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Tackling the Culture of Fear and Greed in the city

Good afternoon ladies and gentlemen, I would like to welcome you all here today and thank you for coming along. I would also like to thank Tomorrow's Company for giving me the opportunity to discuss with you today my thoughts on the today's topic. Tomorrow's company has for many years been helping us to explore what we mean by value, how it is created and measured and critically how value and values are linked. Their premise is that sustainable value creation must recognise the 'triple context' combining economic drivers with social and environmental imperatives. In this lecture, I explore the apparent conflict between social and economic drivers and how this has become distorted within the financial services industry as a consequence of the culture that has developed over the years and how we might go about restoring equilibrium between these two drivers.

Before I begin to outline what I believe is wrong with the financial services industry and what we might do to bring about a paradigm shift of the magnitude required to bring about a real change to the status quo, I would like to acknowledge the millions of hard working, dedicated and diligent employees who work within the industry and have suffered the unfounded blame and retribution over the last few years brought about by those within the industry who have failed them and the customers that they serve. It is for their sakes, as well as all those who are directly and indirectly impacted by the industry, that we must all strive to seek an alternative to the current position we find ourselves in. As someone who has led banks, insurance companies and intermediaries in my time, I share a sense of responsibility for what has gone wrong and a duty to help to put things right.

It was almost a hundred years ago that Albert Einstein identified that the three great forces that drove the universe were 'stupidity, fear and greed'. This was before the Great Depression, the various banking crises, the misselling scandals, and the most recent melt down of the financial services industry.

Interestingly, a new articulation of this hypothesis was postulated 25 years ago by an infamous Hollywood character in the form of 'Gordon Gekko' in the movie 'Wall Street'. He vigorously espoused the virtues of one these forces in his oft quoted speech challenging us to accept that not only is greed a force that drives all financial services but that: 'greed is good!'

From that sadly prescient monologue of the silver screen, the genesis of the 'culture' of the financial services industry was spawned. Whether it be the Banker, Insurer, Trader, Intermediary, Wholesaler or Retailer, the die was cast for a roaring ride of self-serving indulgence that left no margin underexploited and no commission unclaimed. Furthermore, in the last quarter of a century since that rousing speech, one could argue that the financial services industry has vigorously attempted to convince the world that 'fear' is also a positive force and has been used as a major driver for many financial product purchases over the years - often leading to the very worst examples of misselling from endowment mortgages, through to split-capital trusts to the ongoing and painful PPI debacle. Not that we should ignore the fate of the corporate customers which have suffered at the hands of the financial services industry through the cynical sales of highly sophisticated and wholly inappropriate interest hedging products to the devastating consequences of the LIBOR rigging scandal.

Stupidity on the other hand has often been promoted by the financial services industry as a force that impacts exclusively on all those clients or 'muppets' ,as they have been outrageously referenced to by the investment banking community, who transact with the industry.

I can think of few other human endeavours which would be comfortable to have ‘fear and greed ‘as an appropriate strap line, but as is the case in financial services, be positively proud of it.

The sterling efforts of the arms industry over the years has made a valiant attempt to claim the moral low ground, although government oversight and moral outrage has tried to check its rise particularly in the retail market.

The gambling industry comes to mind and is duly regulated and suitably ring fenced to allow it to do as little damage to society as is possible. Organised crime on the other hand, flourishes under the strap line of’ fear and greed’ and yet has never, for some reason, quite managed to achieve parity with the acceptability status that financial services now commands.

If it wasn’t such a devastatingly important subject it would be almost comical to observe how we in the financial services industry have got it so badly wrong over the years.

The recent financial meltdown has reaped havoc across the globe, destroyed people’s lives and created a black hole of debt that will take a generation to escape from. The magnitude of the rescues and bailouts run into trillions of dollars - numbers so vast that it is impossible for the average person to comprehend and yet the ‘Masters of the Universe’ in the financial services industry talk of trillions of dollars as if they were nothing more than numbers on a spreadsheet. The fact that simply to count to the current US deficit would take over 3 million years seems to escape them. The dangers of such divergence from the real world can lead to devastating unforeseen consequences.
The concept of allowing a trader with unlimited corporate capital onto the casino floor with the sole objective of making money for himself with almost no regard to the capital he risks or the impact on the market he is dealing verges on the insane. In reality this happens on a daily basis and the trader is incentivised on the how much he wins not how much he risks, this has lead to some of the greatest corporate losses of all time and anger and derision being piled onto some of the largest financial services companies in the world.

There was a time when the financial services industry was the servant of commerce, facilitating and promoting trade, whilst helping individuals create a secure, better and less volatile future. Today the balding, bespectacled and slightly dull, yet dedicated bank manager has been replaced by a sales brochure and an ATM machine or, worse still, a white socked trader who is more than happy to take money from an unsuspecting client on the proviso that despite all the assurances to the contrary, they will never get anything back. Again, it is important to stress that this is not by any means the domain of simply the banks, the insurers, advisors, intermediaries, both wholesale and retail, are just as culpable. We are all guilty of turning our backs on our role as agent of the client and instead focussing on realising a return for ourselves.

As I look at other industries and professions for reference points, I accept that we can often see other examples through rose tinted spectacles and yet I find it hard to identify any other industries whose plummet to the bottom of the moral abyss has been so comprehensive or complete.

It is often said that the pharmaceutical industry is filled with sharp practices and conflicts of interest and certainly before legislation was enacted in 1993, the idea that a drug sales representative could influence the prescription practices of a GP through a series of direct incentives was highly prevalent and a significant slur on the whole profession. However the code of conduct set out by the ABPI and enforced through the BMC today prevents a doctor from receiving anything in excess of £6 from any pharmaceutical supplier and then only in the form of a consumable to be used on the surgery premises such as a pen and post-it note . This has gone a long way to reassure patients. However, we have to accept that there is something far more fundamental at work here.

The actual regulations that govern medical advice are very limited and indeed they can be summarised in one brief document which is signed by every medical practitioner, namely the ‘Hippocratic oath’.

This document enshrines the relationship between professional and patient and recognises the fundamental asymmetry of knowledge and expertise that differentiates the two parties. The thought of a doctor, even in today's world of amateur physicians and online medical dictionaries, relying on the concept of 'Caveat Emptor' is so anomalous that it verges on the hilarious and yet we as an industry lobby on an almost constant basis to have this Latin term, originally designed to create a level playing field between the purchaser and seller of a property, to be introduced into our own terms and conditions of business. Will we ever realise that Caveat Emptor is as preposterous and ridiculous in this context as it would be if applied to the medical profession? There will always be a knowledge gap between buyer and seller in the context of financial services. Buyers are, therefore, always vulnerable to exploitation and sellers should always be aware of this fact.

The fundamental issue is one of trust. The doctor acts for the patient as their agent, protecting them from false diagnosis or prescriptions through a fiduciary duty of care, combined with real demonstrable experience and expertise and operating within a clear, professional code of conduct. However, it has not always been so, if we go back a few hundred years, the medical 'profession' was plagued, literally, with charlatans and conmen, practising false science and dispensing therapies, drugs and medical procedures that more often than not left the patient in a worse state - if it didn't actually kill them in the process! Then gradually, as science, awareness and arguably the gravity of the situation dawned on practitioners and consumers alike, a new culture evolved. There was also a recognition that despite everyone's best efforts there needed to be rules and regulations around qualifications and practices, increasingly to protect the consumers from themselves as much as from unscrupulous practitioners. Thus, the concept of modern medicine evolved. One great innovation was the advent of prescription drugs, as there are certain things that a patient should never be allowed to do in an unsupervised or unregulated way. Prescription drugs in the wrong hands can cause substantial consumer detriment.

An obvious question, given the asymmetry of knowledge between buyer and supplier in the provision of financial services, is can some financial products do more harm than good if dispensed in an unsupervised or inappropriate way? We know the answer already if we look at the abject misery and suffering that a simple product such as a credit card can inflict. Yet, cards along with many other forms of consumer credit, are still given away like confetti, despite their inherent dangers.
At the other end of the spectrum, a SIPP, which is a highly complex financial instrument requiring a huge amount of technical knowledge to fully understand and which can destroy significant value if applied in the wrong circumstances, is freely available 'off the shelf'. Maybe the British Medical Council should take a look over the FSA's shoulder and give them a few points on the perils of the OTC market.

In my own 25 years working in the financial services industry I have repeatedly heard the phrase 'financial services are sold, not bought', usually with the justification that this is because they are complicated, expensive and often require short term pain for long term gain. What this means is that anyone in the business of supplying or distributing these products needs to be trusted to always do the right thing for the buyer and to act in their best interests. This would preclude, by definition, any forms of sales or distribution incentive that favour the manufacturer or distributor, including sales bonuses, sales incentive payments, variable remuneration linked to sales or any other form of incentive that increases the likelihood that a financial services product or service is sold. The recent FSA Guidance Consultation 12 /11 on the conflict of interest inherent in incentive schemes was met with the usual howls of derision and cries of 'unfair' from the industry, when in reality it simply does not go far enough to truly protect the consumers of the future. The industry, despite the protestations, still contains practices which would be totally unacceptable in any other industry where 'client vulnerability or knowledge asymmetry' is a factor. For example, the practice of a product manufacturer lending money to a financial 'advisor' in order to allow the advisor to buy a book of clients from a retiring or exiting advisor, creates the situation whereby the only way to pay back the debt is to generate ongoing commissions from the client bank through product sales for the

manufacturer. The significant degree of conflict of interest inevitably leads to bias and inappropriate selling and, ultimately, to the further erosion of trust in an already tainted industry.

Too often, we have turned to the regulator to solve our problems and more recently the population at large has blamed the FSA for being asleep at the wheel and not providing sufficient regulation. Whilst the medical industry is regulated largely by one piece of paper, the financial services industry at the height of its so called 'soft touch' regulation period in 2008 was regulated through the offices of the 2500 staff at the FSA under their published rules containing over 1.5 million paragraphs of guidance and direction. The sub-section which describes how firms should interact directly with consumers, the Conduct of Business Rules, if printed, would stand over two metres high!

The problem has always been that it is almost impossible to 'regulate' an industry which is inherently conflicted or where some of the products and services provide little or no social benefit, as was recently identified by the economist, Roger Bootle, and further highlighted by Lord Turner, the Chairman of the FSA .

So what to do about what appears to be an extremely dangerous and highly divisive situation? Firstly, we need to wake up, to remove ourselves from our current state of denial and to recognise the full extent of the problem. Importantly, that we did not cause the problem, but that we are the problem, the very culture that we have created is not compatible with delivering real social value. Then, rather painfully for some, we need to broaden our net to capture those who do not realise that they are also part of the problem - the lawyers and accountants who happily refer their own clients to the industry in exchange for substantial commissions and referral fees, effectively washing their hands of any responsibility for suitability and ignoring the moral hazard of giving a professional recommendation to a vulnerable client by directing them to a firm with a very different modus operandi and value set to their own. Even the self appointed arbiters of our social conscience, the press, are more than happy to rail at the excesses of the industry and their sales techniques, whilst pocketing huge commissions and referral fees from their unsuspecting and often unaware audiences as they click through or follow-up on the introductions to third party financial services firms that many media organisations have aligned themselves to.

Having identified and highlighted the offenders, we need to point out to all of the citizens who make up the customer base of the industry, informed or ignorant, ruling classes or the population at large, that the emperor, who they believe can provide them with untold riches for almost no risk as well as instantaneous and free financial transactions, is bereft of any form of outer or inner garments and therefore in danger of hideously exposing them to crushing disappointment and failure. Put simply, both sides need to get real.

Modern society cannot survive without a fully functioning financial services industry, whether it provides cash at an ATM or facilitates the building of the Olympic stadium. The industry currently employs over 2 million people or 10 percent of the national workforce and pays in excess of £63 billion of taxes; its net export earnings, at £47 billon, are greater than all other industry sectors combined. It allows regular financial payments to made directly or indirectly to the whole of society, facilitates the building of hospitals and manages the pensions of the retired. The people who sat at the steps of St Pauls calling for anarchy and the overthrow of all financial services were the same fraternity who were baying for Stephen Hester's blood after an IT glitch prevented millions of benefit payments from being made. We all need a safer, less volatile, more secure financial future and this can only be delivered by a financial services industry acting on behalf of its customers not itself.
As an aside, I heard a fascinating insight into how inward looking we are as an industry a few weeks ago when a famous industry commentator was asked to justify the fact that the financial services industry took a massively disproportionate slice of the UK bonus pool in 2011. The response was simply that because financial services is subject to the vagaries of markets that bonuses made up a larger proportion of total remuneration in order to ensure that fixed costs were kept low. The fact that on a per capita basis and on an absolute basis, the 'low' fixed compensation element was still

significantly higher than the equivalent salary across all other industries escaped the 'hapless' expert. We pay ourselves too much for the value we deliver, full stop.

So what are the alternatives? The legal profession has used the 'lock-step' approach to the remuneration of their partners for many years, whereby salary increases in direct proportion to the number of years someone has been with the firm, although this practise is sadly starting to fade due to so-called pressure for talent. Very few firms have gone down the obvious route of paying the vast majority of all compensation through salaries with a bonus being just that, an exceptional addition to the normal take home pay that is neither expected nor planned for. This approach leads to better alignment with consumers and a move to a more professional culture. The recent Kay report advocated a closer involvement between shareholder and company. There is no better way to achieve such alignment than through the systematic use of employee share ownership, providing this is tempered with a clear articulation of the potential conflict of interest with the company's customers that could arise as a consequence. Perhaps the most obvious method of assuring alignment with customers is to ensure that the client pays directly for the service purchased. Whilst on the face of it this does not sound like a revolutionary idea, it is extraordinary how the financial services industry has conspired to confuse and obfuscate the consumer, through fee-bundling, intermediation and cross-subsidies and to ensure that no one really knows who is working for whom and why.
The much maligned FSA, soon to transform into PRA and the FCA, has tried valiantly over the years to address some of the more obvious imbalances. The RDR initiative, which is about to be fully implemented at the end of this year, looks to curb the excesses of the financial advice market. The results should lead to markedly better consumer outcomes and clear alignment between adviser and client through the application of a new regime of fees and professional qualifications. Sadly even this initiative has been dogged with industry objections and foot-dragging from manufacturers and intermediaries alike, with some even today looking to find ways around the new rules in order to maintain an outdated and deeply flawed status quo.

This reluctance to accept the patently obvious need for change is symptomatic of an industry that appears reluctant to embrace its own failings. Rather than desperately seeking to enforce a regime of Caveat Emptor in the business terms and conditions, maybe the industry would be better served if it were to adopt the moto of Mea Culpa.

What we need to do is to create an environment where putting the term financial services on an occupation form does not create a shiver of discomfort and anger to both reader and writer. In order to achieve this we need to create an entirely new culture. A culture where greed is not good, but where 'trust and integrity' is the new mantra and then perhaps 'stupidity' can then be replaced with 'humility' as the true forces driving the financial services industry.

Out of a discredited and outmoded industry governed by endless regulations and riven with conflicts of interest, we could create a new profession remunerated fairly and transparently in a fully aligned way, bound through our own 'Hippocratic oath',an oath of allegiance to the needs of the customer to do the right thing under all circumstances. The building blocks required are relatively simple: a compulsory professional code of ethics, the removal of inappropriate remuneration and incentive models and the desire to create a new culture with a foundation of honesty and integrity.

We have a momentous task ahead of us. The world's balance sheet is precarious with concentrated, geographic imbalances of assets and liabilities forcing increasingly volatile and potentially anarchic behaviour. We need to be honest, the skills, knowledge and experience of the financial services industry could help the world move back from the abyss or if it proceeds unreformed, tip it over the edge. Without a fundamental realisation that the culture must radically change through the abolition of 'fear and greed' and the replacement of these destructive forces with 'trust and integrity', we may find that we do tip over the edge. Given how much we know today, we should all know better. If we fall, we will look pretty stupid in the eyes of the generations to come, whilst at the same time proving the accuracy of Einstein's hypothesis all those years ago.