

## PRESENTATION TO IBE – 24 February 2005

Good to see a number of familiar faces as well as many new ones.

Judging by the growth in its membership, IBE is in a very healthy state. This reflects its reputation as a safe forum where companies can share experience, discuss problems and, hopefully, identify solutions relevant to their common pursuit of high standards of business conduct.

The importance of ethical standards has been highlighted by notorious corporate scandals. Failures that have had ethical issues at their core. Issues such as conflicts of interest, personal greed and unprincipled leadership. In many of these cases we've seen business leaders putting their own interests ahead of those of their companies and their shareholders.

We've also seen legislators and regulators around the world responding to these failures, and I want to say a few words about my own experience of the FSA's approach to such matters. But of course I'm now speaking in a personal capacity as an ex-employee. I would then like to pick out a few points from the survey that is

being launched today, and which Simon was kind enough to send me an advance copy.

The FSA is often criticised by the markets for putting form before substance; for imposing what are said to be bureaucratic requirements that amount to box-ticking, but which don't address real consumer risks. From the inside, I found that the FSA's risk-based approach, both to regulation and the supervision of firms, placed considerable weight on an assessment of the individual firm's culture – particularly with larger firms. Admittedly, the FSA tends to focus on a culture of compliance, and I think the Securities Institute is right when it says compliance is not enough, you need to get the ethical culture right.

Howard Davies wrote: “ A firm's culture, policies and procedures have a very clear influence on whether the firm and its employees behave with integrity”. I would add that the example set by the behaviour of the leadership of the firm is equally influential. Leaders should serve as role models for the rest of the workforce. I look forward to reading IBE's next publication from Philippa on the subject.

Legislators and regulators increasingly look to business leaders to take responsibility for ensuring that their firms act within the spirit of the rules as well as complying with the letter, and will punish those who don't. FSA places great importance on its Principles for Authorised Firms. One of the newer FSA Directors said recently that these Principles are "the backbone of the FSA's regulations". Interestingly, that Director was recruited from Citigroup, a bank that has been in some difficulty with regulators across the world. The CEO, Chuck Prince, has identified the need to embed an ethical culture, not just a compliance culture, within his firm to restore the trust and confidence of their shareholders. What a shame, as so often the case, that it's taken a crisis for the firm to recognise this essential requirement for any business.

Returning to the FSA Principles for Authorised Firms, allow me to read to you 3 of the 11 Principles:

- A firm must conduct its business with integrity
- A firm must observe proper standards of market conduct
- A firm must pay due regard to the interests of its customers and treat them fairly.

So you can see the Principles are grounded in standards of ethical business conduct.

These Principles are enforceable in the same way as other FSA Rules. Some firms do not like them because, they argue, they are imprecise and not always easily amenable to legal interpretation. These are the same firms which rail against the bureaucracy and inflexibility of having too many specific rules that result in non-value adding box-ticking, and having their firms run by compliance departments. I am a huge fan of principle-based regulation, as any of you who are familiar with the review of the listing regime I was directing for the FSA will know, and I am happy to have contributed to moving the FSA further in that direction while I was there.

I believe the combination of principle-based regulation and firms looking to achieve an ethical culture, beyond compliance, will have a positive influence on business prosperity by reducing risks, particularly reputation risk, in firms.

Just a word on penalties. There has been some concern expressed about the size of fines imposed by the FSA. Although those tend to be larger than those that used to be imposed by the courts on errant companies or their leaders, they pale into insignificance when compared with the penalties imposed by the SEC or the settlements negotiated by Elliot Spitzer. I'm reliably informed, by the way, that

Spitzer's very effective crusades are motivated by a genuine desire to see business adopting higher ethical standards. It is essential that the penalties for unethical behaviour are seen by business to be greater than the rewards for cutting ethical corners. And it's instructive to note that the FSA's enforcement procedures do allow penalties to be reduced if it can be shown that the firm generally has a strong compliance culture and good track record.

Now I'd like to say a few words about the survey. I'm particularly interested because the previous one came out in 2001, the year I left the IBE, so this gives me an idea as to whether things have moved on.

I'm disappointed that the number of FTSE 350 firms with codes of ethics has slightly reduced. In my view, the existence of a code, approved by the Board, and properly embedded in the organisation is evidence of a strong ethical culture. After all, culture is the sum of the values, attitudes and beliefs of an organisation. The code of ethics is a signpost for all the stakeholders as to what the firm stands for and for the way things should be done. The code is one expression of those values, attitudes and beliefs.

I am delighted to see that the majority of companies measure the effectiveness of their Codes. The HBOS case study is an excellent example. I hope they will use some of the data from the 48 KPI's they have developed when they publish their next Operating and Financial Review. Incidentally, one quibble about the survey is it incorrectly states that the OFR is a requirement only for larger companies. It will in fact be required of all quoted companies which was something I asked for when I was at the FSA. I hope that quoted companies will see it as a communications opportunity to tell their story rather than as a compliance burden to be handed over to the lawyers and the compliance department.

I was also disappointed to see that the proportion of firms providing ethics training to their workforce is not increasing. When I was here Simon and I felt such training was needed to embed ethical standards in a firm. I see the IBE does prioritise the delivery of ethics training itself, having surveyed external providers. So there's no excuse for not providing this training – come to the IBE.

My final point from the survey concerns the content of codes. As I suggested earlier, my experience as a regulator taught me that conflicts of interest is the single biggest behavioural issue in the

business world. The SEC has grasped this and it is worrying if fewer than half of UK companies view it as an issue affecting their organisation.