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## About the report

*A crisis of culture: Valuing ethics and knowledge in financial services* is an Economist Intelligence Unit (EIU) report, sponsored by CFA Institute. It examines the role of integrity and knowledge in restoring culture in the financial services industry and in building a more resilient industry. The report draws on three main sources for its research and findings:

- A global survey of 382 financial services executives conducted in September 2013. Of these, 42% are based in Europe, 34% are based in Asia-Pacific, and 20% are based in North America. One-half are C-suite executives, and the rest are senior executives and managers. Nearly one-fifth (18%) are executives from asset management firms, 16% are from commercial banks, 15% are from retail banks, 12% are from insurance and reinsurance firms, 11% are from private banks, 11% are from fund management firms, 9% are from investment banks, and 8% are from wealth management firms.
- A global survey of 50 executives from firms supporting the financial services industry across a number of areas, including technology, marketing and business processes.
- A series of in-depth interviews with senior financial industry executives and experts:
  - Juan Ignacio Apoita, global HR director, BBVA
  - Peter Cheese, chief executive officer, Chartered Institute of Personnel and Development
  - Prasad Chintamaneni, global head of banking and financial services, Cognizant
  - E. Gerald Corrigan, managing director, Goldman Sachs

- Michel Derobert, general secretary, Swiss Private Bankers' Association
- Bob Gach, managing director, Capital Markets, Accenture
- Steven Münchenberg, chief executive officer, Australian Bankers' Association
- Robert Potter, chairman, City HR Association
- Ulf Riese, finance director, Handelsbanken
- Hiba Sameem, researcher, The Work Foundation
- Richard Sermon, chairman, City Values Forum
- Jacques de Saussure, senior partner, Pictet
- Jon Terry, global head, HR Consulting Practice, PwC
- Andre Spicer, professor of organisational behaviour, Cass Business School
- Gert Wehinger, senior economist, Financial Affairs Division, OECD Directorate for Financial and Enterprise Affairs
- Martin Wheatley, chief executive officer, Financial Conduct Authority

We would like to thank all interviewees and survey respondents for their time and insight. The report was written by Michael Kapoor and edited by Sara Mosavi.

## Executive summary

Back in 1980, just 9% of Harvard MBAs went into financial services. By 2008, the figure was up to 45%. Lured to Wall Street and the City by generous pay packages, financiers were encouraged to chase rapid earnings growth. Short-term profit priorities led to extreme risk-taking at many firms, with employees selling complex derivative products they did not understand (and that many of their corporate clients did not need), and lending to people who could not afford the repayments.

Since the global financial crisis of 2008, the question being asked about the industry is whether it can change, shifting its culture to become more risk-averse and client-centric. There is little doubt that strengthening culture, including the promotion of ethical conduct and greater knowledge, is a priority for the top echelons in the financial services industry. In recent years many firms have launched thorough reviews of their practices as part of their efforts to decide who they are, what they do, and how they should do it. But it could take years before change is seen at all levels of the organisation.

In *A crisis of culture* we examine the global financial services industry's record on ethical conduct; we investigate the level of knowledge financial services executives have of their own firm and of their industry; and we explore the

role that greater knowledge plays in building a stronger culture within financial services firms.

The main findings are as follows.

- **Most firms have attempted to improve adherence to ethical standards.** Global institutions, from Barclays to Goldman Sachs, have launched high-profile programmes that emphasise client care and ethical behaviour. Our survey supports the anecdotal evidence, with nearly all of the firms represented in the survey having taken steps to improve adherence to ethical standards. Over two-thirds (67%) of firms represented in the survey have raised awareness of the importance of ethical conduct over the last three years, and 63% have strengthened their formal code of conduct and the system for evaluating employee behaviour (61%). Over two-fifths (43%) of respondents say their firms have introduced career or financial incentives to encourage adherence to ethical standards.

- **Industry executives champion the importance of ethical conduct...** Despite a spate of post-crisis scandals that suggest continued profit-chasing behaviour, large majorities agree that ethical conduct is just as important as financial success at their firm. Respondents would also prefer to work for a firm that has a good reputation for ethical conduct than for a bigger or more profitable firm with questionable ethical

standards. Nearly three-fifths (59%) personally view the industry's reputation on ethical conduct positively; and 71% think their firm's reputation outperforms the industry's. Executives may have confidence in the effectiveness of current efforts to improve adherence to ethical standards, but consumers remain unconvinced. The industry was voted the least trusted by the general public in the 2013 *Edelman Trust Barometer*.

- **...but executives struggle to see the benefits of greater adherence to ethical standards.**

While respondents admit that an improvement in employees' ethical conduct would improve their firm's resilience to unexpected and dramatic risk, 53% think that career progression at their firm would be difficult without being flexible on ethical standards. The same proportion thinks their firm would be less competitive as a consequence of being too rigid in this area. Less than two-fifths (37%) think their firm's financials would improve as a result of an improvement in the ethical conduct of employees at their firm. It seems that, despite the efforts made by firms in recent years, ethical conduct is yet to become a norm in the financial services industry.

- **To become more resilient, financial services firms need to address knowledge gaps.** The increasingly complex risk environment has made advancing and updating knowledge of the industry crucial for those working in or serving the financial services industry. Nearly three-fifths (59%) of respondents identify better knowledge of the industry as the top priority for

making their firm more resilient to risk. Three-fifths think gaps in employees' knowledge pose a significant risk to their firm.

- **Nonetheless, a lack of understanding and communication between departments continues to be the norm.** Many argue that ignorance was a key contributor to the global financial crisis: managers signed off complex products they did not understand, while HR departments agreed to incentives they did not realise encouraged risk-taking. Five years after the crisis not much seems to have changed: 62% say that most employees do not know what is happening in other departments. Over one-half (52%) also say that learning about the role and performance of other departments would be the least helpful to improving their performance.

Senior executives need to ask whether the power to influence at their firm is shared widely enough. The ultimate question for financial services firms is: who is, or who should be, in charge—the bankers, the traders, or those support departments that keep risks in check, such as human resources, compliance and risk? The challenge for firms is to form enduring partnerships between functions to ensure that the firm is run by experts in everything it does. A number of firms, including ones interviewed for this report, are already bringing together different functions to vet big, important decisions concerning the firm's future and to ensure a coherent culture and approach to risk.

# Introduction

“  
In many cases  
there is no  
such a thing  
as a single  
culture within  
a bank

”

Andre Spicer, professor of  
organisational behaviour,  
Cass Business School

## In search of culture

Pre-tax profits at the world's 1,000 largest banks surged by almost 150% between 2000-01 and 2007-08, according to the magazine *The Banker*, as firms borrowed heavily to boost profits.<sup>1</sup>

Financiers also devised new techniques, such as securitisation, that allowed lenders to sign apparently lucrative deals and then sell on the risk. Martin Wheatley, the chief executive of the Financial Conduct Authority (FCA), the UK's industry regulator, sums up the problems that fed the crisis as a collision between financial services employers incentivised to increase sales volumes

and financial institutions fixated on return on equity—encouraging them both to chase revenue and to keep capital levels modest to increase profitability. In the short term, the effects were dramatic. But the focus on boosting profits rapidly was not sustainable, and eventually led to a global financial crisis in 2008.

Financial services firms are working hard to change the pre-crisis culture. But for change to permeate throughout the firm could take years, if not decades. In fact, since the crisis emerged, there have been a number of scandals in the financial services industry. For instance, Europe's biggest bank, HSBC, paid

**Table 1: Top ten bank fines**

Fine	Bank
US\$1.9bn	HSBC, money-laundering lapses
US\$1.5bn	UBS, Libor-rigging
US\$920m	JPMorgan, trading scandal
US\$780m	UBS, aiding tax fraud
US\$667m	Standard Chartered, breaching sanctions
US\$619m	ING, breaching sanctions
US\$612m	RBS, Libor manipulation
US\$550m	Goldman, misleading investors
US\$536m	Credit Suisse, breaching sanctions
US\$500m	ABN Amro, breaching sanctions
US\$451m	Barclays, Libor manipulation

Source: *The Telegraph*, September 19th 2013.

<sup>1</sup>“The Future of Finance: The LSE Report”, A. Turner *et al*, London School of Economics and Political Science, 2010.

<sup>2</sup> "HSBC exposed US financial services to money laundering, drug, terrorist financing risks", Permanent Subcommittee on Investigations, US Homeland Security and Governmental Affairs, July 2012.

<sup>3</sup> The London Inter-bank Offered Rate (Libor), a benchmark interest rate, is calculated using a "trimmed" average of rates submitted by individual banks at 11 am London time based on their perceived unsecured borrowing costs. Allegations surfaced in 2012 that a number of large banks had manipulated their rate submissions to boost profits.

<sup>4</sup> *Salz Review: An Independent Review of Barclays' Business Practices*, A. Salz, April 2013.

<sup>5</sup> The Big Bang was a period of deregulation for the UK's securities market starting in October 1986. As part of it the London Stock Exchange was privatised, which led to a number of changes, including automation of trading and firms being allowed to operate in a dual capacity, as both brokers and dealers.

<sup>6</sup> "Don't rule out an Asia banking crisis, S&P says", E. Curran, *Wall Street Journal*, October 2013.

penalties worth a total of US\$4.2bn in 2012, split between US\$2.3bn in compensation for mis-selling financial products in the UK and a US\$1.9bn fine for lax money-laundering controls in the US. Senator Carl Levin, the chair of the US Senate Homeland Security and Governmental Affairs' Permanent Subcommittee on Investigations, described HSBC's compliance culture as "pervasively polluted", which had exposed the US financial system to "a wide array of money-laundering, drug trafficking and terrorist financing risks."<sup>2</sup> HSBC's experience is a sobering reminder that avoiding a repeat of the crisis is not a simple or quick task.

### Lost identities

Much of the criticism directed at the financial services industry has centred on culture. The wave of mergers and acquisitions (M&A) that swept the industry before the crisis left behind a number of convoluted firms. Barclays, for instance, bought its way into investment banking through a series of acquisitions. In 1986 it bought De Zoete & Bevan and Wedd Durlacher to merge with Barclays Merchant Bank to form BZW. In 1996 BZW was merged with another acquisition, Wells Fargo Nikko Investment Advisors, to form Barclays Global Investors. And in 2008 Barclays expanded its presence in global investment banking by buying the North American assets of the collapsed US household name Lehman Brothers.

When the Libor-rigging scandal broke in 2012,<sup>3</sup> the board of Barclays commissioned an independent external review of the bank's business practices, headed by Anthony Salz. The review said: "We believe that the business practices for which Barclays has rightly been criticised were shaped predominantly by its cultures, which rested on uncertain foundations." As a result, the review called for "transformational change". "There was no sense of common purpose in a group that had grown and diversified significantly in less than two decades," concluded the review.<sup>4</sup>

"In many cases there is no such thing as a single culture within a big bank," says Andre Spicer, professor of organisational behaviour at London's Cass Business School. "Often entire teams were lifted from outside institutions as a bank expanded into new areas, especially in investment banking. This is not just a question of the split between investment and retail banking ethics and culture. It's that institutions operate as a bunch of separate silos, each one with their own different cultures and operating practices."

Like many other banks, from its compatriot RBS to BBVA in Spain, Barclays bought into new geographical markets as well, paying handsomely to buy a big presence in countries from South Africa to the US. The result, as condemned by the *Salz Review*, was a bank that was too big to manage and a complex corporate culture that made controlling risks problematic.

"The dilution of bank culture, and the leaching of aggressive investment banking values into more conservative fields such as retail can be traced right back to Big Bang,<sup>5</sup> and wider financial services liberalisation around the world in the 1980s and 1990s," says Mr Spicer, in comments broadly echoed by many of our interviewees.

### How the other half bank

Emerging markets were only lightly hit by the banking crisis. Now, however, fears are mounting that Asia, in particular, could face systemic problems as its banks develop and grow more aggressive. In October 2013 the rating agency Standard & Poor's (S&P) warned in a statement that "a regional banking crisis isn't out of the question."<sup>6</sup> In particular, it worries that slower economic growth could lead to a rise in bad debts in both China and India, with China's unregulated shadow banking sector a particular concern. "Years of very rapid credit expansion ... along with a strong increase in housing prices, is set to backfire on banks' asset quality, profitability and possibly liquidity," the agency warns.



So far, tight state regulation has avoided the excesses of banks in developed markets in places like China and India. To avoid future problems, they should perhaps look at the example of Australia, which weathered the global crisis successfully after tightening regulation massively following a big scare in the 1990s.<sup>7</sup>

Steven Münchenberg, the chief executive of the Australian Bankers' Association, points to two things that prevented the collapse of any major Australian bank during the crisis. The first was the very tight regulation after the problems of the 1990s, which meant that "regulators were crawling all over our banks", preventing too much risk-taking. The second was the fact that banks, the government and the regulators were able to talk openly and trustingly about what was happening during the global financial crisis. Another factor, as explained in 2009 by Ian MacFarlane, a former governor of the Reserve Bank of Australia, was the effective bar on the four big Australian banks merging or being taken over by each other, which prevented the mass of mergers and acquisitions that so diluted the culture of banks in Europe and the US.<sup>8</sup> Australian banks still made mistakes (including buying US mortgage derivatives). But they did not make them on a scale that might have led to their collapse.

### Time to change

At a top management level, banks from Barclays to Goldman Sachs have launched a

comprehensive review of their culture and practices, often emphasising the need to prioritise customer service over short-term profits. These are thorough-going exercises as financiers spend time and money on deciding who they are, what they do, and how they should do it.

How far such thinking has filtered down the ranks of financial services workers remains open to question. A recent survey by the Financial Services Authority, the former UK regulator, found that junior retail banking staff were still incentivised to sell maximum volumes, rather than to make risk-return calculations.<sup>9</sup> "And this isn't a question of the big earners," says Mr Wheatley, "but of people earning a modest amount, say £20,000 a year and chasing another £5,000 in bonus payments."

As Robert Potter, the chairman of the City HR Association in the UK points out, reform in the financial services industry ultimately means "hiring a different sort of person", quite apart from a deep reorganisation. Changing behaviour means ensuring that all staff members understand the broader picture of banking and ethics, as well as their immediate roles. And this needs to start in the top echelons of the industry, where culture often comes from.

In the next two chapters we explore two of the building blocks of culture in financial services: ethics and knowledge.

<sup>7</sup> Australia went through a period of deregulation in the mid-1980s, which increased competition between financial services firms as they chased rapid balance-sheet growth. Deregulation led to strong credit growth secured against increasingly overvalued assets. As interest rates rose and commercial property values fell in 1989, the risky nature of the loans that had been paid out became evident. The Australian financial services industry saw individual losses exceeding AUS\$9bn between 1990 and 1992. *The Australian Financial System in the 1990s*, M. Gyzicky and P. Lowe, Reserve Bank of Australia, 2000.

<sup>8</sup> "Four Pillars policy our shield against crisis", J. Durie, and R. Gluyas, *The Australian*, March 2009.

<sup>9</sup> "Guide Consultation: Risks to customers from financial incentives", Financial Services Authority, September 2012.



## Rebranding Goldman Sachs

“It was a wake-up call,” says E. Gerald Corrigan, managing director at Goldman Sachs, when describing the US\$550m fine the firm was issued by the Securities and Exchange Commission (SEC) in 2010 for misleading investors about a product tied to subprime mortgages. “The reputational damage required great attention which we attempted to address through the Business Standards Committee report (BCS).”<sup>10</sup>

Goldman’s reaction to the SEC fine was to launch a fundamental review of its business practices and culture, which US firms are required to publish. Many people blame the shift in Goldman’s culture on two things. First, after the bank moved away from its partnership status in favour of a stock exchange listing in 1999, it encouraged a more short-term, profit-centred approach. And second, its 1990s decision to grow in size to avoid being overshadowed by the likes of JP Morgan. That led to a number of deals marked by conflicts of interest: for example, in its work on private equity deals Goldman advised both the buyer and the target company.

The effort going into the review was extraordinary, says Mr Corrigan, consuming between one-third and one-half of the time of the firm’s 400 partners over a three-year stretch. The result of the BCS was a set of 39 recommendations, published in 2011.

But the review also highlighted some of the tensions faced by big investment banks such as Goldman Sachs. Alongside a commitment to prioritise customer service and behave ethically, the bank still lists the commitment to maximise shareholder returns, for example. A 2011 survey of 200 of the bank’s biggest clients found that some of them thought it placed its short-term interests above those of its clients. Some clients also thought the bank’s involvement in proprietary trading actually put it in conflict with its own customers. As a stock exchange-listed company it has little choice over this, but the tension between maximising short-term performance and maintaining a partnership’s long-term view remains.

There is little doubt that the review is a sincere effort at change, with senior managers going on compulsory courses to make them think about the ethics and big decisions, including involvement in any deals worth more than US\$850m, now vetted by a committee including functions such as HR and risk, as well as the heads of the various business units. Mr Corrigan acknowledges the desire to return to something akin to the old, long-term focused partnership model (pointing to the risk committee in support). But how long it will take to mend the damage done to Goldman’s reputation remains open to question.

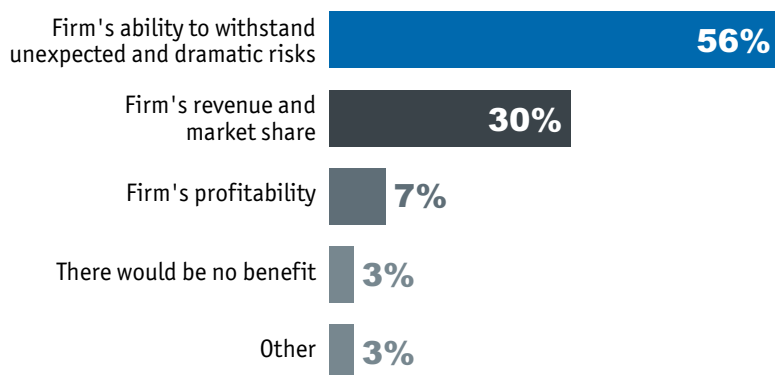
<sup>10</sup>“Goldman Sachs to pay record \$550 million to settle SEC charges related to subprime mortgage CDO”, US Securities and Exchange Committee, July 2010.

## 1

## Ethics in the firm

Chart 1

**Q** Which of the following would benefit the most by an improvement in the ethical conduct of employees at your firm?  
(% of respondents)



Note: percentages were rounded up and may not add up to 100%.  
Source: The Economist Intelligence Unit.

Financial services executives appear to recognise the importance of ethical behaviour. Nearly all (91%) of the respondents to our survey say that ethical conduct is just as important as financial success at their firm. A similar proportion (96%) say that they would prefer to work for a firm with a decent reputation for ethical conduct. The great majority (91%) also agree that aspiring to a set of globally recognised standards would make the industry more resilient.

There is a weaker consensus among executives on the benefits of adhering to a code of ethical conduct. Over one-half (56%) say that stronger adherence to an ethical code of conduct would improve their companies' ability to withstand unexpected shocks. But just 37% of respondents think that better ethics would mean better financial results, despite fines totalling billions

of dollars and the effective collapse of many institutions during and since the crisis (see chart 1).

Ethical conduct might still not be an entirely natural fit with financial services, where over one-half (53%) say that career progression would be tricky without being "flexible" over ethical standards; this rises to close to three-quarters (71%) of investment bankers taking the survey. Across regions, North American and Asia-Pacific respondents tend to agree, while 52% of Europeans counter the claim. Rigid adherence to ethical standards would also damage the firm's competitiveness, say 53% of respondents.

### Bringing out the best

Although there is tension between the importance of ethical conduct to financial services executives and the barriers ethical standards can create for career advancement and competitiveness, financial firms have been trying to work on restoring integrity in recent years. Less than 1% say that their employers have done nothing to improve adherence to ethical standards over the past three years. Just over two-thirds (67%) say that their firms have made staff more aware of the importance of ethical conduct over that time, and more than two-fifths have introduced or strengthened ethical codes (63%) and the system for evaluating conduct (61%) (see chart 2).

More than two-fifths (43%) of respondents' firms have introduced financial or career incentives for respecting the ethical code of conduct, to counter criticisms that bankers have become

Chart 2

**Q What steps, if any, has your firm taken over the last three years to improve employees' adherence to ethical standards across the firm?**

Select all that apply

(% of respondents)



Source: The Economist Intelligence Unit.

for adhering to ethical standards, compared with one-third from retail banking. Noticeably, only 37% from Europe have been given financial or career incentives to be ethical, compared with 50% in Asia-Pacific and 43% in North America.

The use of such an instrument does raise questions about how much banks have changed their ways. If pay packages since the crisis have become more closely aligned with encouraging a risk-averse culture and ethical conduct among financial services employees, then that could go some way towards making the industry as a whole safer. However, it does beg the question of whether the use of incentives means that financial services executives have a tendency to flout codes of ethical conduct, and whether ethical conduct will ever become a norm among financiers rather than a goal.

**Happy-go-lucky or simply deluded?**

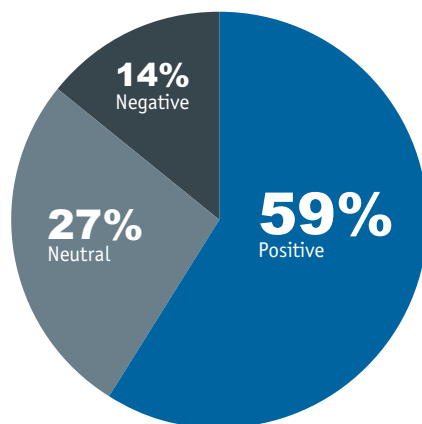
The jury may still be out on whether the financial services industry has seen real change. But the industry's confidence does not waver when it comes to its record on ethical conduct. Perhaps as a result of the action firms are taking, nearly

more motivated by incentives than good conduct. Again, the proportion increases as you go up the risk—and confidence—ladder, and well over half (56%) of investment bankers can get a reward

Chart 3

**Q Rate the financial services industry's current reputation for ethical conduct in your personal view**

(% respondents)

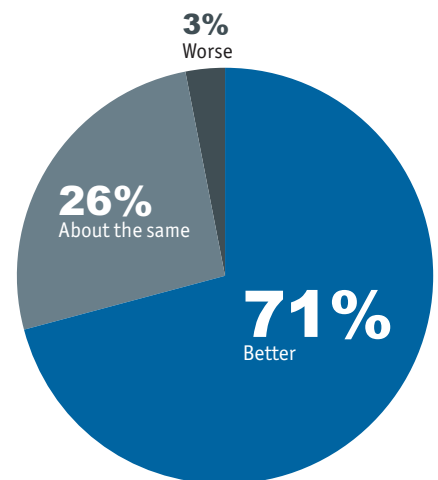


Source: The Economist Intelligence Unit.

Chart 4

**Q In your personal view, how does your firm's current reputation for ethical conduct compare with the rest of your industry?**

(% respondents)



Source: The Economist Intelligence Unit.

three-fifths of the executives surveyed (59%) say that the financial services industry has a strong reputation on ethical conduct (see chart 3). And three-quarters (71%) say that their firm has an even better reputation than the industry norm (see chart 4).

The contrast in attitude between different sectors of the industry and regions stands out. Less than one-half (49%) of asset managers reckon the industry has a positive reputation, as against 70% of investment bankers. Europeans come across as quite uncomfortable too. Only 31% say they have a good reputation on ethical conduct among external stakeholders—a much lower proportion compared with 53% from Asia-Pacific and 51% from North America.

reputation stands in stark contrast to the 2013 Edelman Trust Barometer, an annual survey of global consumer sentiment which found that financial services was the least trusted of all industries, ranking well below technology, the automotive sector, telecommunications and the media. Only 46% of Edelman’s respondents trusted financial service providers to do the right thing; the proportion was higher (61%) among respondents in Asia-Pacific, but lower (29%) in the EU (see chart 5). Nearly two-fifths (59%) of respondents familiar with the banking and financial services scandals say that “the biggest cause” was internal factors, such as a bonus-driven corporate culture, conflicts of interest and corporate corruption.<sup>11</sup> Financial services workers are more confident that the problems have been solved than their customers, it seems.

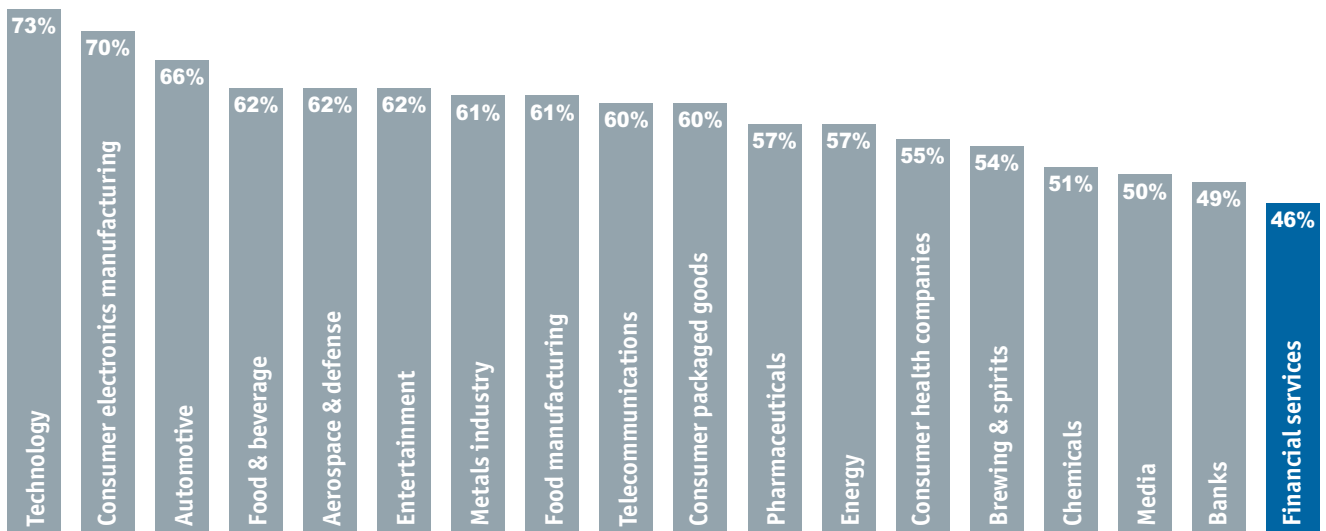
<sup>11</sup> Edelman Trust Barometer, January 2013.

Investment bankers’ confident opinion of their

Chart 5

**Financial services industry is the least trusted to do the right thing by general public**

(% of respondents)



Source: Edelman Trust Barometer, 2013.

## Changing tracks at UBS

It all seemed such a sound idea back in 1998, when Union Bank of Switzerland merged with Swiss Bank Corporation (SBC) to form UBS, a new giant of Swiss banking that dominated the local retail market as well as global investment banking and wealth management. Why, then, did things go so badly wrong with this powerhouse in the crisis? And what can be done to sort out the mess left by a flawed giant that needed a big helping hand from the Swiss state?

The simple answer is that investment banking was allowed to dominate group activity, which led to massive losses: UBS was a heavy buyer of US sub-prime mortgage-backed assets, leading to losses totalling US\$50bn during the crisis. Many blame the investment banking problems on a clash of cultures between the two merged banks, both of which had bought their way into investment banking before 1998.

In 1995 SBC had bought one of the largest London investment banks, SG Warburg, and in 1997 a similar institution on Wall Street, Dillon Read, to become one of the biggest dealmakers in the world. That was a bad fit with Union Bank of Switzerland's acquisition in 1986 of Phillips and Drew, a relatively conservative London stockbroker, wealth manager and hedge fund, along with similar firms in Germany and the US.

The two very different cultures on the investment banking side never truly merged, feeding bad decision-making. In 2007 UBS was the first bank to announce losses from the US sub-prime mortgage crisis. It had set up an internal hedge fund through its subsidiary Dillon Read, which invested its own and clients' money in complex mortgage derivative products. That fed UBS losses of US\$17bn in 2008, the largest in Swiss corporate history.

As the losses mounted, UBS was forced into a series of capital-raising measures, some sold

to outside investment funds and some to the Swiss government (which subsequently sold on a convertible bond issue for a profit). Some of UBS's reactions have been predictable, for example, slashing its investment banking arm by around two-thirds and banning activities such as proprietary trading. However, its moves post-crisis amount to a deep rethinking, and not just to cutting out the bad bits.

Simply put, UBS has redefined itself around wealth management and introduced structures to ensure that its various divisions, from wealth and asset management to retail and investment banking, work together for its clients' benefit rather than operating as separate silos. Investment banking is still regarded as necessary, providing a source of detailed research and product development. But its role has been cut back to those activities that feed the other areas.

Almost more strikingly, there has been a much wider reassessment as the bank rediscovers its wealth-management mandate. Wealth managers and even retail staff have been retrained to focus on advisory services, rather than on selling products. Even the Swiss retail network has been revamped, as UBS accepts both that its home market remains core and its buildings had become a little old-fashioned for modern tastes.

It is a thorough and ongoing exercise, and there are signs that UBS is mending some of the damage to its reputation. As well as improved financial results, it announced in July 2013 that it had regained its title as the biggest wealth manager in the world, growing assets by 9.7% to US\$1.7trn.<sup>12</sup> It is a sign that trust is returning. But UBS remains not only a powerful example of the damage wrought by pre-crisis risk-taking, but also a rare example of a Swiss private bank that lost its way.

<sup>12</sup> "UBS Leapfrogs Bank of America to Top Wealth Manager Rank", G. Broom, *Bloomberg*, July 2013.

## 2

## Safety in knowledge

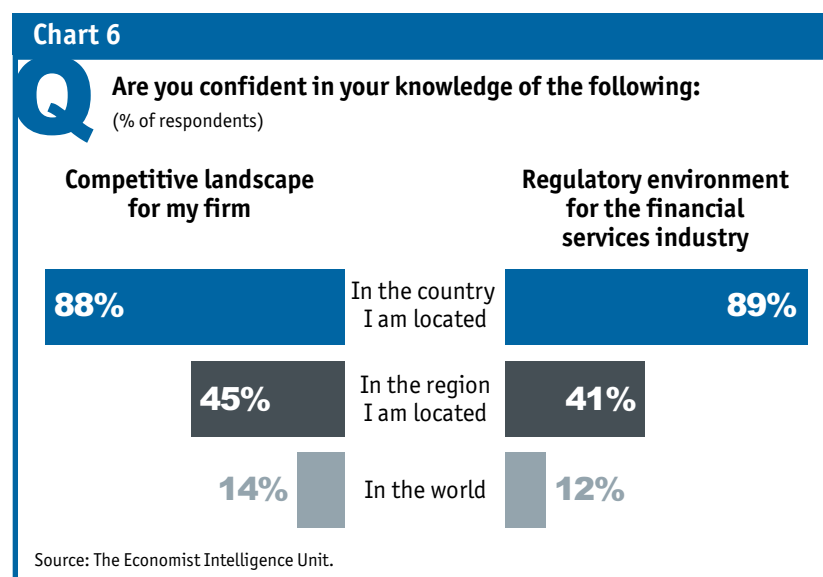
Although nearly all (97%) respondents are confident that they are well qualified for their job, our survey finds a tendency for financiers to specialise. When asked how they could perform better in their job, two-thirds say that learning

regional and national, regulation of the finance industry.

These findings must give rise to concern, considering the litany of complaints of how ignorance drove the financial crisis. Managers

signed off on complex investment products they did not understand. HR departments waved through pay packages that they did not realise were structured to encourage risk-taking.

Respondents to our survey agree that knowledge gaps, such as not knowing what other departments are up to, can increase risk levels: six out of ten



about issues directly affecting their role would be most helpful. However, learning about other departments in the firm would be the least helpful activity. In fact, over three-fifths (62%) report that their colleagues know very little of what is happening in outside departments.

And while they may be confident in the competitive and regulatory environment in their own country, their confidence drops significantly when asked about their region and conditions around the world (see chart 6). This is despite the much-discussed globalisation of financial services and attempts at global, as well as

respondents say that their firm faces a serious threat from gaps in employees' knowledge. Nearly three-fifths (59%) of respondents accept that better industry knowledge is crucial to making their firm more resilient to risk, and essential to understanding an increasingly complex risk environment. Closing knowledge gaps among financial services executives could make the industry as a whole safer.

### Losing control?

Efforts to improve knowledge among financial services employees can be challenging. Dramatic cost-cutting since the onset of the global

<sup>13</sup> "More cuts to take UK financial job losses to 132,000", M. Clinch, *CNBC*, January 2013.

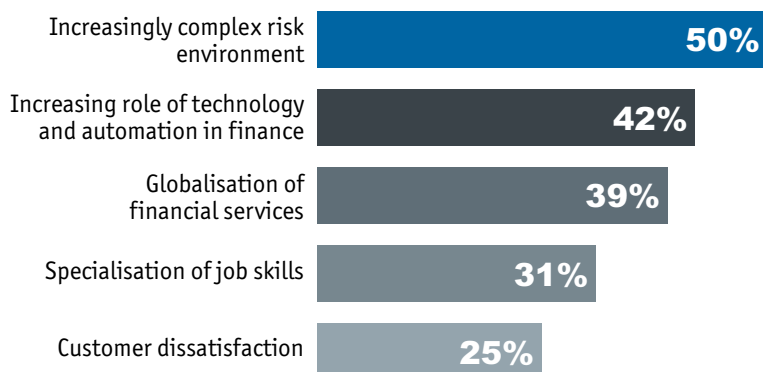
<sup>14</sup> "Financial sector job cuts announced: 200,000", S. Hyman, *Bloomberg*, January 2012.



Chart 7

**Top five reasons to improve knowledge of the financial services industry**

(% of respondents)



Source: The Economist Intelligence Unit.

“  
If you’re going to outsource, you need to be darned sure the company knows what it’s doing

”

E. Gerald Corrigan, managing director, Goldman Sachs

financial crisis has seen hundreds of thousands in the sector lose their job: since the fourth quarter of 2008, 132,000 jobs have been lost in the UK, and 380,000 in the US.<sup>13</sup> In 2011 more than 200,000 job cuts were announced in the financial services industry globally, with most of them taking place in 2012 and 2013.<sup>14</sup> As firms shed employees, they rely more heavily on outsourcing partners to carry out processes that were previously handled internally. That places a heavier burden on remaining staff to control the activities of outside companies on which they increasingly rely.

As part of the research conducted for this report, the EIU surveyed executives working in firms that support the financial services industry, ranging from business processes outsourcing companies to legal firms. Remarkably, opinion among these respondents was split exactly in half on whether employees have a basic understanding of the financial services industry. Only 28% report a good or excellent level of knowledge of the industry, and just 24% say employees have a good grasp of the regulations affecting the financial services industry.

“If you’re going to outsource, you need to be darned sure the company knows what it’s doing,” says Mr Corrigan of Goldman Sachs, who credits

his own firm’s survival of the crisis in part to its development of very sophisticated systems in-house. In other words, if processes such as credit vetting are being increasingly automated and outsourced, the parent bank had better keep a very close eye on both the risks it is running and on how those decisions are being made. According to 42% of financial services executives, the increasing role of technology and automation has made updating knowledge of their industry crucial (see chart 7).

Bob Gach, Accenture’s head of capital markets, makes the argument that big firms like his own can develop a depth of expertise in the areas they cover and develop the systems to make sure that financial services firms obey, for example, risk parameters strictly. “But it’s for the bank to manage its business, set its risk appetite and oversee its client service,” he says. Prasad Chintamaneni, the global head of banking and financial services at Cognizant, an IT services and consulting firm says that financial services firms are implementing significant technology and process changes to evolve a more holistic view of a bank’s global risk across its entire operations. “Clients, counterparties and investors simply didn’t realise the level of risk exposure Lehman had through over-leverage,” he says of the US investment bank that collapsed in 2008. “The current risk-related regulatory compliance initiatives and the overhaul of risk management applications and processes at banking and financial institutions endeavour to mitigate any recurrence of Lehman-like market crises.”

Realistically, with claimed cost savings of up to 50% on offer for some back-office services, according to Mr Gach, financial companies will continue to use outsourcing more heavily as tighter regulation makes capital, and cash, harder to find. Big banks have been looking at it for many years with increasing numbers of mid-sized institutions taking a closer look more recently.

## 3

## Reincorporating culture

“Partnerships must take a long-term view by definition

”

Jon Terry, global head of PWC's HR Consulting Practice

Once firms list on a stock exchange, they tend to focus on short-term results, driven in part by quarterly reporting requirements and in part by the proliferation of short-term investors. In the years leading up to the global financial crisis many banks, encouraged by their stock exchange-listed structure, pursued short-term profits, which contributed, some argue, to the severity of the 2008 meltdown.

In the past, however, a partnership structure was much more commonplace in the financial services industry. “Partnerships must take a long-term view by definition,” says Jon Terry, the global head of PricewaterhouseCooper's HR Consulting Practice. “Senior staff tend to be more focused on their longer-term success, including their own retirement prospects, than on the short-term results encouraged by listed companies' quarterly reporting requirements.”

Many of the institutions that weathered the global financial meltdown either adhered to a partnership structure, such as Pictet, a large Swiss wealth manager, or found ways to emulate it, such as Goldman Sachs (which gave up its partnership status when it listed on the stock exchange in 1999). Others have made a long-term view an integral part of the running of the bank, such as Handelsbanken in Sweden, which does not set its branches sales or financial targets but has grown consistently for 40 years (see box: *Keeping it simple*).

In Switzerland, none of the members of the Swiss Private Bankers' Association hit trouble as a direct result of the crisis, according to the association's general secretary, Michel Derobert.

Pictet has managed to continue expanding since then, using its core private banking skills to expand its presence in asset management. Like many of the Swiss private banks, it remains a partnership at the group level, although this has become trickier as a result of regulatory changes.

In many ways, the most telling point about Pictet is that it was offered, and declined, the complex investment products that proved unsound, from collateralised debt obligations (CDOs, the US mortgage derivatives that made wobbly sub-prime debt seem safe) to Bernard Madoff's pyramid scheme that offered apparently high but safe returns to investors. It turned them down because they were not transparent enough, or because the sums did not add up (as at least one financial analyst told the Securities and Exchange Commission about Mr Madoff's scheme back in 1999).

### Sharing power in financial services

It would be unrealistic for large multinational banks, such as Barclays, to return to a partnership model. But one very concrete question to ask in this context is who controls the bank: investment bankers, retail bankers or those departments that keep risks in check, from human resources to compliance and risk? If such support departments have no say over setting policy, then risks can quickly get out of control.

This is an area at which many financial institutions are looking hard, and where the most convincing solution might be to bring back some of the practices that worked well from the partnership model. According to Mr Derobert,

the ultimate responsibility for human resources usually lies with the bank's senior partner. Choosing the right people is one of the best ways to ensure continuity of culture. Goldman Sachs, a partnership until its stock exchange listing, has introduced a management committee to vet big decisions, in a bid to ensure that departments such as risk and compliance have the same say in decision-making as the heads of the various business units.

"The real challenge is not just to ensure that non-banking staff understand finance," says Peter Cheese, the chief executive of the Chartered Institute of Personnel and Development, "but to ensure leaders of the business, whether their roles are in HR, IT, or more core banking functions, are taking genuinely shared responsibility for the purpose, culture and strategic direction of the business." In other words, these departments need to work in partnership together over running the bank. That is a big organisational shift. It also means that financial services staff need a much wider understanding of their employer, and the industry, to juggle risks and returns effectively, and certainly to manage companies.

### Out of the chaos

Cost cutting, M&A, increasing automation—none of these fits well with the need to foster a single culture at firms. Ideal solutions are tricky to find, certainly beyond the likes of Handelsbanken,

which has operated in the same way since 1970. However, Spain's BBVA does seem to prove that it is possible to forge a coherent entity from a muddle of mergers, acquisitions and international expansion.

"We're a retail bank," says Juan Ignacio Apoita, BBVA's global HR director, "and our focus remains squarely on our retail and corporate customers." And like Goldman Sachs, BBVA has set up a management committee mixing the heads of specialisms such as HR and IT with the heads of the business units to ensure a coherent culture, and approach to risk, across the group. Financial education is taken very seriously, with the bank home to its own university, Campus BBVA.

The strategy has worked well enough for BBVA, formed from the merger of various Spanish banks through 1999, to avoid the worst of the crisis. It did take a hit from the collapsed Spanish property market and accepted funds from a Brussels-led bail-out of the country's banks, but it avoided collapse. Mr Apoita points out that BBVA lost market share to more aggressive Spanish rivals during the pre-crisis property boom, suggesting that some sanity remained over lending policy. And since the crisis the bank has expanded successfully into the US and Latin America as it grows international revenue. "We have the systems and the structures to ensure that foreign subsidiaries follow bank policy," says Mr Apoita.

## Keeping it simple

There are a plethora of differences between Handelsbanken and mainstream banks, according to its CFO Ulf Riese, which taken together mean not that it is risk-averse, but that its whole ethos is about long-term returns rather than short-term profits. First there is its profit-sharing scheme, Oktagonen. If the bank makes a return on equity (ROE) above the annual average of its peers, then every employee receives an equal share of the profit. But this is only payable at the age of 60. The bank has beaten its ROE target for every one of the past 41 years. And an employee who has been in the scheme from the start can now expect a pay-out of more than £1m.

“This is one of the keys to us taking a long-term approach,” says Mr Riese. The other is that “the bank is the branch”. Branch managers are allowed a remarkable degree of autonomy, having complete authority within their own area over everything from marketing spend to credit decisions. That is a big contrast to many universal banks, which are tending to centralise to cut costs. This localised approach explains many of Handelsbanken’s apparently eccentric practices, from refusing to set financial and sales targets for branches to having no central marketing budget.

The important point is that it has worked, allowing Handelsbanken to survive the global financial crisis without help, as well as Sweden’s own serious banking crisis in the 1990s. In fact, Handelsbanken has had the world’s best-performing shares since 1900: £10 invested then was worth £20m by 2009, with very low bad debt levels and a business that has grown impressively since the crisis. It has expanded fast in the UK, growing its network in the country from 60 branches in 2008 to 161 in 2013.<sup>15</sup>

Handelsbanken’s success might take too long to show in financial results for there to be any realistic chance of a stock exchange-listed bank following its lead. But it does show two things. First, that banks can reinvent themselves: Handelsbanken introduced its present system in 1970 after several scandals broke when it was operating as a normal universal bank in the 1960s. And second, that a localised approach such as this avoids many of the problems that blighted banks in the US and Europe.

“Everything revolves around our clients,” says Mr Riese, “and so if things aren’t useful to them, we don’t do them.” That is why it avoided the very complex derivatives products that caused such problems in the US and elsewhere. And that is why it was never tempted to use its small investment banking division for proprietary trading that would have endangered the bank itself.

In many ways that is also the message from Pictet. One of Switzerland’s older private banks, it has expanded rapidly by using its core wealth management skills to expand its presence in asset management, continuing to attract new money even after the crisis. Its senior partner, Jacques de Saussure, credits much of that resilience to its partnership structure, “which means we must have a long-term outlook”. In fact, it has recently incorporated many of its business units to satisfy new regulatory requirements, but its holding company remains a partnership. And, in an echo of Handelsbanken, it avoids aggressive bonus payments for most of its staff, just as it spurns acquisitions in favour of organic growth. “Taking over another company can cause problems with company culture,” says Mr de Saussure.

<sup>15</sup> “Handelsbanken is championing an old way of doing new UK business”, H. Wilson, *The Telegraph*, August 2013.

# Conclusion

Emerging from the global financial crisis, the financial services industry recognises the importance of creating a universal, resilient and pervasive culture based on integrity and mutual understanding. At an industry level, there is little doubt that sincere attempts are being made at change. Industry bodies are teaching non-banking staff about financial products and client needs, and bankers about ethics. And many big banks have launched large-scale exercises to identify and mend their culture and practices to avoid the scandals that have continued to erupt since the crisis.

Both our survey and our interviews indicate the industry has the willingness to change. There is a widespread belief in the importance of ethics among financial services employees, with both anecdotal and quantitative evidence of steps being taken to improve adherence to ethical standards. Executives also report a basic level of understanding of the industry among employees at all levels. They feel prepared for their current role, and see learning about issues that are relevant to their everyday job as a priority to improve performance. Finally, they recognise how a stronger adherence to ethical standards and greater knowledge can be beneficial to their firm's ability to withstand risk.

A number of deep-rooted tensions, however, will make creating a strong culture a big challenge for the industry over the coming years. While executives champion ethical conduct, they struggle to see the benefits of greater adherence to ethical standards, reporting that, in reality, it can hamper career progression in the industry as well as the firm's competitiveness. Also, few see knowledge of other departments and functions as crucial to improving their everyday performance, even though a lack of communication and understanding between functions is often quoted as a factor of the financial crisis.

The pressures firms faced before the global financial crisis—such as quarterly reporting requirements and pleasing short-term investors—will not go away anytime soon. But it is clear that the financial services industry is trying to mend its ways. The key will be to overcome the basic tensions that continue to riddle the industry, and over time see whether the top echelons are doing enough to foster a strong, risk-proof and client-serving culture at their firms.

# Appendix

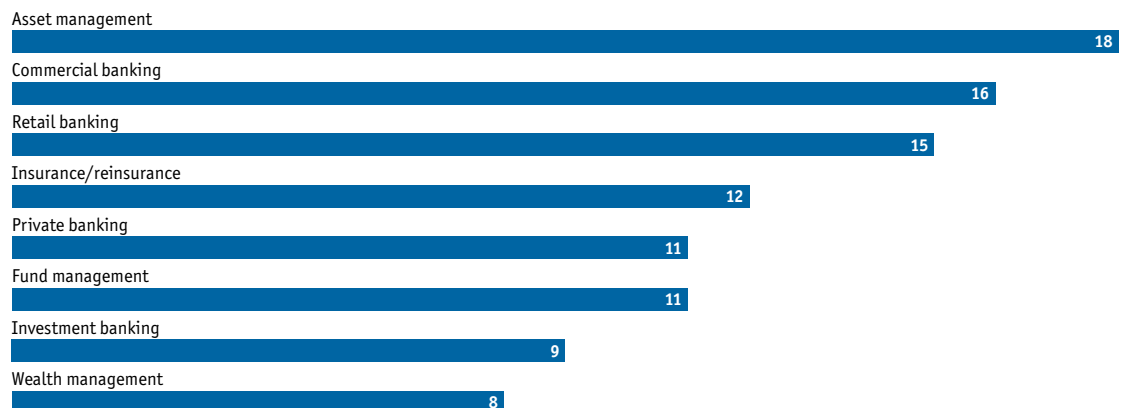
The Economist Intelligence Unit conducted a global survey of 382 financial services executives and 50 executives from firms that support the financial services in September 2013. Our sincere thanks go to all those who took part in the survey.

Please note that not all answers add up to 100%, either owing to rounding or because respondents were able to provide multiple answers to some questions.

The following charts represent responses from financial services executives only.

## In which of the following industries, if any, do you work?

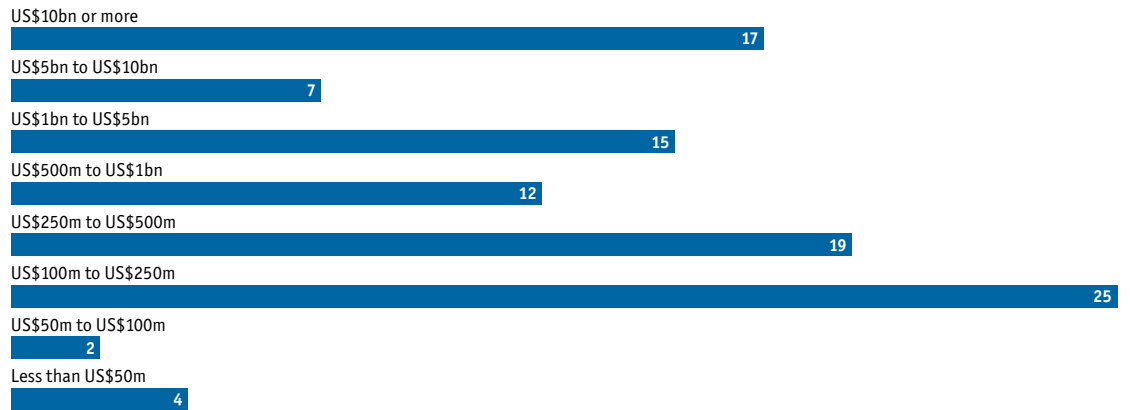
(% respondents)





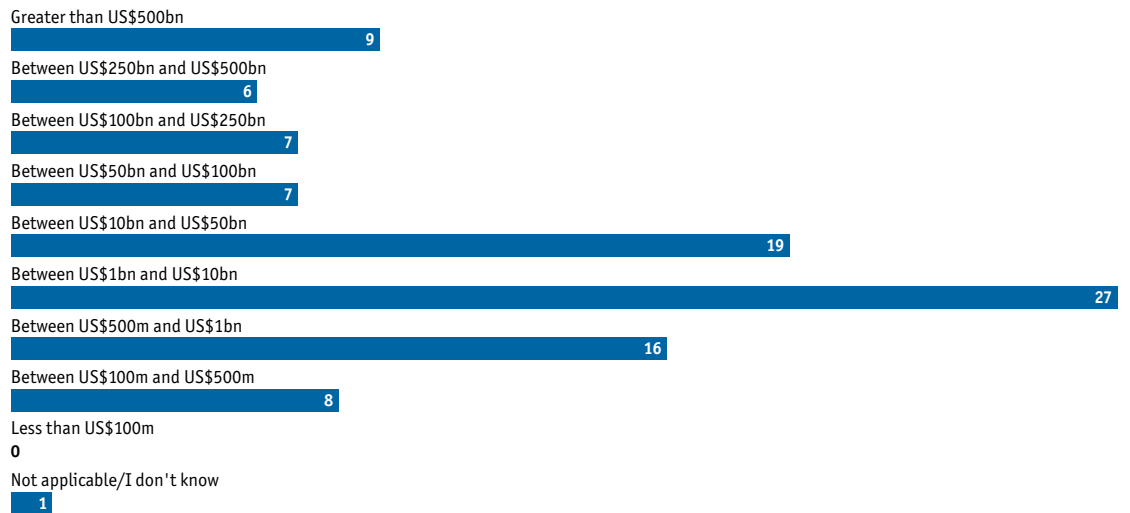
**What are your firm's annual global revenues in US dollars?**

(% respondents)



**Which of the following best describes your firm's total assets under management?**

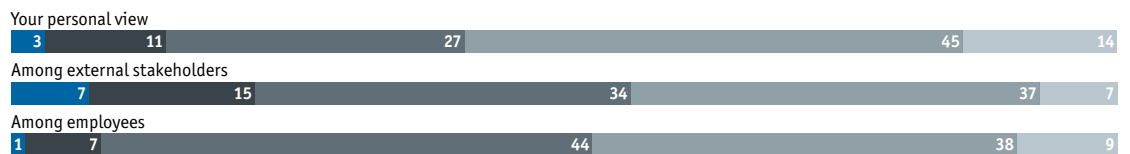
(% respondents)



**Rate the financial services industry's current reputation for ethical conduct on a scale of 1 to 5, where 1 is Poor and 5 is Excellent**

(% respondents)

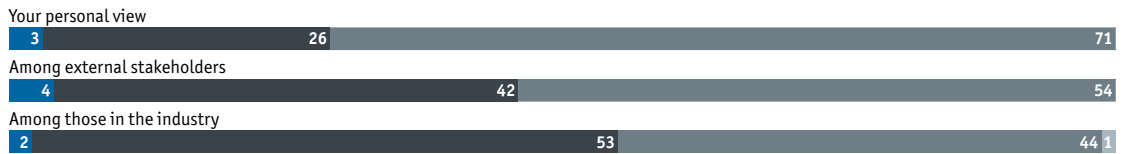
1 Poor 2 3 Neutral 4 5 Excellent



**Compared to the rest of your industry, how would you describe your firm's current reputation for ethical conduct?**

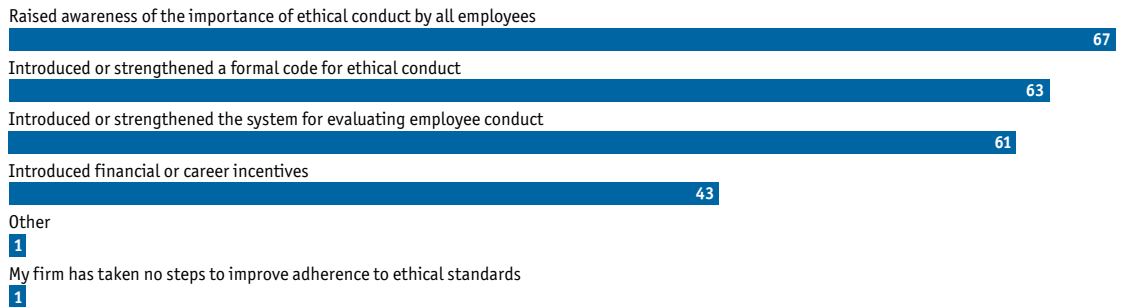
(% respondents)

Worse About the same Better I don't know



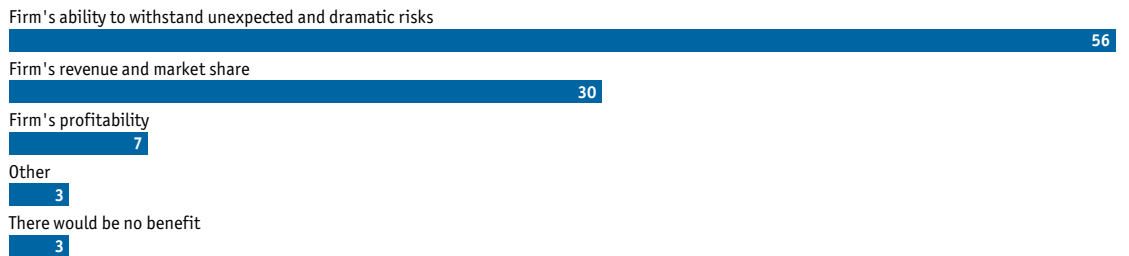
**What steps, if any, has your firm taken over the last three years to improve employees' adherence to ethical standards across the firm? Select all that apply**

(% respondents)



**Which of the following would benefit the most by an improvement in the ethical conduct of employees at your firm?**

(% respondents)



**To what extent do you agree or disagree with the following statements?**

(% respondents)

Strongly disagree Disagree Agree Strongly agree I don't know



**How would you describe your firm's performance in doing the following over the next two years?**

Rate on a scale of 1 to 5, where 1 is Poor and 5 is Excellent

(% respondents)

1 Poor 2 3 Neutral 4 5 Excellent I don't know



**How confident, if at all, are you that if you take action against or report unethical behaviour by any of your colleagues you will have the firm's full support?**

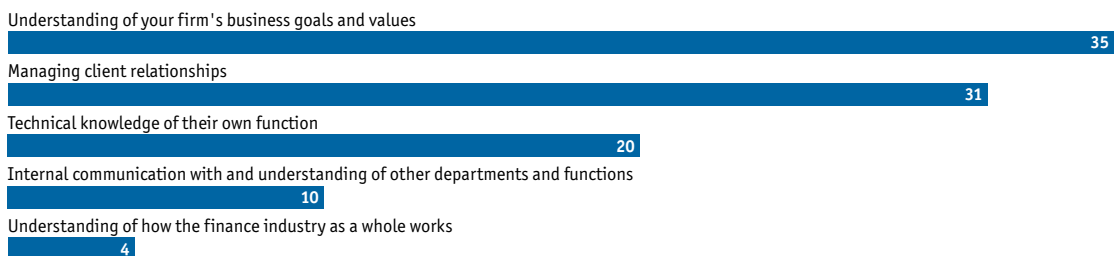
Rate on a scale of 1 to 5 where 1 is Not at all confident and 5 is Very confident

(% respondents)



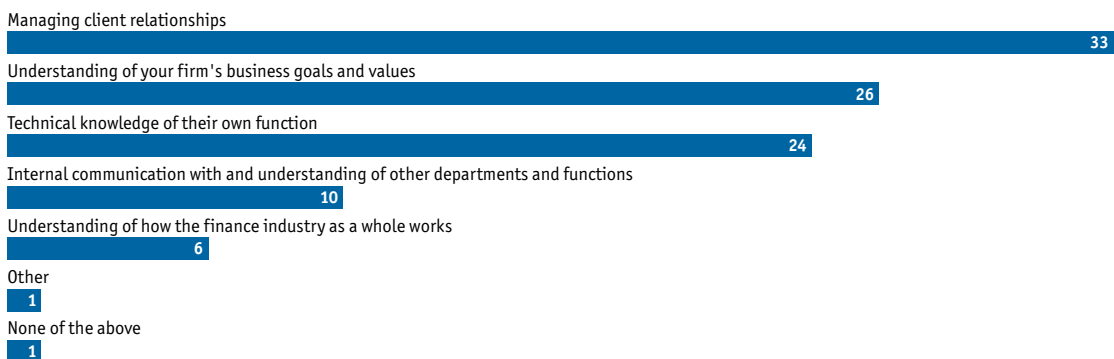
**Improvement in which of the following among your firm's employees is currently the most important priority for your firm?**

(% respondents)



**In your opinion, improvement in which of the following among your firm's employees is most likely to lead to better financial performance?**

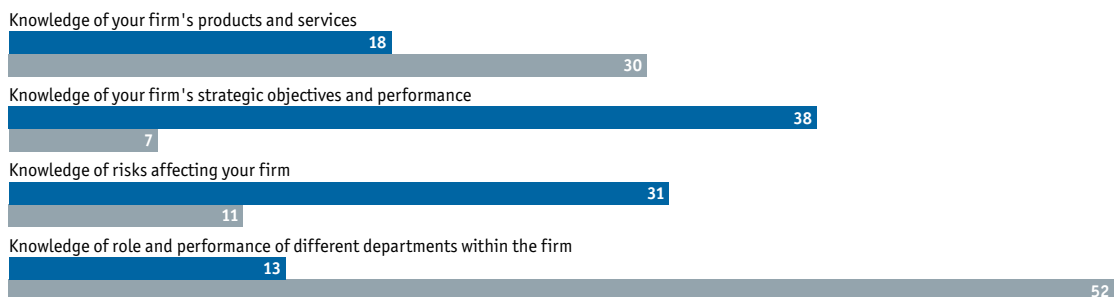
(% respondents)



**Which of the following is the most helpful to your ability to perform your role?**

(% respondents)

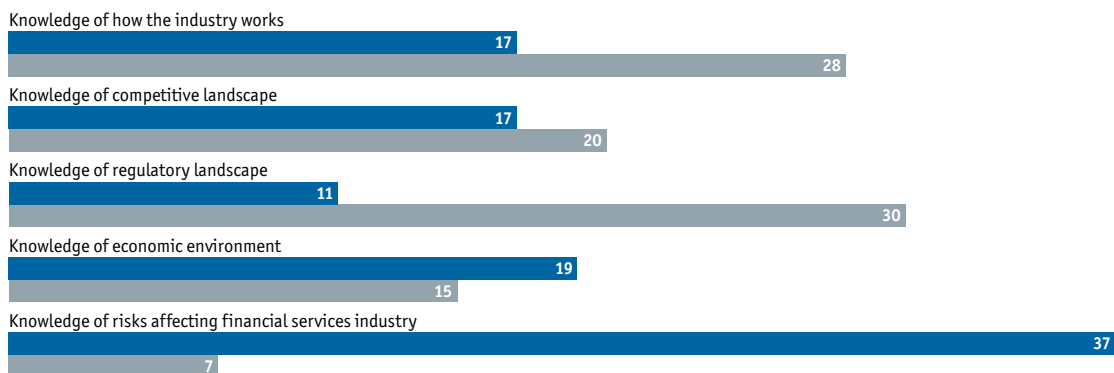
■ The most helpful ■ The least helpful



**Which of the following is the most helpful to your ability to perform your role?**

(% respondents)

■ The most helpful ■ The least helpful



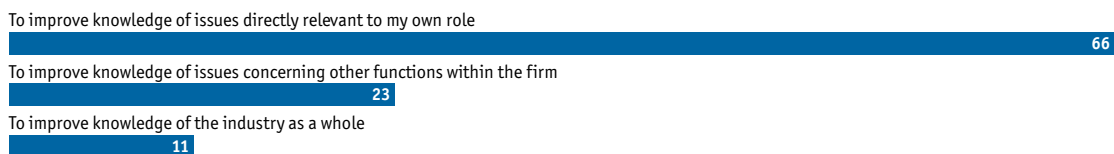
**To what extent do you agree or disagree that your previous knowledge and experience have prepared you fully for your current position?**

(% respondents)



**Which of the following, if any, is currently a priority for you to perform better in your role?**

(% respondents)



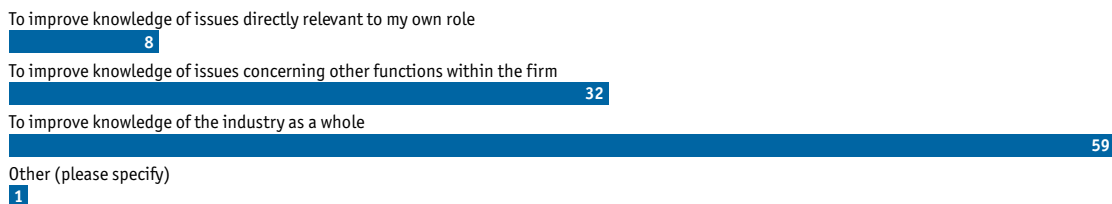
**Which of the following do you think would help you the most in advancing your career in the financial services industry?**

(% respondents)



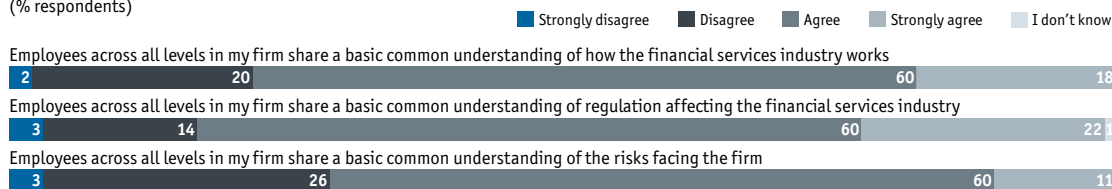
**Which of the following do you think would help the most in improving the resilience of your firm?**

(% respondents)



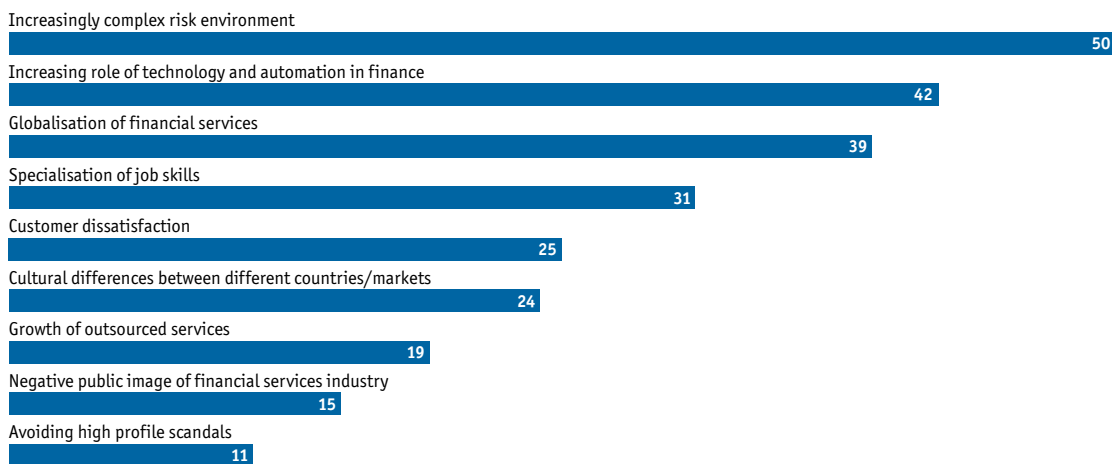
**To what extent do you agree or disagree with the following statements?**

(% respondents)



**In your own opinion, which of the following factors makes it most crucial for those working in or serving the financial services industry to improve or update their knowledge of the industry? Select up to three options**

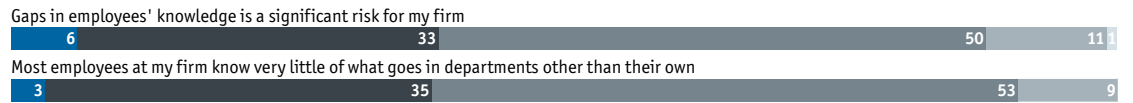
(% respondents)



**To what extent do you agree or disagree with the following statements?**

(% respondents)

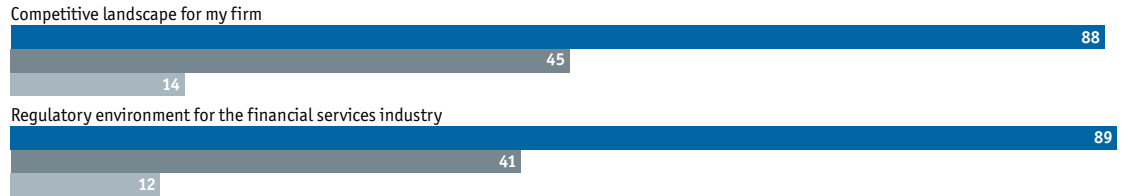
Strongly disagree Disagree Agree Strongly agree I don't know



**Under each column indicate whether you are confident in your knowledge of the following**

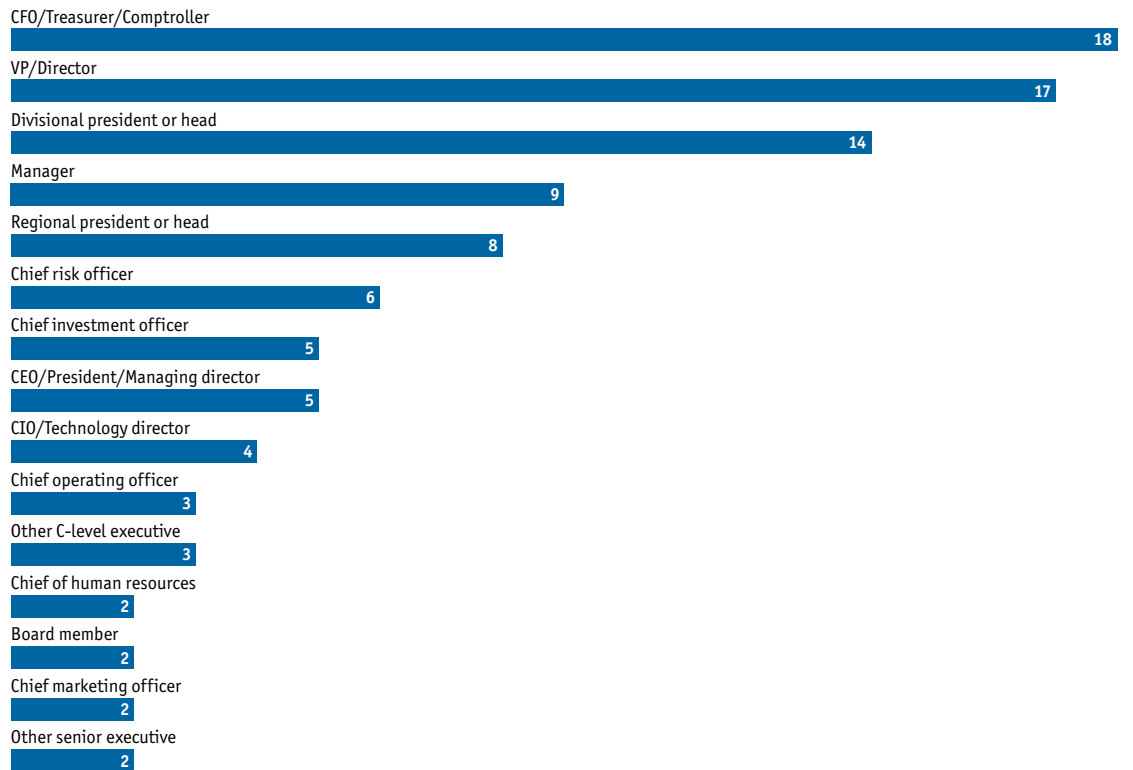
(% respondents)

In the country I am located In the region I am located In the world



**Which of the following best describes your job title?**

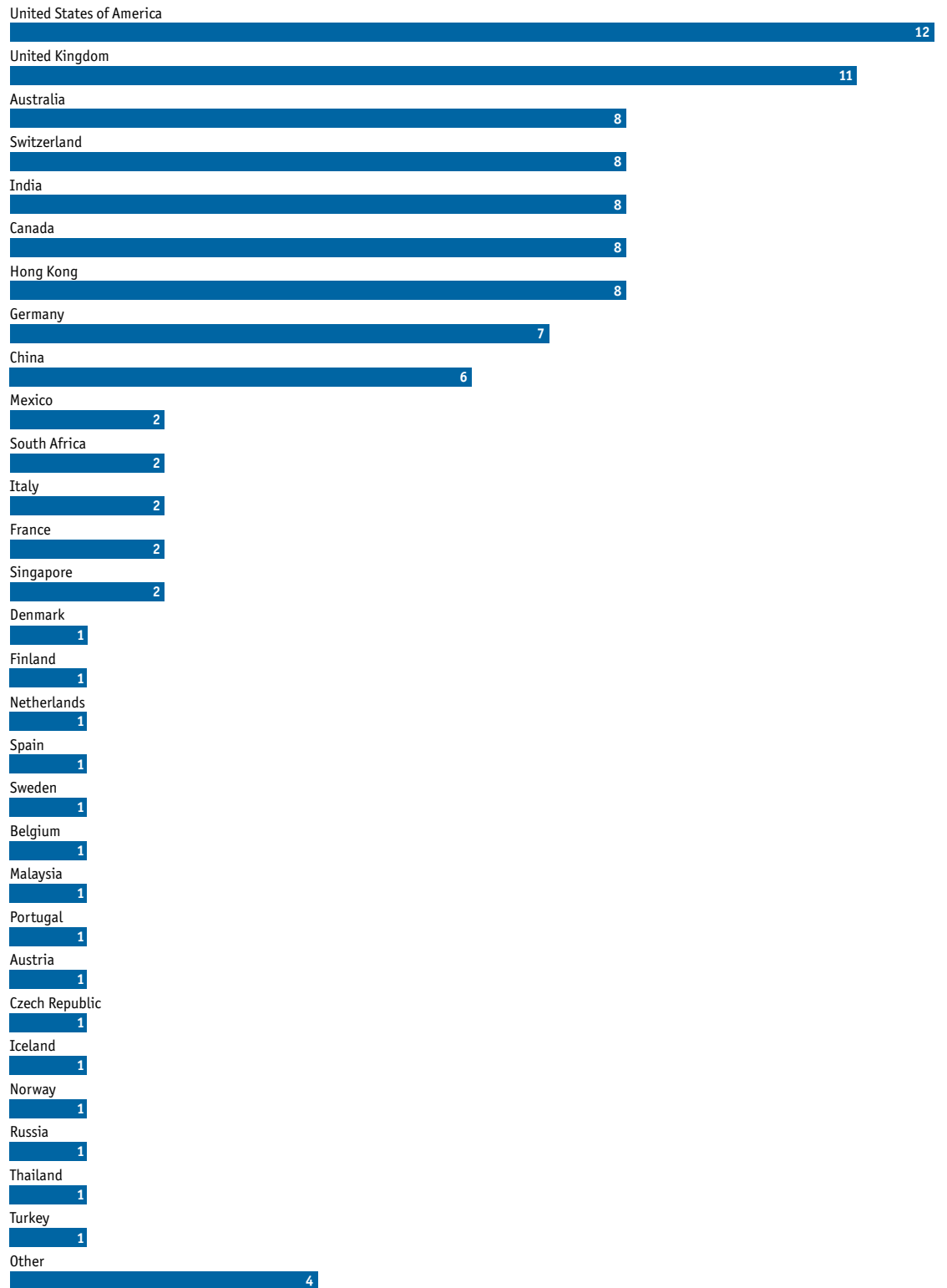
(% respondents)





**In which country are you personally located?**

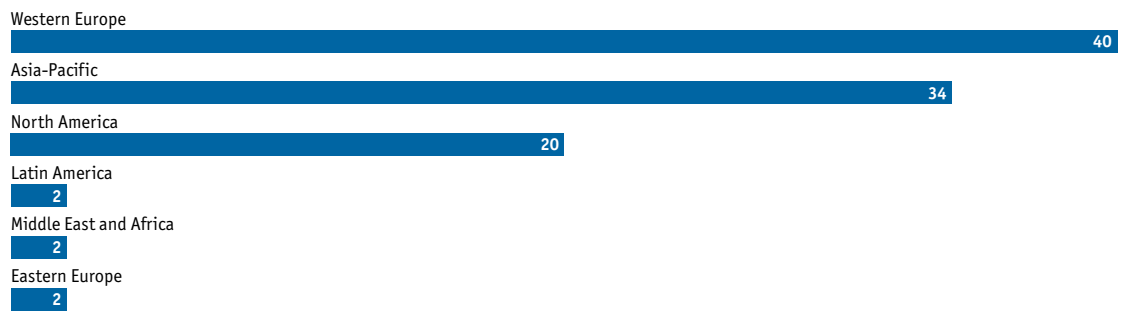
(% respondents)



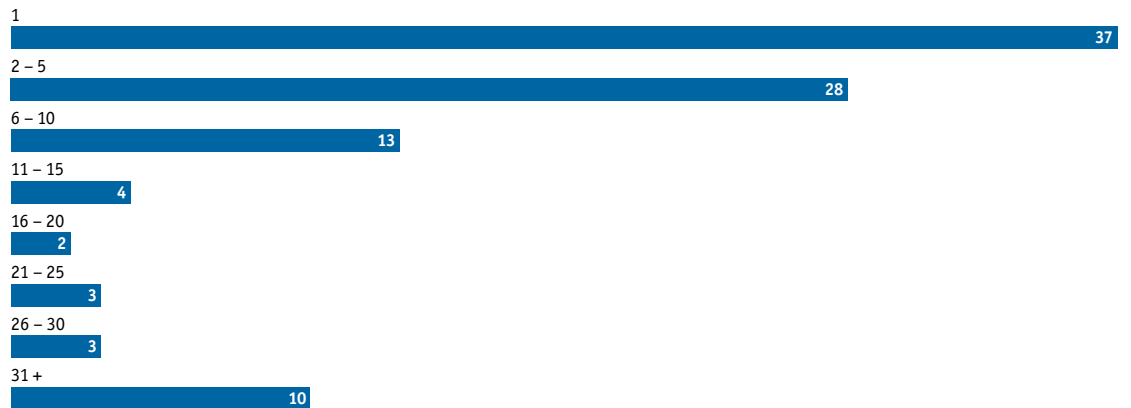
**In which of the following regions does your firm operate?** Select all that apply  
(% respondents)



**In which region are you personally located?**  
(% respondents)



**In approximately how many countries does your firm operate?**  
(% respondents)



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