

The challenges of risk, culture, behaviour and corporate integrity in financial services

Findings from the MoralDNA™ of culture and conduct in global financial services

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About the author

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*...I also want to talk about ethics — doing the right thing. Is it necessary for the regulator, in a very prescriptive way, to set out what is right, what is fair? The traditional mechanism for dealing with a lapse has been to beef up the rules. To close loopholes in the law as and when they appear. To require more disclosure or compliance with specific processes. The problem with this approach is twofold. First: it is 'static'. So is closing stable doors after horses have bolted. Second: it encourages the very behaviours it seeks to stamp out. In his excellent book **ethicability**, Roger Steare argues for a more sophisticated interpretation of integrity in business — one that is not simply defined by the ethics of obedience — so what is legally right or wrong — but actually looks toward the ethics of care and the ethics of reason. Steare makes the very good point that: 'At their worst, rules, laws, regulations and red tape have a tendency to multiply because they remove our responsibility for deciding what's right.' His chief criticism? The fact that governments over the years have responded to scandal with rules and regulations, without considering that it was 'the obedience culture' that often failed in the first place. So if we trace back to around 2005–8, the breeding ground for many of the cases we are dealing with today, we find them occurring in a period that — far from witnessing a de-escalation in the rules — actually saw FSA guidance expanding by some 27%.*

Martin Wheatley,
"The Fairness Challenge," Financial Conduct Authority, October 2013



Foreword

Culture, ethics, behaviours and corporate integrity go to the heart of building confidence and trust in the financial system. As firms and supervisors look to understand more about the drivers of personal behaviour, particularly in relation to the management of risk, it is useful to understand the effect organisations have on the ethical orientation of individuals.

We are delighted to have facilitated some initial dialogue between Professor Roger Steare and representatives from the industry on the possible implications

of the MoralDNA™ findings. Some commentary is included in this paper to provide a flavour of the immediate dialogue we have witnessed and contributed to, and we hope that the discussions, discovery and debate will continue to develop as the financial services industry moves forward on this challenging topic.

Clive Martin
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What is MoralDNA™ and how does it assess culture and conduct?

MoralDNA™ is a diagnostic tool that measures how we make decisions based on the ethic of obedience (rules), the ethic of reason (principles) and the ethic of care (outcomes for others).

It also measures the values or principles we use to make these decisions about what is right; and how these insights can be correlated with conduct and behaviours. MoralDNA™ is also able to detect changes in the way we make ethical decisions in both our professional lives as well as in our personal lives. These differences therefore offer clear insights into the influence of organisational culture on how we think, decide and act at work.

MoralDNA™ was designed by Roger Steare, Visiting Professor in the Practice of Organisational Ethics at Cass Business School in London; and by Pavlos Stamboulides, a chartered psychologist and Director of Psycholite in Athens. Coincidentally, it was launched in *The Times* (London) on October 8, 2008, the day following the UK government bailout of the banking system. Since then, 130,000+ people from over 200 countries, working in 43 occupations, have completed MoralDNA™. Several systemic financial services firms, as well as organisations in the energy, technology and health care sectors, have used MoralDNA™ as a tool for culture assessment and change. In the UK, the authors of *MoralDNA* have conducted research for the *Chartered Management Institute into Managers and their MoralDNA* (2014) and *The MoralDNA of Performance* (2014). Professor Steare has advised the UK government on methodologies for assessing corporate culture.

Introduction

Organisational culture is a complex, adaptive and systemic phenomenon. Therefore, attempts to change



Looking back, what struck me is the degree to which we were able to shift senior leaders in the bank from a place of uncertainty or denial, to a place of increased confidence that values-based culture change is possible. This was achieved by enabling them to explore themselves, the bank's culture and their purpose, using evidence-based diagnostics and techniques. This process may have been triggered by regulatory failings, but the outcomes are now positively impacting clients, shareholders and wider society. However, the tension between a controls mind-set and the best interests of clients and investors remains.

**Global Head of Leadership
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culture using simplistic and deterministic controls and processes will inevitably lead to failure, simply because we can never fully understand and therefore predict the consequences of the changes we make in these processes and controls. In this paper, we explore how financial services professionals prefer to make decisions based on rules (deterministic controls), principles (moral values) and outcomes (for customers, investors and communities), and then how these cognitive biases change at work. We invite further debate and exploration of these findings, so that not only do we continue to improve financial stability, but we also ensure the positive social and economic outcomes of a thriving financial sector – one that truly serves our communities.

MoralDNA™ measures factors that have been correlated both with risk of organisational failure and with exceptional, sustained financial performance. In *How The Mighty Fall* (2010), Jim Collins conducted research on a number of firms that had failed or were failing. From this research he identified five destructive behaviors including “hubris born of success”, “undisciplined pursuit of more” and “denial of risk and peril”. MoralDNA™ detects cognitive bias toward arrogance, greed and dishonesty in decision-making.

By contrast, *Firms of Endearment* (2014) by Raj Sisodia, Jag Seth and David Wolfe analysed the consistent factors that determine the exceptional long-term success of firms, and the authors conclude that “today’s best companies get it. From retail to finance and industries in between, the organisations who recognise that doing good is good business are becoming the ultimate value creators. They’re changing their culture and generating every form of value that matters: emotional, experiential, social, and financial.”

The common factors in the success of these firms include having a clear purpose to serve others and to care deeply about all of their stakeholders. MoralDNA™ identifies mindsets that focus on good outcomes and how much people care.

In the findings that follow, most are illustrated with graphs which show the percentile scores of financial services professionals when making decisions, based on the three ethical dimensions of Rules, Principles and Outcomes — and in terms of 10 moral values when doing so. For example, a 50th percentile score is the average score for any factor in our database of over 130,000 individuals. A 70th percentile score means that a group is scoring higher than 70% of our population. A 30th percentile score means that this group is scoring lower than 70% of our population. The size of our financial services database is 26,969 people, most of whom are not self-selecting, they have been required to complete MoralDNA™ as part of a mandatory culture change programme.

So what are the key insights revealed by the MoralDNA™ of culture and conduct in global financial services? These are outlined on the following pages.

MoralDNA™ is a trademark of Roger Steare Consulting Limited.

Key insights

1 On a personal level, the MoralDNA™ scores of financial services professionals are consistent with the moral norms of our global database of 130,000 people. In fact, their scores are about average and significantly higher than those working in politics, government and the media, who hold them to account. This insight clearly challenges the media stereotype of the “greedy banker.” However, the Libor and forex scandals demonstrate the disproportionate impact of the actions of a tiny minority on the reputation of the industry as a whole. Does this also suggest that financial services firms and regulators should pay even more attention to assessing the moral character of all those who are hired?

Selected occupations ranked

Occupation	Rank	Percentile
Homemaker	1	58%
Healthcare	4	57%
Financial services	13	51%
Government	33	45%
Print media	40	42%
Politics	43	37%

Insights from initial discussions

In the initial discussions it was clear that some comfort was taken from this headline result. Attention then typically turned to what it could be about the organisations themselves, which means that, despite this parity on a personal level, differences could emerge when the same individuals’ “at work” personas were considered (see the next insight).

2 However, the corporate, regulated culture of the financial services industry increases compliance with rules and consideration of principles, but suppresses empathy. In other words fear is the dominant emotional driver. So while those in financial services will try to comply with the rules and consider principles in their decisions and behaviours, they are less concerned about good outcomes for their customers, their stockholders and other stakeholders. Is this culture really what governments, regulators and firms want? Do we really want a financial services sector that appears

to be “safer”, but then fails to fulfil its purpose at the heart of our economies? *(See graph 1)*

Insights from initial discussions

Whatever the reason for the change in thinking styles between personal life and work life (and that itself would be interesting to explore further), the initial discussion around this finding related to the implications for the risk culture improvement plans of firms and supervisors.

The industry is well aware that over-focus on compliance with rules without sufficient consideration of outcomes has caused some issues in the past but the results suggest that it is the dominant “natural” driver of thinking of those in the industry.

Discussions went on to consider the limits of human ability to navigate and remember a large number of rules. It may also be that a lack of focus on outcomes relies on well-designed processes always delivering a good outcome, which is a significant presumption in the increasingly chaotic environment that the modern world presents.

3 In terms of moral values, leaders in financial services score significantly higher than average on honesty, courage, fairness, trust and excellence. However, scores are lower on love and humility. While the media might question the higher scoring values, the everyday reality is that without high levels of honesty for example, the banking system would collapse. But what does the low score on love suggest in terms of outcomes for customers and investors? What are the implications for a low score on humility? Does this insight suggest that in terms of pay for example, this is not a matter of greed, but of the need for relative status? What are the implications for optimal leadership styles? Should leaders become more or less hierarchical, and accessible to customers and colleagues? *(See graph 2)*

Insights from initial discussions

In the initial discussions, these results led to dialogue on the extent to which these mindsets

convert into actual behaviour and whether there could be value in understanding who in certain organisations exhibits behaviours which are against the prevailing norms of the business overall.

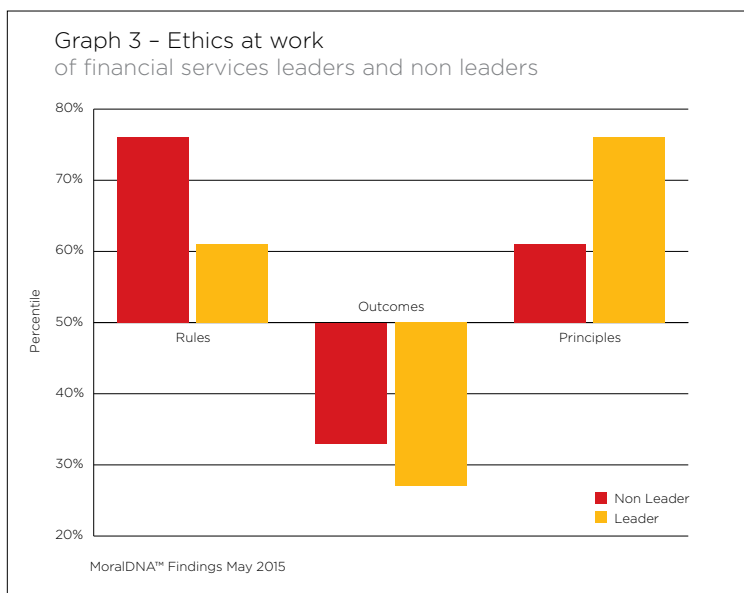
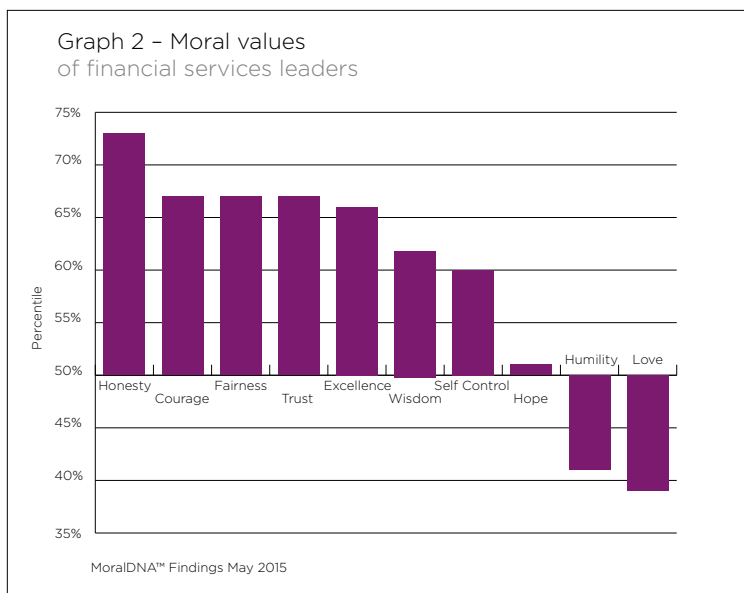
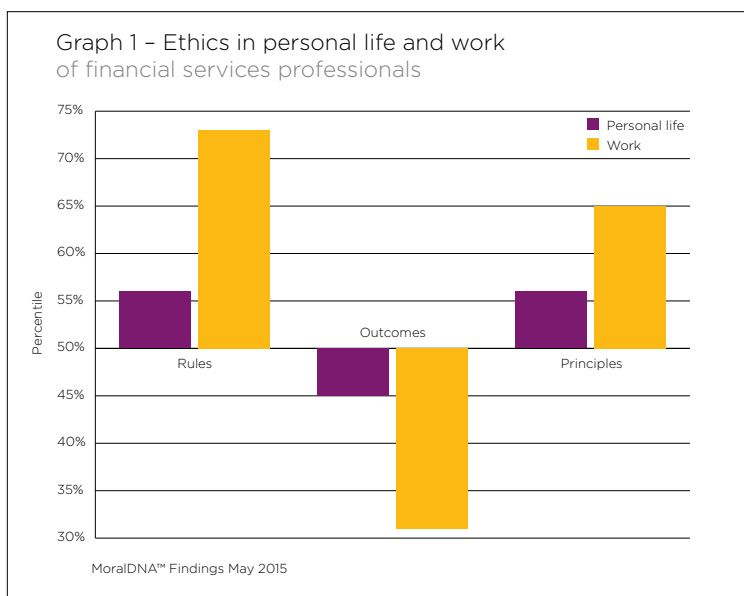
4 Leaders in the financial services sector are significantly more principled in their approach, but less rule-compliant and less concerned about outcomes for others than their employees. If leaders shape cultures, is this where we need to think more deeply about the moral profile of those appointed to senior manager roles? How do we improve balance and diversity of thought on boards and in senior leadership teams? (See graph 3)

Insights from initial discussions

Initial discussion on these results considered that confidence in reason, judgement and logic is perhaps what differentiates financial services leaders from their employees, and it is possibly not surprising to see this reflected in the results of the principles dimension. However, unless the rules in an organisation are built around the ability of individuals to operate empathetically, then personal tension could arise for employees.

The discussion also considered whether leaders are promoted because they exhibit these traits, or whether it is as a result of being promoted that they then exhibit these traits (due to the nature of performance measurement at that level).

The dominance of principles (logic/reason) among leadership potentially leaves organisations more exposed to cognitive/behavioural biases – particularly in relation to decision-making. The discussions also considered that the tone from the top is typically reflected in the key performance indicators of firms, and if these don't include sufficient consideration of caring outcomes, then employees might suppress their feelings of empathy in order to meet the KPIs. This means that leaders could not rely on their local staff to operate in an empathetic manner.



5 Women leaders in financial services firms are a little less compliant, but are more concerned about outcomes for others than their male colleagues. The importance of gender diversity and the role of women on boards and in senior executive positions has been well documented. What then is the right gender balance for leaders? Should we be looking more closely at both the relative performance and the risk profiles of those teams that are led by women and men?

(See graph 4)

Insights from initial discussions

The overall similarity of score balance for both genders was identified and attention turned to the relative differences. In addition to the broader benefits of gender equality initiatives and high-profile items such as board composition, the initial discussions touched on the importance of understanding the effect that gender mix can have on the conduct risk profile of firms overall and individual businesses and branches within them.

6 Within financial services, there are some significant differences between retail banking, investment banking, insurance and asset management. Investment bankers have the highest scores for being driven by rule compliance, but the lowest scores for focusing on good outcomes for others. Retail bankers have the highest score for good outcomes, closely followed by insurers and asset managers. Insurers have the lowest score for principles-based judgement with retail bankers and asset managers scoring highest. What then are the implications for the effective governance, management and regulation of these financial sub-sectors? What does this insight mean for the future of universal banking with several different ethical drivers with a single organisation?

(See graph 5)

Insights from initial discussions

Participants in the initial discussion also found these results interesting from a relative perspective and felt that they could stimulate

further thinking on the true drivers of behaviour in these different types of organisations. Various types of intervention will clearly be necessary to make changes within different types of firm or business unit inside groups.

7 Financial services professionals in Asia Pacific are the most driven to be compliant, followed by those in Europe, the UK, Africa and then the Americas. Those in Africa are the most principled, followed by those in the Americas, Europe, the UK and then Asia Pacific. Financial services professionals in Europe are the most outcomes-focused, followed by those in the UK, Asia Pacific, the Americas and then Africa. These regional variations are deeply rooted in the culture of these societies, despite the relative mobility of senior managers. For example, traditional Eastern philosophies and cultures show greater respect for authority than is seen in the West. What then are the implications for improving management and supervision across regions? Should there be a more flexible and adaptive approach to the effective governance, management and regulation of global financial services firms? *(See graph 6)*

Insights from initial discussions

Initial discussions showed interest in these results from global institutions investing in emerging markets, albeit recognising the large number of variables in each territory such as regulatory activity, public perception, and the relative status of financial services compared to other industries. There was discussion on whether the emergence of principles- and outcomes-based supervision in some territories has influenced these results. There was also recognition that these results supported the view that approaches to improving risk culture would need to vary by region.

8 There are significant differences in the MoralDNA™ of financial services across the three “lines of defence”. The greatest difference is with the relatively lower score on rules and outcomes for the second line of defence

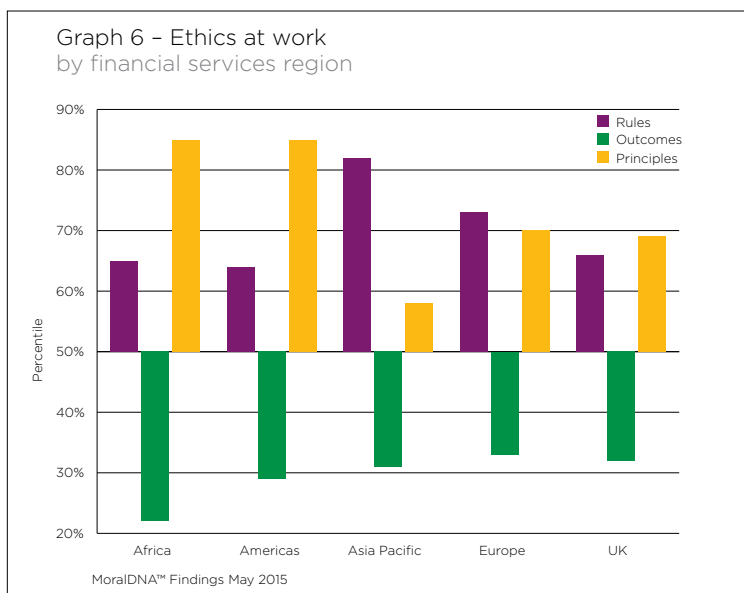
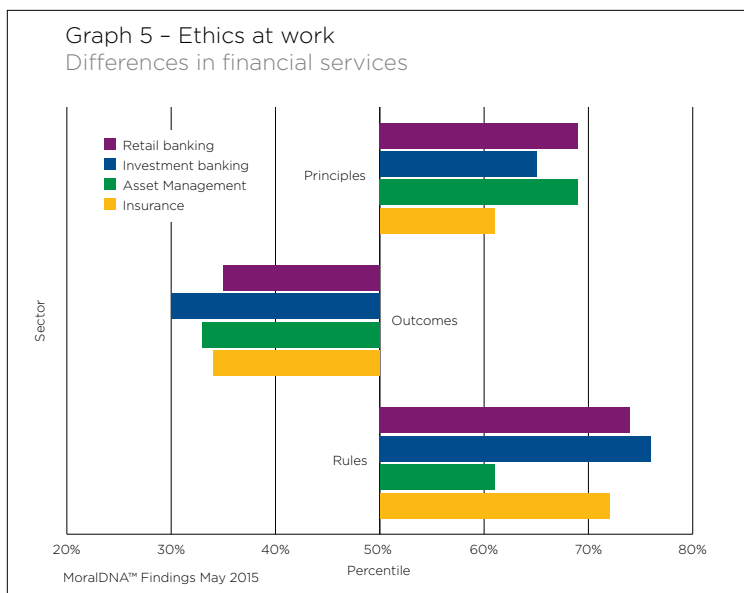
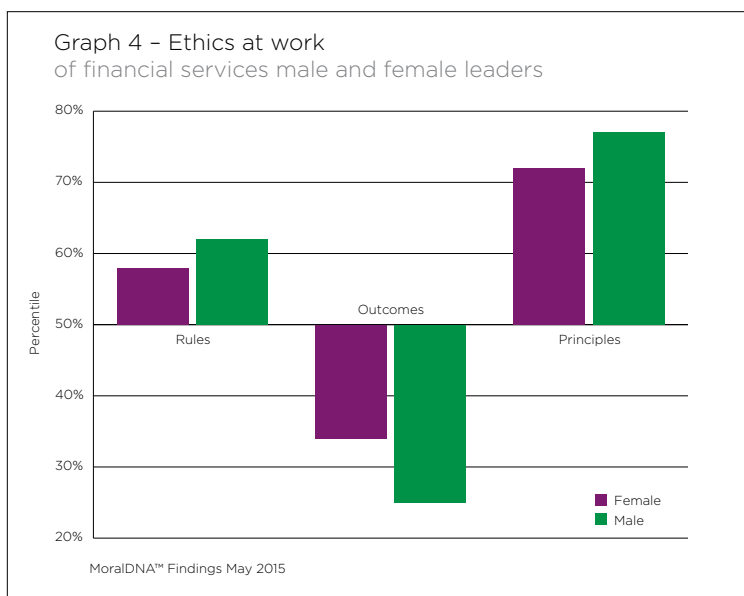
... the compliance and risk professionals. The scores between the first and third lines of defence are more aligned. Does this insight suggest that governance, compliance and risk management are working or not? If they are working, should we see alignment or difference?

And what about regulators? What might we learn from an exploration of the MoralDNA™ of supervisors? *(See graph 7 overpage)*

Insights from initial discussions

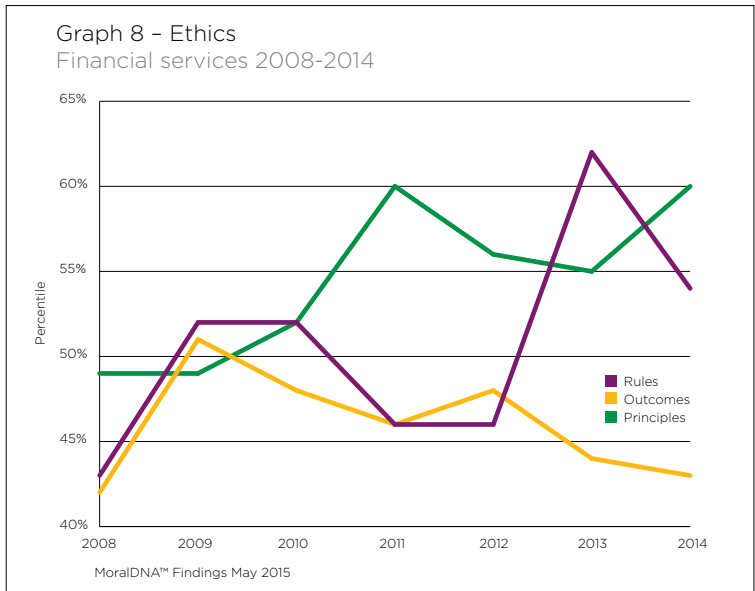
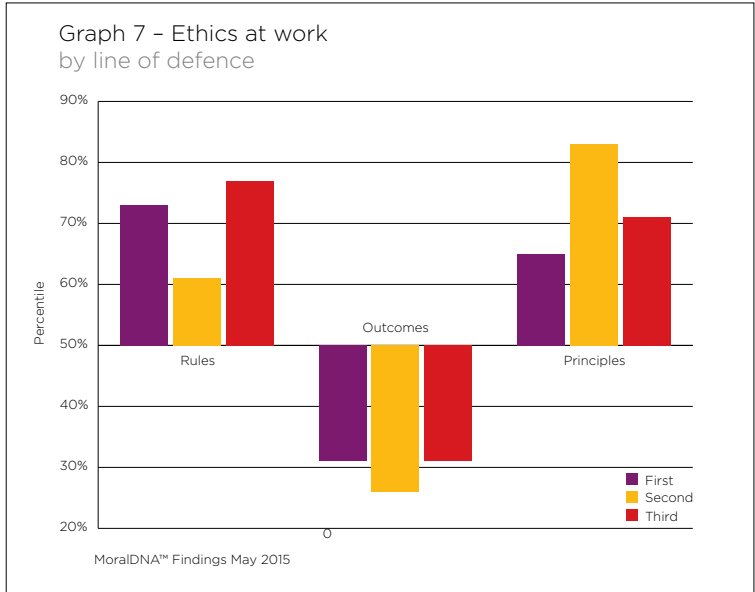
This was an area of particular interest in the initial discussions, with some views such as “to challenge the first line, you need to think like the first line” being expressed. On the other hand, if the intention is to bring balance to the business through its challenge, then perhaps it would seem sensible to create a second line which has “opposite” moral values... and to that extent the higher principles score seemed attractive. However, the lower outcomes score seemed unattractive in that respect when conduct risk was considered in the initial discussions. Some firms explained that they had started to explore optimising staff mix through psychometrics.

9 MoralDNA™ has been tracking the scores of financial services professionals since the summer of 2008. While principles-based decision-making has increased from 2009 to 2014, outcomes-based thinking has declined since 2009 and remains significantly below average. Rules-based decision-making has been more volatile, increasing immediately after the financial crisis in 2008 and then again as the Libor scandal unfolded in 2012. These results suggest that, while our financial system may be safer, leaders in financial services firms do not seem as concerned about delivering good outcomes for customers, our communities and the wider global economy. So what then is the optimal blend of rules-based, principles-based and outcomes-based regulation? What are the implications for better governance, leadership and management within firms? *(See graph 8 overpage)*



Insights from initial discussions

Participants in the initial discussions identified that these results demonstrate a change in mindset, and pointed out that change was intended by firms and supervisors. However, discussion revolved around whether the changes were actually those envisaged by industry leaders, and the relative score for consideration of outcomes for customers was particularly interesting. Additionally, it was acknowledged that these results are an indicator of mindset and not necessarily actual behaviour, although a possible link was recognised.



Overall EY observations from initial client reactions

We can tell from our preview client interactions that these findings are useful in prompting more thinking about the best way to influence behaviours in firms. Many organisations want more detail on the findings before drawing conclusions. However, several areas have already been identified by organisations for possible analysis/further study, including:

1 What causes thinking styles to change when individuals come into work? Is the increased thinking emphasis on rules and judgement/logic and the decreased emphasis on empathy/care for others a good thing? Can the decrease in empathy/care be improved where it seems desirable?

2 Is the increased focus on rule-based thinking desired or not? If it is not desired, then to what extent is it a result of the regulations themselves or the way in which they are translated into internal rules/processes?

3 To what extent is leaders' thinking across the three dimensions likely to be influenced by moves to increase individual accountability through regulatory initiatives such as the Senior Managers Regime in the UK? Is this likely to make them place more or less emphasis on rule-based thinking?

4 Are particular sub-cultures useful in particular parts of the organisation where different emphasis in ways of thinking could be appropriate? If so, how

can they be confident that they have the right mix? Are monocultures still appropriate in increasingly complex and dynamic organisational environments, or are there places where it would seem better to introduce greater diversity? If changes should be made, then what is the best way to bring about the change, as new joiners can quickly adopt the same monoculture?

5 To what extent are organisations clear about the basis on which organisational and individual decision-making should be shaped if the relatively low consideration of outcomes for others is prevalent?

We hope and trust that more insight on these and other areas will be useful to organisations as they continue to seek ways of influencing the behaviour of their people in order to achieve more effective management of risk.

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