Roll Back The Years

By Paul Q. Watchman | October 2014

'Society no, more, community no more, compassion no more.'

The 1970s were characterised by an emphasis on the needs, if not rights, of the individual. Pension funds and their asset managers corrupted legal principles of fiduciary duties to justify an exclusive focus on short-term gains. Salaries and bonuses in the financial and corporate sectors started to spiral rapidly upwards, based on a voracious hunger for individual reward. Insider trading, if not condoned, was not yet criminalised.

Yet, bankers were still held up as exemplars of financial rectitude. If not quite hen-speckled, bankers were viewed generally as quaint. Somewhere between Old Etonian classicists with a vague but largely irrelevant skill set to modern banking and a Presbyterian-version of Captain Mainwaring.

The era of Thatcherism was epitomised by a 'devil take the hindmost' attitude as the heavy industries, which had fuelled the industrial revolution, were closed to make way for silicon glens and a new service based economy. The basic infrastructure for regulation of the city and corporate activities may have been in place, but there was little appetite on the part of government or regulators for enforcement.

Admittedly, there was 'no soul to damn, no body to kick' when corporate white-collar crime was uncovered. Even if there had been, it was counter-cultural for regulators to seek to punish transgressors. Regulators viewed their role generally as educative, cajoling errant pupils to pay greater attention to their responsibilities or to remedy their ways. To fine or punish for regulators then was an admission of failure, and very much a last resort.

After Big Bang, more focused regulation of the financial and corporate sectors was put in place. However, there was still little aptitude for enforcement. Greed had become accepted as good and regulation, not to discourage inward investment, had to be light touch or, it could be said, light-headed in retrospect.

Where corrupt practices, bribery, market rigging or money laundering was uncovered, it was seen strictly to be the acts of rogue traders rather than a systemic risk to the global economy presented by unregulated financial misconduct or corporate irresponsibility. In other words, a few bad apples in an otherwise healthy orchard.

At the same time, the old school bankers were being replaced by mathematicians and economists, aping and running private equity and venture capital financial models in the banking halls of venerable financial establishment.

Then in 2007-2008 the financial world was turned upside down by casino banking which threatened the global economy. Governments and regulators finally were no longer able to stand idly by while contagion spread from financial institution to financial institution.

There was also widespread acknowledgement by governments and regulators that things had to change. Shareholders and stakeholders too refused to be treated like errant children. Demands for greater transparency and accountability by NGOs, such as ShareAction and the Tax Justice Network, were made shrill by the advent of the social media. Financial institutions and corporations were called by civil society to demonstrate their corporate values and social responsibility. The exclusive pursuit of short-term profits, irrespective of the social and environment impacts of the activities that provided those profits, was questioned. A new financial lexicon began to emerge with concepts such as carbon footprint, climate change, Environment, Social and Governance (ESG), and The Equator Principles with the establishment of UN Environment Programme Financial Initiative (UNEP FI), the Principles of Responsible Investment (PRI) and the Principles of Sustainable Insurance (PSI). Old concepts, such as fiduciary duties and directors' duties, were also remoulded not to defend the acts and omissions of directors and investment houses from external scrutiny but to justify and increase transparency, disclosure and accountability.

This, however, was not and is not the dawn of a golden age of financial responsibility and improved corporate ethical values. Fines and punishments continue to escalate as regulators throughout the globe continue to lose patience with the corrupt, the venal and the incompetent. The million and billion dollar, euro and sterling fines imposed on JP Morgan, RBS, Barclays, Credit Suisse; the travails of BP and GSK in the United States and China, respectively, to say nothing of Tesco's vast overstatement of profits audited by PwC, are but a few current examples which would challenge an optimistic view frequently expressed that such difficulties lie in the past rather than the present. All bear witness to the fact that financial and corporate bodies continue to break fundamental laws.

It is, however, not a false dawn. A bright light has been shone into the Stygian gloom of the financial world by Roger McCormick and his team at the Conduct Costs Project, a former LSE initiative and now an Associated Research Project of the CCP Research Foundation CIC (CCP RF). Their work on conduct costs has been seminal and its importance has been acknowledged globally. In asking searching questions about how banks discharge their duties towards their shareholders, stakeholders and civic society as a whole they have been game-changing. Yet, lest it be thought that their work is an attack on the financial sector. It is not. Indeed, it is important to recognise that it is quite the opposite. By focusing on the conduct costs of global banks it provides an important risk-assessment tool to enable financial institutions, investors and the public to better understand and assess financial risk.

Already it can be seen that pension funds and asset managers have begun to divest their investment in banks and other industries, such as the extractive, pharmaceutical and energy industries. The Norwegian Global Fund has long been known to divest shares in companies which do not meet its requirements for investment due to adverse social, environmental or governance risks. This view of the need for ESG risk assessment has now spread to mainstream investment. As has divestment due to the escalation of fines and penalties imposed to punish and curb errant behaviour.

It has, for example, been announced that the Rockefeller Brothers Fund has decided to divest its investments in energy and extractive companies which rely on fossil fuels and reinvest in companies that are developing alternative and renewable energy sources. Additionally, a major asset manager has divested shareholdings in HSBC because of the increases in the magnitude of fines imposed on banks.

The Law Commission, following the reports of Walker, Myners and Kay and the United Nations on the need for sustainable long-term investment strategies, has also echoed the need for greater awareness of financial risk and the need for financial sustainability in investment decision-making.

It is against this background of the potential for real and fundamental change that I have decided to join CCP RF and to contribute to the important work it is doing. CCP RF's work dovetails with my own interests in business and human rights, sustainable investment, corporate responsibility, governance and social and environmental impacts. I am proud to be pursuing this work with CCP RF and with the University of Glasgow where I have been recently appointed to an Honorary Professorship in Law.

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