurs d'alerte qui passent par les canaux publics est la solution ici. Les informations fournies peuvent être correctement vérifiées, les prochaines étapes déterminées et les lacunes relatives à un mandat démocratique comblées.

veto on serious investigative reporting? Should we be surprised that, as consumers of news, we routinely find headlines such as; “Curious cockatoo inspects traffic camera” (Sky News), and “The Korean island in love with sex” (BBC)?

These headlines appeared on the homepages of the major news outlets at the date of writing (28 March 2019). It is not to diminish the importance of cockatoos or sex, but these are hardly topics that will make thugs think twice. With respect to the impunity documented above, I find it difficult to blame the journalists or editorial teams for pursuing such “human-interest” stories. If civil society is apathetic about the need to have a serious conversation about protections for journalists, then the adage “garbage in, garbage out” may apply.

A Space for Supranational Organisations to Demonstrate Competence

The only good news is that there is acknowledgement of the problem at the supranational level. The UN Plan of Action on the Safety of Journalists and the Issue of Impunity, adopted in 2012, is one such example (IMS 2017, p.11). It “outlines more than 120 measures to improve safety and combat impunity through the coordinated responses of states, NGOs, media, and international organisations” (IMS 2017, p.20). Further, “five resolutions have been

adopted across the UN system since 2012, including by the UN General Assembly, the UN Security Council and the UN Human Rights Council” (IMS 2017, p.57).

IMS has also proposed a framework based on its experiences (IMS 2017, pp.37-45) which merits consideration. However, traction on the issue is clearly difficult to achieve. It is still the case that in “only a small number of countries do journalists have access to state-supported programmes for protection, and even in these countries, many journalists at risk fall through the cracks” (IMS 2017, p.19).

Whistleblowers are facing difficulties of a different nature. Oei and Ring (2017) report the experiences of some of those who were behind the variety of leaks reported earlier, regarding offshore jurisdictions. For example:

- For his part in the HSBC Suisse Leak (2006), Hervé Falciani “was tried *in absentia* in Switzerland and convicted of aggravated industrial espionage in November 2015. (...) He faces a five-year prison term if he ever returns to Switzerland” (Oei & Ring 2017, p.15).
- With respect to the UBS leaks (2008), Bradley Birkenfeld was “charged by federal prosecutors on one count of conspiracy to defraud the U.S., to which he pled guilty and was sentenced to 40 months in prison (...) subsequently awarded a \$104

million whistleblower award.” (Oei & Ring 2017, p.12).

- For the Luxleaks (2012), prosecutions were brought against the whistleblower (Antoine Deltour) and the journalist who broke the story (Edouard Perrin). They were charged with “theft, breach of confidentiality, trade secrets violation, and fraudulent access to automated data processing systems”, and “theft, complicity in theft, whitewashing, and accessing protected databases” (Oei & Ring 2017, p.22). They were fined and received suspended sentences.

Who would dare blow the whistle, regardless of the transgressions, in the face of almost certain prosecution by the state? It is clear that whistleblowers are being aggressively disincentivised. It is in this context that “John Doe” (the source behind the Panama Papers) writes: “Legitimate whistle-blowers who expose unquestionable wrongdoing, whether insiders or outsiders, deserve immunity from government retribution, full stop” (Obermayer & Obermaier 2016, p.347). This argument is hard to dismiss, given the clear risks to whistleblowers’ reputations, job prospects and liberty.

The Indispensability of Democratic Mandate

The above, however, needs to be qualified. In a New Statesman debate (2011), Julian Assange appeared on

the same stage as the British author Douglas Murray. Mr. Murray put a series of questions to Assange that are similarly difficult to dismiss. Among other questions, Murray asked: “Who funds Wikileaks?”; “Who works for you?”; “Who are you involved with?” “Where are you even based?” Importantly, Murray also asked: “What gives you the right to decide what should be known to the public and what should not? Governments are elected, you, Mr. Assange, are not.”

Oei and Ring (2017, p.44) also cite challenges in this respect, stating that “leakers have obvious discretion over whose information to collect, when to collect, what kinds of information to collect, and what date ranges to capture”. Referring to the organisations that ultimately disseminate the leaks, the authors note that they “may have independent and potentially conflicting agendas that may shift over time and that may not be primarily about optimizing tax compliance, enforcement or social welfare” (Oei & Ring 2017, p.46).

The need to provide whistleblowers with protections, whilst acknowledging the absence of a democratic mandate for whistleblowing organisations thus needs to be balanced. Can this goal be achieved? I would suggest that auto-immunity for leaks made through public channels, such as EULeaks, launched in 2016, could help close the gap in this respect. It seems reasonable that if individuals

Les incitations sont essentielles au vu des actions qu'elles déclenchent. À ce jour, les acteurs (gouvernements, entreprises, médias et particuliers) se sont retrouvés dans un environnement où les révélations d'information menaçantes pour le système donnent suite à des sanctions affligeantes et prévisibles. Cependant, un ensemble puissant d'incitations concurrentielles commence à émerger, ce qui peut amener des réactions différentes permettant d'aller de l'avant. Prenons les gouvernements, par exemple, la défense zélée des modèles offshore est parfaitement compréhensible dans un contexte de peur, qu'il s'agisse de pertes d'emplois, de pertes d'impôts ou de la diminution de la croissance économique de chaque État. Cependant, l'isolement politique, le principe de la réciprocité, l'effet dissuasif des prélèvements fiscaux massifs antérieurs et des informations sur d'autres prélèvements fiscaux énormes pourraient s'avérer dissuasif et modifier le calcul à l'avenir.

are incurring enormous personal risks to protect what they believe to be in the public interest, then public institutions should seek to protect them in return. Of course, pitfalls exist. For example, it could well be that the leaker gets quashed if submissions are made on a national level, where the subject of the leak has both power and an interest in suppressing the information. It seems to me that such a system could only function at the supranational level. Even then, consensus around the idea and how this system would work in practice would clearly be difficult to achieve.

However, it is noteworthy that in March 2019 the European Parliament “reached a provisional agreement on the first EU-wide rules on protecting whistle-blowers when they report on breaches of EU law” (EU Parliament 2019). Key aspects of the proposed legislation include ensuring safe reporting channels and safeguards against reprisals. This is certainly a commendable step in the right direction.

Incentives

In *The Power of the Powerless* (1978, p.9), Havel wrote of Soviet era communism that “individuals confirm the system, fulfil the system, make the system, are the system.” Havel’s words still hold a compelling logic with regard to the two major topics addressed in this paper: – the system of offshore jurisdictions and threats to journalists and whistleblowers..

There is no conspiracy. There are just individuals acting in line with the prevailing structure of incentives. Against this background, this section will highlight a series of heuristic approaches for different players which merit consideration.

1. Government

The present situation: Governments that maintain an offshore economic model do so to attract foreign investment and jobs to their local jurisdictions. Any narrative that challenges the merits of such an approach is zealously defended against on the grounds of *tax competition* or *tax sovereignty*, etc.

Heuristic approaches:

(i) Political Isolation: In *Why Nations Fail* (Acemoglu & Robinson 2012, p.74-75), the authors cite the importance of inclusive economic institutions as critical to a nation’s success, with characteristics including “secure private property, an unbiased system of law, and a provision of public services that provides a level playing field in which people can exchange and contract...”. This point is made with respect to individual nations. However, a double standard is present if economic institutions are inclusive in nature at a national level, but extractive by nature when orientated towards external players. The authors continue: “The most common reason why nations fail today is because they have extractive institutions” (Acemoglu & Robinson 2012, pp.368-369). How the

Les fuites ne disparaîtront pas. Dans le monde moderne, tout ce qu'il faut, c'est un enfant de 12 ans doté d'une formidable compétence informatique, ainsi qu'une raison pour être en colère et le résultat final peut être une fuite. C'est dans ce contexte que l'on peut bâtir un argument valable en faveur sens éthique et responsable dans la vue des affaires. La participation au jeu offshore par les intérêts des entreprises est logiquement motivée par la protection des bénéfices et le désir de ne pas subir de désavantage concurrentiel. Cependant, les pertes énormes subies par les entreprises impliquées dans le scandale des Panama Papers (en termes de capitalisation boursière), les coûts en flèche liés à la conformité et une volonté politique manifeste d'imposer de lourdes amendes pourraient remettre en cause la compréhension jusqu'à présent bien établie de l'obligation fiduciaire. Si ces facteurs se conjuguent et dépassent la valeur des activités offshore, les dirigeants de sociétés pourraient être tenus légalement responsables vis-à-vis des actionnaires d'une manière qui n'avait pas été prise en compte auparavant.

inclusive versus extractive nature of institutions works between countries is thus of critical importance.

Palan *et al.* (2010, p.238) note that “tax havens raise important questions about the sovereign rights of smaller countries; they also raise questions about the nature of sovereignty more broadly; especially where the rights of one state impinge, or are perceived to impinge, on the sovereign rights of other states”.

Questions of sovereignty are thus on the table, although perhaps not in the manner originally conceived, if a country is actively contributing to the failure of other nations via the extractive orientation of her institutions, in the context of targeting foreign-based citizens and businesses. Reputational risk, financial risk, willingness of other nations to make new agreements and to honour existing ones (on bilateral and multilateral levels) may all come into play. The risk of political isolation and diminished standing in the international order should not be underestimated.

(ii) A Two-Way Street: It follows that if government *abc* seeks to frame its offshore economic model as a matter of tax sovereignty, then the same logic holds if government *xyz* starts targeting businesses in the jurisdiction of *abc*. The principle is also applicable if everyday citizens who dutifully pay their taxes in a given jurisdiction notice that there are multinational corporations paying nothing to state coffers. By persisting with this demonstrable

unfairness, governments are incentivising their own tax-paying citizens to explore tax avoidance schemes.

(iii) Massive tax takes foregone: In terms of reputation protection and seeking to be perceived as a reliable partner in commitment to offshore, governments run the risk of foregoing enormous tax takes. In the case of Ireland, for example, in September 2018 there was still EUR 14.3 billion sitting in an escrow account, paid in by Apple following an EU ruling that state aid had been provided *vis-à-vis* a favourable tax regime (The Guardian, 2018). The matter is still progressing through an appeals process.

Furthermore, disincentivising whistleblowers in the manner discussed reduces the likelihood of being able to tap into enormous reserves of untaxed wealth.

Competing Incentives in the Private Sphere

2. Corporate Executives

The present situation: Corporate executives are incentivised to pursue offshore tax reduction strategies because their firms might be left at a competitive disadvantage if they do not. In addition, their fiduciary duty may compel them legally to pursue such strategies.

Heuristic approaches:

(i) Share price and reputation effects: Consider that the Panama Papers data leak “erased US\$135 billion in market capitalization

La presse libre est continuellement attaquée et toute personne concernée par la démocratie doit être inquiète. La situation est urgente et il n'y a pas de solution facile. Le nouveau statu quo est peut-être le fait de se méfier des histoires à grand retentissement et d'observer quelle sera l'efficacité des récents efforts législatifs. Certains efforts ont été déployés en matière de reportage coordonné en ce qui concerne les meurtres de journalistes, mais il faut les renforcer. La tendance à la concentration dans l'industrie pourrait en réalité être une bonne chose à cet égard. Si Google s'engage par exemple à afficher les informations sur chaque journaliste assassiné sur sa page d'accueil - ou que Newscorp s'engage à mettre sur sa page de couverture des articles sur ce sujet - un ou deux monstres pourraient être enclins à penser que cela ne vaut pas la peine de s'y risquer, car il en résulterait une perte pour leurs affaires.

among 397 firms with direct exposure to the revelations (...), reflecting 0.7 percent of their market value" (O'Donovan, Wagner & Zeume 2017, p.26). That is \$340 million on average. The leak "wiped a total of 220-230 billion dollars of market capitalizations of firms around the world" (Wagner, 2016). Interestingly, "high reputation firms are significantly more negatively affected when implicated" (O'Donovan et al. 2017, p.5). In the context of continuing leaks, it is thus a significant risk for corporate executives to continue pursuing offshore strategies.

(ii) Compliance costs: Compliance costs can be enormous in a changing regulatory landscape. When the US initiated FATCA, for example, "UK business face(d) one-time implementation costs of £2-3 billion to comply with its provisions, followed by ongoing costs of £100-170 million annually" (Omartian 2016, p.6). It stands to reason that if firms are not engaged in the offshore game, then substantial compliance costs can be eradicated, if not greatly reduced. It is in this context that "regulators need to focus on 'nudging' – encouraging, persuading and empowering – companies to recognise and embrace the commercial and other strategic benefits of more open communication" (Fenwick & Vermeulen 2016, p.7).

(iii) Political willingness to leverage massive fines: The ICIJ reports that the "global tally of

fines and back taxes resulting from the Panama Papers investigation's exposure" now exceeds \$1.2 billion" (ICIJ, 2019). Furthermore, the same publication notes that this figure "almost certainly understates total revenue raised as a result of the Panama Papers given that many countries do not disclose information on tax settlements".

(iv) Inverted Fiduciary Duty: McGee (2016, p.8) notes that "corporate board members have a fiduciary duty to their shareholders to safeguard the assets of the corporation. (...) Thus, the argument could be made that the top management of a corporation has a fiduciary duty to export profits if doing so is in the best interests of the shareholders."

The calculus could be changing with respect to the implications of fiduciary duty, given the impact on the share prices of companies caught up in leaks, compliance costs, and the demonstrated willingness of governments to leverage heavy fines. For instance, there could be a legal basis for shareholders to argue that the executives acted in contravention of their fiduciary duty, if taxes saved via offshore jurisdictions are exceeded by compliance costs, share price hits and fines (in the instance of a disclosure).

Does Violence Need to be Inevitable?

3. Media Organisations

The present situation: It has become truly dangerous for

Les citoyens ont également un rôle à jouer. Tant qu'un système largement démocratique prévaut, les gens ont la possibilité de faire entendre leur voix. Pourquoi la grande majorité des gens ne participe-t-elle pas au système offshore? Une absence d'information? Les coûts de coordination? L'irrationalité économique? Aucune de ces réponses ne l'explique. Il est plutôt vrai que la vaste majorité des gens savent qu'il existe un lien entre les impôts qu'ils paient et la possibilité d'appeler la police ou une ambulance en cas d'urgence, la possibilité de conduire sur de bonnes routes ou d'avoir leurs enfants éduqués. Il y a de la dignité et de la valeur dans cela.

media outlets, journalists and whistleblowers to hold power to account. Hence, a shying away from difficult topics may be emerging.

Heuristic approaches:

(i) Coordinated disincentivising of monsters: Considering the dangers and examples of impunity highlighted earlier, I find it impossible to blame media organisations that are reluctant to take on hard-hitting stories. The solutions might come from “concerted efforts through national coalitions and partnerships or under state-led mechanisms (that) can build a safer climate in which the media can work” (IMS 2017, p.49).

Yet the most effective tool for better outcomes may be the global media platforms themselves. Whenever a journalist is murdered, coordinated news coverage across networks may just serve as a strong disincentive. The reporting would ideally follow the work of the deceased, and provide in-depth analysis of the business holdings and individuals the journalist was investigating. However, this would necessarily require broad participation, because a small number of players sticking their heads above the parapet would be extremely dangerous for them to do so.

4. Private Citizens

The present situation: High levels of apathy exist with respect to the integrity of politics and business, reinforced by repeated scandals and seemingly impenetrable opacity.

Heuristic approaches:

(i) Democracy as a vehicle for accountability: Apathy is understandable in the face of the opacity that characterizes offshore jurisdictions. However, these matters do not simply concern finance and economics, but also speak to the vitality of democracies, considering that “opaque jurisdictions contribute to the creation of an extreme concentration of wealth, which may cause economic instability and long recessions” (Ferreira & Madeira 2010, p10). A good case can be made for individuals to be a little less apathetic. “People who often feel hopeless about prospects for change often forget that democracy is a mighty weapon, and it remains very much alive” (Shaxson 2018, p.273).

Conclusion

This paper set out to make four arguments and the success with which each has been made is for others to decide. I believe there is a clear relationship between the two main topics of offshore jurisdictions and protections for journalists and whistleblowers. Opacity kills by endangering those who seek to reduce it. When tackling it in public policy forums, this should perhaps be borne in mind, as it packs more of an emotional punch than purely numerical and statistics-based arguments. I hope that (a) something akin to a Treaty of Westphalia can be negotiated with respect to tax avoidance and evasion; and (b) the free press, as most people understand it, is upheld, supported

and protected by all available means.

Lastly, the following comments seem particularly pertinent regarding each of the topics addressed. On offshore jurisdictions, the former US Attorney General Loretta E. Lynch remarked that “acquiescence is the very opposite of good government – hoping for right to come from what is profoundly wrong – inserts a cancer into the ethical life of a society” (Trautman 2017, p.840). If such sentiments are reflected in public policy moving forward, then the future can be very bright indeed.

Although protections for journalists and whistleblowers are not a laughing matter, an old Soviet joke neatly captures the absurdity of the situation:

“A big crowd of people is quietly standing in a lake of sewage coming up to their chins. Suddenly a dissident falls in it and starts shouting and waving his hands in disgust: ‘Yuk! I cannot stand this! How can you people accept these horrible conditions?!’ To which the people reply with a quiet indignation: ‘Shut up! You are making waves!’” (Yurchak 2005, p.278).

I hope you agree that if we find ourselves standing around in sewage up to our chins and one of us happens to fall, directing our anger at that particular person will not help change anything in the long run. •

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Changing Frontiers of Ethics in Finance Ethics & Trust in Finance Global Prize Awards 2012-2017

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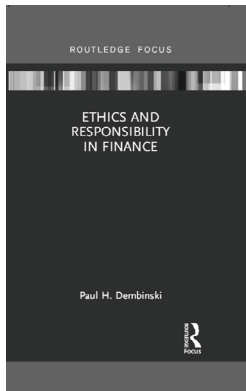
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Ethics and Responsibility in Finance

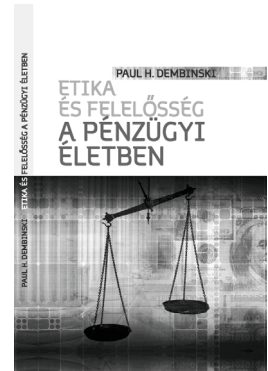
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Observatoire de la Finance

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