



Corporate Governance in the City
City & Financial
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The Rt Hon The Lord Mayor of London
Alderman Nick Anstee

Ladies and Gentlemen

I want to start by quoting a well-known book.

"I considered him my best customer; he was easily my favourite. He trusted me, I think, even though we had known each other for only four months. And here I was, selling him something I probably wouldn't touch with a bargepole if there hadn't been such glory in it for me. I knew it was awful. But I feel much worse about it now than I did at the time. After thinking it over for maybe a minute, he bought the 86 million dollars worth of Olympia & Yorks."

That is of course an extract from Michael Lewis's book, Liar's Poker, about working as a bond salesman at the investment bank Salomon Brothers in the 1980s. He's writing about making a sale in the interests of his business -a sale which will net Salomon Brothers about 2 million dollars- but which is emphatically not an investment in the best interests of his customer.

This book is about Wall Street 25 years ago. It paints a rather ugly picture of short termism, greed and unethical behaviour. As Lewis writes, 'It was the job of people like me to make up reasons, to spin a plausible yarn. And it's amazing what people will believe.' I think I can say that is not what any of us wants the City to look like - and I will come back Michael Lewis's new book later.

I am going to leave the experts to talk about regulation and its - very considerable - part in Corporate Governance.

What I would like to address today is how to start restoring trust - as a consequence of putting more ethical conduct and more effective corporate governance at the heart of the City.

As Lord Mayor of the City of London, my principal role today is supporting and promoting the City. That is all UK-based financial and professional services. In this role, I am often called on to bang the drum for the City brand both here and overseas.

I could tell you about how excellent the City is for both ethics and corporate governance; that the UK is no5 in the world for Ease of Doing Business (World Bank, 2010), and in the top five for corporate governance worldwide¹ - topped perhaps only by King III, South Africa's new corporate governance code. And that City firms and their employees work hard to assist the deprived communities in the boroughs around them.

This is all true.

But the fact is that the traders from Liar's Poker walk among us - and while they may be a little less monstrous than that picture of 80s excess, we can't dismiss the financial crisis as something that was simply a Black Swan, a highly unlikely event and not - in any way - our fault, or the fault of our culture.

In the global financial markets, there were lots of 'good people' who were doing the wrong thing. A bit like the politicians in the expenses scandal - most of them probably didn't even realise what they were doing was wrong. With the benefit of hindsight, we all see that nevertheless it was wrong. That's to do with a seismic shift in perspective. We don't expect people to 'play the rules' or even just 'play by the rules'. We expect better.

We find ourselves at a crossroads. On one side is a return to life before the financial crisis. It's a well-trodden path. In the words of Lewis in his latest book The Big Short, 'A society with deep, troubling economic problems had rigged itself to disguise those problems and the chief beneficiaries of the deceit were its financial middlemen.'²

On the other, the UK's financial services sector can reposition itself so that ethics and effective corporate governance are at its heart -

¹ www.gmiratings.com Governance Metrics International

² Michael Lewis: The Big Short, quoted Sunday Times, 21 Mar 2010)

ensuring that there are workable sanctions to enforce good behaviour. In other words, we need to extend governance beyond its usual meaning, 'giving effective direction' to include its other meaning, 'ensuring fast feedback', too.

We have a real opportunity here to ensure that the UK is known around the world for fair dealing into the future. That is the way to another successful century.

- I want to talk to you about the historical basis of ethics and corporate governance in the City.
- How that has changed.
- And then to discuss how we could strengthen and cultivate an emerging 'virtuous culture' in the City through tougher self regulation. A virtuous culture which has always been there but which may not have been prominent in recent years.

History

Good ethics and good corporate governance was born here in the City of London - along with much of the modern financial system.

This has been a business district for nearly 1000 years. As you know, it really took off some 400 years ago when both London and Amsterdam became centres of a maritime trading empire. We were both competing and cooperating internationally. Shipping goods around the world involved such huge sums of money that forms of mutual insurance, futures, trade finance- and other financial instruments, were invented or improved to facilitate international commerce.

The City was a very tight knit place and business was based on personal ties and a common culture. In the days before transparent annual reports and audits, you knew you could trust someone because you knew what kind of person they were. You knew they adhered to the high standards of their livery and their firm and you knew people who vouched for them.

The London Stock Exchange's motto, My Word is My Bond, has come to symbolise this early City.

Trust in the City was through long personal association over time and glued together by common cultural expectations. Scandals, breaches of trust, corporate defaults - all happened, but they were clearly exceptions and led to long term social exclusion.

While this individual expectation of good behaviour continues, in the nineteenth century the Chartered Business Professions emerged with their own codes of ethical practise - and failure to comply could result in being struck off from the profession, or fines.

How the City has changed.

Since the opening up of the City to an international market after 1986, that common culture has changed.

Today the City is larger, more international and more diverse. There are many benefits to this - I am not harking back to a pre-Big Bang 'golden age' and most of the people in this room have benefited from the major business opportunities the 1980s changes created. But in many areas, the idea of long-term trust based on a common culture has faded. The career path of people working here, too, is different: once upon a time, a City worker might expect to be with the same company for life. This is no longer the case.

This should not be a weakness; but - despite the voluntary codes of corporate governance, and despite regulation, I think we have not yet found a substitute for that personal level of trust and personal code of ethics - though perhaps a Facebook-style transparent contacts book is just around the corner.

We have also moved from a landscape where business was very diversified, - to one where the company limited by shares has become the main structure with one prime aim: to maximise shareholder value.

It's a balance between three things - as the late Sir Brian Pitman said,

- To deliver the reasonable short term demands of the owners
- Assessing the cost of capital
- And ensuring the long term health of the business.

The company limited by shares has created problems of its own - how to ensure that the aims of the board are aligned with the shareholders? And has entailed new laws to ensure, for example, that there is an external financial audit, In our new Companies Act in the UK we are starting to recognise that companies only serve their shareholders well if they pay due regard to the health of their key relationship with customers, employees, suppliers and community, and to the triple context of the changing economic, social and environmental scene. And of course there is a voluntary code of corporate governance for listed companies, which came about because of business' need for greater transparency.

Over the past few years, up until the financial crisis, companies rewarded short termism, with short CEO tenures, sometimes under 5 years, and with board directors given incentives to push up the share price - rather than foster the long term, sustainable value of the company. There is nothing in company law that forces companies to put short term profit ahead of long term health - but a number of factors have pushed it that way³.

It is pretty hard to argue that lending people money to purchase assets they cannot afford to pay back, and which are not actually worth the price, is sustainable and responsible behaviour - even if you've managed to transfer the risk away from your own company. It's a bit like Liar's Poker all over again. As the Economist put it 'I-B-G-Y-B-G' or 'I'll be gone, you'll be gone', so we don't have to worry about the long term consequences.

Where's the fair dealing in that?

Probity is all about fair dealing - it's one of the fundamental values of corporate governance. Fair dealing is what draws investors and those seeking investment to the City. What we must address, urgently and in many forums, is how we can strengthen and cultivate a(n emerging) virtuous culture in the City and in global financial services.

I believe the first thing we need is a proper assessment of ethics and corporate governance in the City today, to make sure we are not working on inaccurate assumptions. Work is already taking place, for example by the FRC constructing the new Stewardship code, but I think there's more to do.

That done, we need to think about how to put ethics at the heart of the City, and how to ensure it is more than nice words and good intentions.

I am going to touch on a few options because the City has become something of a test bed for corporate and financial services reform. It is reforming itself, and there are some very interesting ideas about what to do next. This has not just been happening over the past 2 years - it has been happening over the past 20.

I believe that UK is leading the world in this debate by not producing just a single report but a well designed raft of initiatives:
- the 2006 Companies Act

³ For example, liquid markets, technology, globalisation, shorter investment mandates, impatient media, wrong incentives

- the consultation on the revision of the Combined Code
- the Walker Review into Banking Governance
- the Investors Code.

Here in the UK the independent business led think tank Tomorrow's company, has been asking difficult questions⁴ about business since 1995.

In 2004 Tomorrow's Company wrote a prescient paper called 'Restoring Trust'. It sets out a stark choice for the City - to 'take the initiative and set out to live by its own standards, or to lose further control of the agenda and be suffocated by increasing regulation'. The paper develops a clear agenda for aligning the incentives and behaviours of everyone in the financial services and investment chain with the long term interests of their customers; for making sure that shareholder ownership rights and responsibilities are exercised, and for creating a professional code and disciplinary structure through which investment and financial services might discipline itself, a City equivalent of the doctor's Hippocratic Oath.

And then there is work by the UN, whose Global Compact has been gathering support since 2000. This is a voluntary compact which brings together over 4,700 plus corporate participants from over 130 countries⁵ - with a commitment to align their operations with 10 principles in human rights, labour, environment and anti-corruption. And it provides practical guidelines on what companies can do⁶. At the end of last week there were 212 UK signatories, of which 170 are businesses⁷.

There is a long trail of research, too, that suggests companies need to take account of stakeholders not just shareholders. A paper by Jones and Pollitt (2001) suggests that four groups influence corporate governance:

- 1) Business - corporations, professional, financial and non-financial stakeholders.
- 2) Authorities - government and regulators
- 3) Public opinion - media and popular feeling
- 4) External factors, economic and social events.

⁴ In 1993 the UK's Royal Society for the encouragement of Arts, Manufactures and Commerce (RSA) initiated an 'Inquiry into the role of business in a changing world' Following the involvement and feedback of more than 500 companies in the UK, Tomorrow's Company was formed as an independent business-led think tank.

⁵ Nakajima and Palmer. 'The Fall out from Globalisation, - Why we, at Cass, take business ethics and sustainability seriously?'

⁶ Daniel Malan, 'Financial Services and Human Rights'

⁷ www.unglobalcompact.org/

I would argue - as many others in this industry have - that it is in the interests of business to take account of the wider world. Sustainable businesses, businesses our grandchildren will respect - are conscious of their impact on society. They are not businesses which treat their employees badly - they empower them to make a contribution to society. They are not businesses which gain a reputation for ripping people off - they nurture customer relationships. They think very carefully about their contribution to the common good.⁸

The business and finance sector has also been learning from other sectors and becoming more professionalised. Take the new Chartered Director qualification -an IOD qualification available since 1998. The first 1,000 have now qualified. This should ensure that those directors are exposed to a common culture and grounding in ethics -and if they fail to live up to the standards of the new qualification, and update their knowledge continuously, they will be struck off the Chartered status.

This could spread. As you know there is a history of professions - such as the medical profession - limiting access to their ranks and thereby limiting access to work to those who commit to uphold high standards.

And we find a new emphasis on ethics in Business Schools both here in the City and overseas⁹.

- You probably know about Harvard's new MBA oath binding MBA graduates to high standards of behaviour. This is excellent, but we have to ask what it will achieve, and how it can be enforced.

The City's own Cass Business School has taken to heart the lessons from the financial crisis. It has created a new senior role of Associate Dean and the focus of the role and the team that has been assembled is to embed a deeper understanding of business ethics across all Cass's programmes but, particularly, the more technically oriented Finance postgraduate degrees. At the same time, Cass is giving strong emphasis to its leading position in providing management education for the voluntary sector, and is

⁸ As argued by Stephen Green Sep 2009 HSBC

⁹ - Harvard Business School's approach : Harvard has introduced the MBA oath 'As a manager, my purpose is to serve the greater good by bringing people and resources together to create value that no single individual can build alone. Therefore I will see a course that enhances the value my enterprise can create for society over the long term.'

- University of Stellenbosch Business School in South Africa was the first South African business school to subscribe to the UN Global Compact's Principles for Responsible Management Education. A module on sustainable leadership counts for 20% of the entire course marks.

looking to encourage more engagement between its student base and this sector.

I believe that the initiatives of Harvard and of Cass are just a beginning: in future business schools worldwide will make sustainability central to what they do.

And of course, the FRC's proposed Stewardship code for investors- the first of its kind in the world and another example of the UK's forward looking approach- which is out to consultation, may help to address another issue - the lack of engagement of some investors in promoting good corporate governance within the companies where they have shareholdings.

I know that Sir Christopher Hogg, Chairman of the FRC, argued the case for this new code at the International Corporate Governance Network conference at Guildhall last week.

And the ancient Livery companies of the City of London are adding their voices to the debate. Today we have modern Livery Companies such as the World Traders, the Management Consultants- which has Professor Bob Garratt as its master, and the International Bankers. Indeed, the Worshipful Company of International Bankers recently produced eight Principles for Good Business Conduct - drafted in large part by Anthony Belchambers, our chair today. It sets out customer and employer relationships, and there's a clause at the end, 'A material breach of the principles would be incompatible with continuing membership of the Company', which I believe means you will be thrown out.

We also need to explore other options.

For example to learn from other countries

I am just back from a business trip to South Africa, where I have heard reactions to their new King III code of Governance Principles for South Africa, which came into force this month. Sir Adrian Cadbury describes King III as 'The future of Corporate Governance,' and it introduces 'apply or explain' rather than 'comply or explain', with an emphasis on how to apply the principles or recommendations, as opposed to whether to comply or not. It applies to all companies across the public and private sector - and not just those that are listed.¹⁰

And to learn from the voluntary sector.

In a draft paper by Paul Palmer, Chizu Nakajima and Peter Grant, Capitalism in Crisis, Lessons from the Voluntary Sector, they suggest that the voluntary sector has avoided many of the problems

¹⁰ From Daniel Malan's King III International Best Practice or International Best Preach?

of the private sector, in its emphasis on long term stewardship and trust. It has also proved innovative - for example in the field of microfinance and fairtrade - which today attract City banks, investors and blue chip companies such as Cadburys¹¹.

The last decade has seen those voluntary sector organisations encouraged to become more like the private sector - but let's look through the lens the other way. How could the voluntary sector influence us?

Between 1996 and 2006 the charitable sector in the UK lobbied government to reform the laws relating to charities and to increase regulation in order to give greater public confidence in them.

And there have been numerous examples of NGOs working with business to create new rules and frameworks - such as the Forestry Stewardship Council and Marine Stewardship Council.

The authors of the draft 'Capitalism in Crisis' paper suggest that the charitable foundations - worth some \$84bn between them, could get together to reform the private sector by forming an organisation called Share Watch and using their votes to attend AGMs and call for suitable reforms.

This century is going to be a century of immense and sweeping change. We live in an era when one slip, one mistake, one foolish comment, can be relayed around the world in minutes. In this internet age, people expect a degree of accountability and engagement with the public and with their values that is - I believe - absolutely unprecedented. We cannot be unresponsive to these changes.

And investors are already being drawn to sustainable investments. Investor power will change things, too. Let me give you an example of where engagement is turning out to be good business. Hermes Equity Ownership Services, which advises on voting and engagement with the companies they are investing in - has recently had £16bn in new mandates, mainly pension funds -and is now advising on over £60bn of assets. This is one example of many.

The fact is there is unlikely to be a golden bullet that will help put effective corporate governance and ethical behaviour at the heart of the City. They are complex issues and ethical behaviour in particular is the result of collective values and actions over the long term. It is

¹¹ Cadburys plans to source all cocoa in dairy milk and drinking choc in UK and Ireland from fairtrade producers - cocoa industry is in decline, but higher prices of fairtrade farms mean better long term relationships - and a more secure supply chain for Cadbury.

a battle we need to keep fighting on many fronts - as many in the City always have.

I hope that the new FRC Investors Code, the Companies Act, the work of the FSA and the work of City organisations in self regulation - individually and collectively, will help to ensure that ethics and effective governance permeate every aspect of City life.

In my role as Lord Mayor I believe it is essential that financial services in the UK are trusted throughout the world. If this is to remain a world-leading centre, we don't need to be 'as good' as everyone else. We need to be better.

Thank you.

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