

# Moral Dilemmas in Financial Services: The Challenge for the City

■ by James Featherby



**In this lecture at the *Faith in Business* April Conference, James states that the morality of the City is only a reflection of the morality of the UK, and both have to undergo culture change. The pre-conditions are changing the purposes and the structures. Then the change in morality can be achieved by using the technique of the abolitionists of slavery, showing that good ethics produce good profits.**

I've worked in the City for over 30 years, mostly as a lawyer. So my observations on the financial services sector come from a practical, rather than a professional ethical or economic, perspective. I am a great fan of practical experience, but I'm also conscious that most of us, and that certainly includes me, tend to create a theology that fits our circumstances. So please bring your own wisdom and discernment to bear on what I have to say.

I begin with a social impact investment opportunity I visited in Kenya in November last year. The idea of the social impact investment industry is to combine social alongside financial returns. It took me a seven-hour journey across the Rift Valley to the west of Nairobi to get there. Right out in the bush, just on the edge of Lake Victoria, there's a community of 40,000 people, nearly all of whom get their living from artisanal gold mining. Basically, that means picks and shovels, mineshafts 100 metres deep, and no safety equipment. The gold is separated using mercury and other lethal chemicals by hand. It's then sold to local traders at way below market price, and almost none of the proceeds are invested back into building any social infrastructure - such as schools, medical care, sanitation, or decent housing.

The aspiration of most of the miners is to strike it lucky and buy a motorbike. Just before I got there, one miner had done just that, got drunk and killed himself on his bike. I visited one site where a gold rush is happening because they've found a rich seam. It was like a scene from a wild-west movie. Nearly every miner I met told me the same story. If only they had the finance to buy better equipment, they could extract and process more rock, and sell more gold. Then they could solve both their economic and their social problems.

But as I reflected on what I was seeing, I began to realise that their problem was not one of finance; it was one of philosophy. Their problem was their worldview: their definition of what was 'helpful' for them, individually and socially; their definition of what was 'harmful' for them, individually and socially; and their understanding of how one might achieve the former, and avoid the latter.

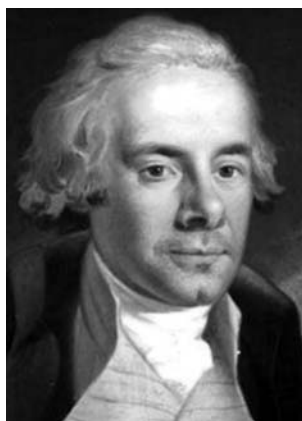
Of course I could, with others, provide some capital to improve their productivity. But any increase in their finances would probably be short-lived. It would probably make some people a lot richer, but turn others effectively into slave labour. And it would probably do as much harm socially as it would do good. ▶▶

▶▶ This story reminds me in so many ways of the City of London.

**Spiritual error**

The City’s real problem is not one of moral dilemma, it’s one of spiritual error. I’m often struck by the force of David’s cry in Psalm 51: ‘Against you, you only, have I sinned.’ The fear of the Lord is not only the beginning of all wisdom. It’s also the lynch-pin for knowing vertically, what right personal behaviour before God looks like - and for knowing horizontally, what real love and justice between individuals in society looks like. When God is jettisoned, it is inevitable that both righteousness and justice will fade, and lose their meaning. If, as a society, we rub out God we also erase His inspiration to serve others, and His value system for restraining excess.

In this respect the City is no different to the rest of the UK. It may be just that in the City it’s easier to quantify - in pounds, shillings and pence - what our spiritual error has cost us. And the City’s also similar to the rest of the UK when it comes to morality, not just spirituality. To reform the morality of the City, the morality of the UK must also be reformed. Recognising this helps to frame the challenge of reforming the City.



William Wilberforce

I’m reminded of the task that William Wilberforce set himself: not just the abolition of the slave trade, but the ‘reform of manners’. He set out to make ‘good’

fashionable. We face no lesser task now. Let me mention three ways in which the City’s jaundiced view of morality reflects the UK’s view of morality:

1. Morality principally means judgmentalism and hypocrisy.
2. Morality and profit are mutually inconsistent.
3. Morality makes absolute demands that can’t be reconciled with the real world.

So for these three reasons it’s best not to bother with it, and indeed the assumption has arisen in many areas of life, including the City, or at least until recently, that they are in fact moral-free zones - zones where morality has no relevance in the modern world. On a deeper level, as in the rest of the UK, there are three other post-modern things going on in the City:

- An unwillingness to accept any constraints on personal freedom.
- A great reluctance to impose values on other people.
- And an assumption that it’s acceptable to live by one set of values at home, and a different set of values at work.

But there are three other similarities between the City and the UK that have a particular outworking and relevance in the City

First, as the Bible confirms, without vision the people perish. And crucially, as Alasdair



Alasdair MacIntyre

MacIntyre argues so powerfully in *After Virtue*, morality loses its *raison d’etre* without a defined destination – or vision - of who or what we’re wanting to become, because without a defined destination the sacrifices sometimes called for by morality simply make no sense.



Why do we find it so difficult to aspire to a shared common future? There are many reasons for this, including of course the loss of Christian hope. But there are other factors at work. A feeling of helplessness in the face of globalisation; a diet of fear sold by a 24-hour media; a loss of trust as others have indeed become less worthy of trust; scientific determinism, known to the rest of us as fatalism.

But perhaps most significantly of all, the mistaken belief that it's not possible for individual dreams and communal objectives to work together: the mistaken view that a good society must necessarily involve uniformity and conformity. The whole premise upon which libertarian government is founded is one of neutrality between different versions of human flourishing, and this has found its echo in business. What this means in practice is an unwillingness to discern the difference between good and bad outcomes, and to provide rewards and discouragements accordingly. This transgresses one of the key roles that the Bible ascribes to government, or in the modern era one might say to corporations.

Very few businesses, at least in the City, define the kind of future society they would like to see, or the kind of contribution that they can make towards seeing that future come about. And without that vision, as I say, morality makes little sense. It's interesting that the independent review about the cultural problems at Barclays identifies the lack of a shared common purpose within the bank as one of the main reasons for its serious cultural failures.

The second similarity that I'd like to mention between the City and the rest of the UK relates to the worship of economic growth. It's not just that worshipping the wrong god is a spiritual and moral mistake. It's also an intellectual mistake. The problem with idols is that they fool you into believing that the world works in a particular way that revolves

around them. So money has fooled many into thinking that increasing wealth is the only and best answer to our personal anxieties and our social problems: providing status to resolve our need for personal recognition, and paying taxes to fund others to solve our social ailments.



Indeed, anyone who doesn't maximise his capacity for making money is not only a fool but is also in some way letting the side down. We see this latter argument popping up regularly in relation to people who stay at home to look after their children.

And thirdly, *hubris*. It's the mistake of many generations to believe they've reached the height of sophistication - the end of history. This was the mistake the political, academic, regulatory and financial community made in



'Pride goes before destruction, and arrogance before a fall.'



▶▶ spades in the years running up to the banking crisis. The promotion of low inflation and economic growth, rising shareholder values, global-sized salaries, outsourced production, and fool-proof risk management. The hubris was institutional, and personal. Challenging conventional wisdom was career limiting, not least because it was just so non-entrepreneurial.

Many have remarked on greed. I'd put my finger more on arrogance. There was a confluence of people and circumstances who convinced those in leadership that they were right. They became increasingly resistant to challenge. Their conscience became dulled. Their empathy level faded. Their judgment, including their business judgment, became impaired.

### Love for the City

However, let me emphasise that I do love the City of London. My intention is not to pull it down, but rather to build it up. Business and finance won't, on their own, solve all of the world's problems. But we will struggle to solve the world's problems without the help of business, and without the help of the finance that supports it. I believe passionately in the power of private enterprise to create wealth, enable individuals and communities to flourish, and cement peace. To quote the last Pope, 'The creation of wealth is an inescapable moral duty'.



City of London

I make these two points, an affection for those who work in the City, and a belief in the contribution of business to society, because starting-points are important. If our starting-point is distrust and dislike, our attitude becomes judgmental rather than discerning, and our audience becomes alienated rather than engaged.



**A sacked banker taking out his anger**  
*Eric Dale from the film 'Margin Call'*

I love the people who work in the City, and I'm passionate about seeing it play its full and best role in the life of this country and further afield. The mess that the City has got itself into, and the stunted lives of those who've devoted themselves to its many false promises, I find deeply distressing. This is illustrated by individual stories.

I know countless investment bankers living on the edge of personal disaster: grossly overworked and permanently exhausted. They have no job security as they wait for the next economic downturn, or the next edict from Frankfurt or New York. They are subject to manipulation by their boss because their remuneration is so discretionary.

Bankers may not get much sympathy these days, but the lives of three of my past close neighbours have been ruined by the financial services industry. One who had worked his whole life for Lloyds Bank and was so ashamed by what happened to the bank after it bought HBOS, that he had some kind of breakdown and left his wife and children. One who is in prison for a series of mortgage frauds, and has lost his family and his home. And the professional career, and mental health, of another – an accountant – which was ruined by an accounting scandal not of his making. ▶▶



▶▶ I can't argue strongly enough that the City is not a place full of bad people doing evil things, or at least not more than anywhere else. To write it off as if it is, is itself a moral and intellectual mistake. It's mostly a place where good people do their best with what they know or believe to be true. A place where poor choices are made often because that information is incorrect, but the beliefs have shaped the system. And we shouldn't underestimate the power of the system to lead people into making poor choices.

### Culture change

But to be a fan of business doesn't mean one has to be an unconditional supporter of how things are.

The City is currently awash with initiatives to reform cultures and behaviours. But perhaps not surprisingly, a generation that's forgotten the language of morality is now struggling to resuscitate the corpse. Some of these culture change initiatives I think will succeed. Some of them I fear will not. Some cultural change programmes are focussing on financial incentives for good behaviour, whilst



*Financial incentives for good behaviour*

others are looking to professional standards or simply enhanced personal integrity. Worthy though these efforts may be, my fear is that they are likely to fail if they only go that deep.

Our increasing lack of trustworthiness has not surprisingly led to an obsession with accountability. And so some culture change

programmes are focussing on increasing controls, more reporting to compliance departments, and other business equivalents to the tagging of ex-offenders out on parole.



*Increasing controls (ankle tags)*

These I think are the cultural change programmes most likely to fail.

In my view, the culture change programmes in the City that will succeed will be those that tackle three pre-conditions: first purpose, second structure, and third worldview. In this article I shall concentrate on purpose and structure, but world-view is also important.<sup>1</sup> We can of course define all of the issues that lie behind these pre-conditions as moral dilemmas, but I find it more helpful to define them as intellectual mistakes. Partly because I think that helps us reframe more constructively, for the audience that really needs to deal with them, how best to respond to them. I have often reflected on a slogan that Jim Wallis was using a few years ago in relation to the US economy. 'Every budget is a moral decision'. That is certainly true, but it's also true that when you're holding a hammer every problem looks like a nail. Morality is not always the most helpful tool for analysing problems.

### Purpose

So the first pre-condition to change. It's becoming increasingly clear that the question of purpose is absolutely vital. This is true both at a macro level, and at an individual business level. ▶▶

<sup>1</sup> For a fuller outline of my thinking see my *Of Markets and Men*. This was reviewed by Ranjeet Gupta in FIBQ 15:4.

▶▶ The City has little purpose other than to connect savers and borrowers. Its fundamental purpose is to channel capital down from savers to high-performing companies, and then to ensure that the profits



**Purpose: Connecting savers to borrowers**  
*Grameen bank in Bangladesh*

of those borrowers are translated back up into returns for savers. When this fundamental purpose is served well, society benefits.

To perform that service well, two other things are necessary. First, the costs of intermediation between savers and borrowers must be minimised, and second the players must be able to assess the real value of assets. Of course an element of market making and liquidity are necessary to support the market. But it is clear that the market is now being used for many reasons that have very little indeed to do with this fundamental and beneficial public purpose. It is the responsibility of every financial services industry business to ask itself whether its operations are damaging the fundamental purpose of markets. Many may fail this test.

The question of purpose is also fundamental at a more granular level. The paradox of business is that profit comes after service. Look after your customers first, and then profit will follow. But it's surprising how far this principle has been forgotten in the City. Many have business plans that look mostly inwards, seeing customers as little more than revenue streams. We need instead business models that look outwards, constructed with

customer service as the central pillar around which all else is built. Identifying and then meeting the needs of the community is the only long-term sustainable business plan.

I believe that it's only by rediscovering public purpose, and then using that forensically to determine its products and services, that the City can find the direction, momentum and passion it now needs to find a new way forward.

Abandoning market sectors because they may be bad for one's reputation is only half a start. The real test is whether the business will focus on the needs of others.

Ethics on their own, without purpose, are lifeless; in fact ethics are stifling without purpose. Only purpose provides the necessary energy and courage to sustain good ethics. The cart must follow the horse. Unilever has become one of the most admired companies in the world. Its purpose is not to create shareholder value but to solve the health and nutritional problems of the world. Its public purpose is clear, and hasn't had to be imposed by regulation. Voluntary adoption is much more powerful than imposed regulation.

This is why banks are now struggling. They are finding it difficult to express their purpose ▶▶



**Customer service leads to profit**

*Customer satisfaction is set to replace cost reduction as the prime self-service driver according to a survey conducted by the MyCustomer community website*

▶▶ other than by reference to financial metrics that serve only themselves and their shareholders. They must find and



### **Public Purpose**

*Seattle City Council passes a Responsible Banking Ordinance in response to this Occupy demonstration. The Resolution calls on the city to examine its banking and investment practices, home-foreclosure patterns, and the financing of local elections*

communicate a more inspirational public purpose, and then apply that rigorously to shape their products and services.

Indeed they must realise that no business can succeed in a society that is failing. And if they play a key role in that society, which banks certainly do, then helping to shape the economic health of that society – which may involve looking beyond the immediate ambitions of their customers – is not only their responsibility but is also in their best interests.

So the focus needs to move away from selling products that produce revenues for the bank. In the retail sector, banks need to focus on helping customers save and budget as well as borrow. In the commercial sector, banks need to take seriously and imaginatively their responsibility to help society by supporting SMEs. In all circumstances, banks need to make more strenuous efforts not to sell unmanageable debt, and to help those who find they cannot manage their debts.

Anti-monopoly legislation and consumer protection laws may set the outer limits of how businesses can treat customers. But they provide no inspiration for genuinely serving

the best interests of customers, or of the society on which they depend. Only a clear sense of public responsibility or purpose can do that. It's no coincidence that it's those parts of the City that have the least public purpose that are those where the most serious cultural problems have arisen.

### **Structure**

**T**he second pre-condition for successful cultural reform is structure. Sometimes the structure of a market, or of an industry, can make it nigh on impossible to have a positive purpose, or a positive culture. That is where I believe the City and Wall Street now stand in many respects.

The problems arises from public subsidies for banks that are too big to fail, multiple layers of agent/principal conflicts, and a variety of power imbalances based on a lack of competition or an inequality of information or bargaining power. In many cases these are simply overpowering attempts to improve cultures and behaviours. The obstacles to good behaviour are too many, and the temptations to poor behaviour are too frequent. A start has been made in some areas of banking. In investment banking and asset management we have only just begun to lock horns.

The task is not always to change the structure. Given where we are, sometimes that's just not feasible as a practical matter. Sometimes the task is instead to identify the structural problem, acknowledge the difficulties to which it gives rise, and then work to lessen the negative implications, even if that means a short-term cost to the business.

But there are two even more pressing areas in need of structural reform.

The first is excessive debt. Some debt is of course helpful, but I'm talking about excessive debt. This is in part because of the effects of ▶▶



- ▶▶ excessive debt on society. Excessive debt centralises power, increases inequality, encourages over-consumption, favours asset price growth over productivity improvement, boosts inflation, creates unstable economies, and traps the poor.



**Excessive debt**

I find it surprising that excessive debt has not been more widely discussed as a driving force behind the growing financial inequality of recent decades. The logic is simple. The more assets you have, the more you can borrow, and therefore the more you can multiply— not just add to - your wealth as asset prices inflate. If I have £200,000 I can buy a house for £200,000. If house prices go up by 20% then my wealth has increased 20%. But I could borrow £800,000 and buy a house for £1,000,000.

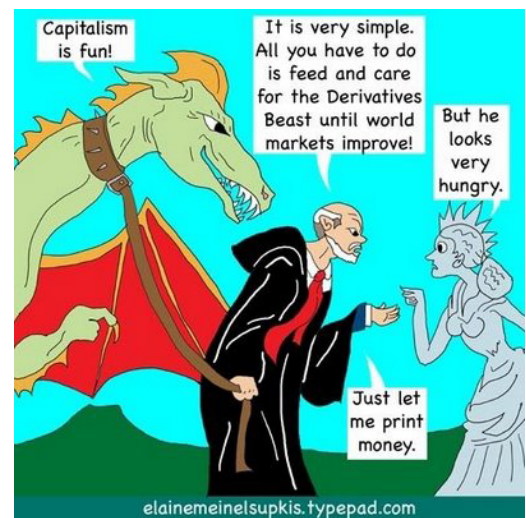
If prices go up by the same 20%, then, even after repaying my debts, my wealth has increased by 100%. And these numbers can get very big indeed when you're talking hundreds of millions invested, with many more hundreds of millions of pounds of borrowings.

If you have no assets, you can't borrow in this same way. Your wealth remains static at best, particularly in the face of low wage competition from Asia. And, as we're now seeing right across Europe, excessive debt also undermines democracy.

Governments and banks are the engines that manufacture debt. We need to put brakes on the system and slow them down. And we need to make banks safer. This is a different

issue to the quantum of debt. It may be right that the Government had no choice but to bail out the banks. Back then, the mechanisms didn't exist to follow the sort of plan recently implemented in Cyprus, where depositors have been made to contribute towards their losses, thereby reducing the extent to which taxpayers have had to pick up the bill. But in the UK banks still remain too big to fail, they continue to hold too little capital to ensure their survival in very difficult circumstances, and they continue to rely on tax-payer guarantees. These are serious moral as well as intellectual mistakes. They strike against a fundamental pillar of capitalism.

The other pressing area in need of structural reform is speculative trading, and what I call claims-based trades - basically hedging and derivatives. Their volume and velocity - often super-charged by borrowing, naked short-



selling and margin trading - are economically harmful because they're damaging the efficient operation of the fundamental purpose of markets. Many, if not most of them, are zero-sum deals, with money simply moved from one set of investors to another - net of commission of course - but with little or no value added to the real economy.

But these deals are also damaging for other reasons. It's not just the rents extracted from savers and borrowers who, taken as a whole, see no benefit. There is the instability that



▶▶ these deals add to the system, and the distorting effect that they have on fundamental values.

Truth matters as much in investment as it does in science and religion. When market prices diverge from fundamental values, the process of efficient capital allocation is damaged, which means it's harder for investors to spot and invest in higher-performing - as opposed to lower-performing - executive management teams. So the economy suffers. Savers and borrowers are ceasing to believe in the integrity of the prices in the market. As one senior trader put it to me recently 'We no longer invest in fundamental values, we invest in politics'. I believe we need to draw some lines between hedging that covers genuine business risk in the real economy, and hedging that is frankly just betting. Support the former; lean against the latter.

I'd make two other points about speculation and derivatives that are unconnected to the needs of the real economy. First, gambling with investments is dangerous not just because it leads to addictive behaviour. It's also dangerous because there's no underlying sense of ownership of any real asset or



*The financial sector remains addicted to gambling*

business. Where's there's no sense of ownership there's no sense of responsibility. Estimates vary as to the nominal value of derivatives. Some say 600 trillion dollars, 40 times the size of the US national debt, which is itself no small figure. That's a lot of money to deploy with little sense of responsibility for what it's doing to the real economy.

Secondly, these sums of money are huge. But of course they're not represented by anything physical that actually exists. It's just an exercise in metaphysics – three-dimensional chess. I can't quite put my finger on why, but this dealing in non-physical reality troubles me. I'm not arguing for a return to the gold standard, but I'm troubled that the traders will become unhinged from reality.

In terms of structure, I also worry about size. It's not just that the gargantuan size of banks poses systemic risk in terms of financial contagion, a lack of competition, a lack of diversity of business models, and a tendency to manipulate the political process.



*Big banks - Dinosaurs or too big to fail?*

It's also that it is very difficult to manage a big organisation in a way that values the human spirit of employees, and so release their energy and creativity into positive outcomes for the benefit of all stakeholders.

It is said that positive cultures can only grow in trusting and inspiring environments.

If that's right, then it will always be difficult to grow a positive culture within a large bank, given that banks are highly controlling and instrumental in their relationships with staff. This is partly because of regulatory pressure, but it's also because of the very nature of banking where bankers have a tendency to think in terms of zero-sum games (even though in many cases that's not what's going on), with the customer's gain representing the banker's loss – and hence the need for tight control. In addition, it's because you don't get trust or long-term thinking from staff if you don't show them loyalty, and you don't get loyalty or long-term thinking from investment banking staff who fear they may be sacked at the first sign of an economic downturn. ▶▶

### Integrity

I'm conscious that I've hardly spoken about personal integrity, character and leadership. But I know you know about these things already, so I've not covered them this evening. What I would say though is that leadership only qualifies for the title 'good leadership' if it knows the right destination and it knows how to get there. And of course integrity and character matter enormously, and I'm very mindful of the corrosive effect that outsized pay has on both. But what has become clear to me over the last few years is that on their own integrity and character are not enough.

Personal integrity is little more than polite manners when it's in a business with no public purpose, when it's in a structure that over the decades has come to work against the common good, and when it does that so convincingly well that even you are persuaded that black is white. It's not just that private integrity that fails to influence public morality is a pretty limp thing.

When a crowd's financially and intellectually convinced that it's best to rush south, walking north simply gets you crushed. To turn the crowd around you have to join with others and persuade them, intellectually – and maybe, yes, morally and financially too - that the pot of gold at the end of the rainbow lies in another direction.

### Conclusion

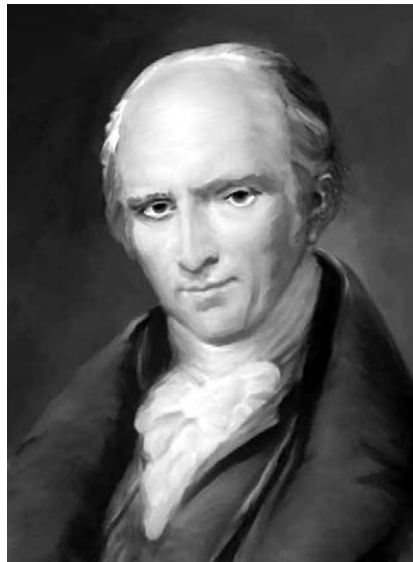
I mentioned William Wilberforce earlier. It's interesting how he set about winning the argument for the abolition of slavery. Certainly he spoke strongly about the moral outrage that slavery represented - and this was to an audience that at least knew it was

supposed to be Christian. We have no such luxury now. But Wilberforce also set out to win the argument rationally. Many feared that the British economy would collapse without the slave trade, and this at a time when Britain was in a state of almost constant war with France. Many fear the same now, that a reform of the City will lead to the UK damaging its most precious economic asset at a time of intense global economic competition. Wilberforce proved that the opposite was in fact true, and indeed the slave trade was finally banned on the back of an economic - not a moral - argument that its abolition would help win the war with France.

Our task is the same. We should not lose sight of the spiritual and moral arguments for reform. But we must also demonstrate, by rational argument, why it is that a reformed City, one built on serving the needs of the real economy, trustworthiness and fair dealing, will increase the attractiveness of the City as the leading global centre of finance.

Let's not think that as Christians we have little to contribute, nor that maybe as folk who don't work in the City, there is little we can do. As I've tried to emphasise, the culture of the UK and the culture of

the City will change together. At home, as we teach our children self-control and respect for others we are changing culture. At school, as we teach our pupils to see consequences and implications, and to find solutions that benefit many, we are changing cultures. At university, as we teach our students to define and aspire to the common good, we are changing culture. And in business, if we can recruit and promote based on character as well as competence, and if we can define and pursue our contribution to society, we are changing culture. ■



*Abolitionist economist James Stephen argued that the West Indies economy would collapse due to social instability unless slavery were abolished.*

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