Ethics in finance: the post crisis challenge

Dublin meeting | Fondazione Centessimus Annus

October 24th, 2014 | José Manuel González-Páramo; BBVA Board
“We are what we repeatedly do. Excellence, therefore, is not an act, but a habit”. Aristotle
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The financial industry has lost its reputation

Transforming assertions to action is a must: ethical principles and share values cannot be “only words”
Ethics goes beyond regulation

The board and the management

**Are the first responsible for Ethics:** they have to fully assume their responsibilities and promote values and ethics from the top, leading by example.

Regulation and supervision

**Are only complements:** Regulators and supervisors are there to safeguard that the Board and the management follow the right path.

A more ethical banking with the highest standards would have avoided many of the excesses committed before the last crisis
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Be ethical even when nobody watches you

Typical self justification to break moral: Plenty of excuses. Everybody does it (herd behaviour), we have always done it, if I don’t do it, someone else will do it...

Before acting we have to consider:

- “What would my internal Jiminy Cricket or my mother would say to me? (or whoever I respect)” C. Lagarde; IMF Oct’14

- “Would you behave the same if your actions were public?” “we suppose ourselves the spectators of our own behavior”. The “impartial spectator” (Adam Smith). I. Angeloni; ECB Sept14
Business must be responsible and lead by example

Ethical principles and values

Corporate governance

- Transparency
- Integrity
- Prudence
- Proper Organization + Professional Competence + Leadership

Training on a regular basis

Ensuring proper conduct by participants in innumerable situations not covered by law

Entities have to commit publicly to Ethics and values. Those should be binding from the top.

Responsible Banking is a transversal function that should involve the whole strategy & all people in the organization

Corporate Governance should reach the right balance stakeholders & shareholders’ utility. It is not an easy task.

Sound ethical values is essential especially for an industry (finance and banking) which business relies on trust. Trust is hard to achieve but easy to lose
A new paradigm for entities: Main drivers

1. Transparency
   - Open, timely and clear communication and information to public

2. Integrity
   - Avoid the tick in the box philosophy. Managers have to do the right thing in any circumstance & avoid using loopholes to circumvent the law. Managers must have values not just be concerned about regulation.

3. Prudence
   - Responsible Banking-needs an adequate risk culture and management: the enhancement of the risk-appetite framework (governance of risk decision making) will make a difference

4. Corporate Governance
   - It has to go further than internal controls and compliance, its ultimate goal must be ensuring an optimum conduct. It is one of the four pillars of the SREP*.
   - Ensuring high skills of the board and the senior management. Avoiding conflicts of interests.
   - Independence of the Board: An ample majority of Independent Board members supported by a minority of executives with deep knowledge of the group.
   - Compensation scheme: Aligning incentives to avoid excessive risk-taking

* Supervisory Review and Evaluation Process
Corporate governance and SREP

Supervisory Review and Evaluation Process (SREP):
Scope

Capital
Liquidity
Business Model

Corporate Governance:
should encompass the following areas

1) Overall internal governance framework
2) Corporate and risk culture
3) Organisation & functioning of the management body
4) Remuneration policies and practices
5) Risk management framework
6) Internal control framework
7) Information systems and business continuity
8) Recovery planning arrangements

Competent authorities will evaluate the risk of prudential impact posed by poor governance and control arrangements and their effect on the viability of the institution.
A new paradigm for entities: Effects on the industry

- **Diversity**
  - Promoting a wider range of firms and business models

- **People**
  - A customer-centric culture
  - Responsible creation of value
  - Competition on clients' satisfaction, as clients are "entities' ambassadors"

- **Society**
  - Financial industry function is to help companies & people to implement their projects.
  - Banks are fundamental to social welfare & development

Other global banking impacts on society: Wealth generation (through payment of taxes and job creation) and social progress (via financial inclusion & financial literacy commitment and investment in social programs)
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Putting the skin in the game

1. Ethical principles and share values cannot be “only words”

2. Mutual trust, transparency, clear communication of our commitments and cooperation are key variables

3. Banks must be responsible and lead by example as they play a key role to society

4. More principles and more ethics are required as they guarantee a proper conduct in situations not covered by law or not regulated

5. An ethical banking model does not reduce profitability as it is an investment in clients’ confidence

6. “Being profitable does not mean doing business at any price”: Profitability adjusted to principles should become a key variable
Thank you for your attention!
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