GOOD LEADERSHIP.

Culture, ethics and conduct in financial services.

December 2016

CII

CMI Chartered Management Institute

CONTENTS

ACKNOWLEDGEMENTS

This paper has been prepared by CMI in partnership with CII. At CMI, the work of Patrick Woodman, Shadi Ghezelayagh and Lysbeth Plas is acknowledged, as is the writing of Richard Brind. We would like to thank David Thomson and Daniel Pedley at CII for their support and insightful commentary. Thanks also goes to Professor Roger Steare and Pavlos Stampoulidis of MoralDNA and Psycholate for their ongoing support.

This report condenses the key findings of previous work conducted by CMI and CII along with some new data. Full details of these reports can be found at the end of this paper and due thanks are extended to their authors.

First published December 2016

British Library Cataloguing in Publication Data
A CIP catalogue record for this report is available from the British Library
ISBN: 0-85946-620-5

FOREWORDS
ANN FRANCKE

Ann Francke MBA CMgr CCMI FIC
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Businesses whose managers display strong values tend to outperform those without a moral compass over the long term.

In any sector of the economy, good leadership is about how things get done, not just what gets done.

That's especially true of the financial services sector. But the evidence of recent years suggests that how things get done has too often been a distant second to the drive for profit at any cost.

Mis-selling, rate fixing and rogue trading have tarnished the reputation of a sector that is not only critical to the UK's economic health, but remains a world leader. Preserving that hard-earned status in a highly competitive global market – especially in the face of political and economic uncertainty – demands that leaders redouble their efforts to improve company culture.

Of course, financial services haven't been alone in the spotlight. Off-shore lawyers, car manufacturers, supermarkets and global internet giants have all been in the dock. The exposure of rotten management cultures, customer rip-offs and skewed company priorities has sparked public outrage and undermined trust.

But financial services clearly have particular responsibilities, not least in facing a changing regulatory environment. Leaders have to enable, empower and reward people to do the right thing, not just the thing that looks profitable in the short term. Without strong ethical cultures, regulation and compliance will never be enough.

And there's a significant upside for businesses who embrace the challenge. Businesses whose managers display strong values tend to outperform those without a moral compass over the long term. They're likely to have more engaged and loyal staff, and more satisfied customers.

So I'm delighted to partner with CII on this paper. We both have an important contribution to make, by setting professional standards and developing great leaders who deliver excellent performance, sustainably and ethically. We hope this paper provokes discussion about how best to do that.

By working together we can help to restore confidence in the financial services sector after the often self-inflicted harm of the past decade.

December 2016

SIAN FISHER

Sian Fisher ACII Insurance Practitioner
CEO, Chartered Insurance Institute (CII)

We must aspire to 'go beyond compliance' and drive up ethical standards across the industry.

The new regulatory focus on business culture is an opportunity for individuals and firms to improve public confidence in the financial services sector. However, it is no longer enough for individuals and firms to simply 'comply' with regulators such as the Financial Conduct Authority – we must aspire to 'go beyond compliance' and drive up ethical standards within our industry.

The Chartered Insurance Institute (CII) is committed to supporting businesses across insurance and financial planning in raising their standards, particularly in the field of ethical behaviour. Our Code of Ethics provides a framework for individuals, complemented by wide-ranging materials that give our members further support on their journey to professionalism. However, in a highly regulated world it is important professional bodies help firms develop good culture. Doing so will benefit the sector as a whole.

As with many issues, senior managers play a hugely important role in setting the ethical tone of their organisations. In large firms leaders cannot so easily connect with every individual employee, but they can send strong signals to their workforce about what is expected and ensure that middle managers are engaged and empowered. In small firms the leaders often are the culture of their firm, which presents challenges of a different nature. Regardless of the size of the organisation, it is essential that staff feel empowered to discuss difficult issues and challenge those in more senior positions.

The CII's Chartered Firms initiative is one example of firms committing to voluntarily raise standards on behalf of the public interest. We hope, and expect, to see other significant changes in culture in the months and years to come, and we will continue to support our profession's leaders in driving up standards.

This report is another stepping stone along that path and I hope that you find it thought provoking.

Sian Fisher

December 2016

WHY CARE ABOUT ETHICS?

Recent history is littered with cautionary tales of failures in business ethics. There is an ever-lengthening list of businesses which have become the focus of outrage across society for their misdemeanours – and which have seen the destruction of financial value and jobs alike.

BHS collapsed with the loss of 11,000 jobs after apparent mismanagement. $15bn was wiped off Volkswagen's value as the emissions scandal emerged: it faces more than 200 lawsuits from global investors and has agreed a settlement in the US of $14.7bn, with the likelihood of further fines in Europe. News International was effectively forced to close the News of the World in the wake of the phone hacking scandal.

Business ethics have also been criticised over tax avoidance and evasion. Global tech giants like Amazon and Google have faced criticism and investigation for their tax arrangements, with Google offices raided across Europe as part of inquiries. And the giant leak of more than 11.5 million financial and legal records from Mossack Fonseca in April 2016 led to widespread outcry.

It is surely the financial services sector which has faced most scrutiny in the wake of the banking crisis of 2007-08. The catalogue of errors, failures and fines is familiar but remains breathtaking. Malign management cultures were exposed after the collapse or near-collapse of banks as the sub-prime bubble burst. Banks have paid fines worth over $10bn over the manipulation of foreign exchange rates. And the protracted saga of PPI mis-selling settlements has, by one assessment, cost £37.3bn – or four times the cost of the 2012 London Olympics[1].

These failures have coincided with a wider sense that business leaders are becoming further and further divorced from society. Their pay is seen as continuing to spiral upwards while the wages of most of their workforces have stagnated. The rise of the internet and social media have transformed expectations for transparency, putting new pressure on businesses. Meanwhile, the political landscape is changing at a remarkable pace, most visibly with the Brexit referendum vote. Anger at 'elites' is visible across Europe and America.

At a time of political and economic uncertainty, good management and leadership is at a premium. Ethical leadership must be part of the response.

The business case for ethical frameworks

Against this backdrop it may be tempting for businesses to think about ethics from the perspective of damage limitation. But focusing solely on the negatives is to ignore the significant commercial opportunities. As detailed in this report, there is good evidence that organisations which embed ethical cultures tend to be more successful.

What's more, a focus on operating within the letter rather than the spirit of the law can backfire badly. It is crucial for any company to ensure its employees understand and champion its values and understand why it actively wants to be doing 'the right thing'. That is especially true of regulated financial businesses.

As such, the role of senior managers and boards in setting the ethical tone of a company is absolutely fundamental. Without a clear tone from the top, there is the risk that junior employees operate robotically, complying with rules and regulations without ever engaging with their spirit.

[1] https://www.theguardian.com/money/2016/apr/11/misconduct-has-cost-uks-banks-53bn-over-15-years-ppi

MANAGEMENT ETHICS IN A REGULATED ENVIRONMENT

Since the banking crash there has been an increasing focus on culture and conduct in financial services. The enhanced scrutiny of how these firms and individuals behave is partly due to the architecture of the current regulatory regime, with the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA) bringing increased attention to their respective areas of interest. The work of the Parliamentary Commission on Banking Standards has also ensured a continued focus on the legislative and regulatory framework.

One major effect of these changes is the Senior Management Regime: enhanced requirements to hold to account senior managers and other key individuals. Much of what they contain reinforces what is already seen as good practice and as such is appropriate for wider application across all firms. Although the new requirements only apply to banks and insurers now, and not smaller brokers, they will be transferred over to other firms by 2018. The direction of travel is clear.

The CII paper, *Developing a culture of personal responsibility in a regulated environment,* examines how financial services regulation impacts on the development of an ethical culture. It highlights those parts of regulation that can assist in securing an ethical culture and behaviour and the changes under way in conduct risk structure. Personal responsibility and individual accountability is becoming an integral part of regulation. This reinforces both the importance of responsibility in an ethical sense, but also the importance at an enterprise level of getting the culture of an organisation right.

Because whilst regulators can compel businesses to take action, regulatory compliance in itself is not enough. Firms must take ownership of their ethical cultures with support from their professional bodies. During the boom years, there were too many voices whispering, or indeed arguing openly, that the financial services industry should do no more than meet the bare minimum regulatory threshold standard.

Subsequent events have shown the vulnerabilities of this approach. As the sector slowly rebuilds trust, the core value must be the aim of doing the right thing – not because it is obligatory, but because it is right. Quite aside from questions of morality, this also happens to be the best approach for clients and customers, and therefore the only way to build successful and sustainable businesses.

Initiatives such as the Financial Reporting Council's (FRC) Culture Coalition show that businesses are taking steps to address their issues. There is, however, undoubtedly still much work to be done.

"The financial crisis and the conduct failures which subsequently came to light have had far-reaching effects. They highlighted fundamental errors made by both firms and regulators. They identified deficiencies in the regulatory framework and structure. And they called into question some of the most fundamental aspects of fair dealing and integrity for which London's financial markets are known. And the response has been an unprecedented wave of legislative, regulatory and structural change and a deep, and critical, re-examination of the cultures, behaviours and incentives – of regulated and regulator – that created the conditions which allowed this to happen."

Tracey McDermott, CEO of the Financial Conduct Authority, October 2015

A VOICE OF EXPERIENCE – COMPLIANCE IS NOT ENOUGH?

Nick Leeson

In conversation with CMI in early 2016, Nick Leeson, the man at the centre of the collapse of Barings Bank more than two decades ago, spoke out about the managerial and cultural failings that led to the bank's demise – failings which remain all too common today.

Leeson makes the point that regulation alone is not enough to address the issues facing financial services. Not only is there a long history of subverting such rules in the sector, it needs to be absolutely clear why the regulation is there in the first place.

"Whatever constraints you try to impose on the industry, banks are the absolute best at getting around them."

As such, it is essential to foster an ethical culture where staff embrace the spirit of regulation: they know why the regulation exists, why the company chooses to actively apply and promote it, and why it is beneficial for them and the company.

It also means creating a culture where issues can be discussed openly and without fear of reprisals. Leadership from the top is essential in this respect and something that was sadly lacking at Barings. The chain of events that led to the collapse began when Leeson hid the errors of a junior colleague from a senior colleague.

"He was not a very approachable person. He was a pretty nasty man. He wasn't very good with the local employees and would often belittle them in front of other people."

Environments such as this naturally tend to incubate dishonesty – it is easier to lie than to discuss bad news when faced with hostile managers. Compounding the lack of transparency within Barings, senior staff had been reshuffled into roles they had insufficient knowledge of. This meant that in addition to being motivated to lie, junior staff were also more able to do so and get away with it.

"I was able to fob them off with completely ridiculous stories that had no merit and would not have withstood any sensible form of investigation or interrogation."

With alarming speed, a flawed culture and poor leadership caused a relatively small issue to become a billion dollar disaster.

THE COMPETITIVE ADVANTAGES OF AN ETHICAL CULTURE

The financial services industry has already learned to its cost the downsides of remuneration packages which prioritise short-term returns over long-term growth. Poor ethical frameworks, which incentivise employees to game the rules and effectively reward staff for providing clients with a poor service, have had a hugely detrimental impact on the financial health of many companies. However, the benefits of a strong ethical framework extend far beyond issues of disaster avoidance.

Research by CMI has shown that staff in organisations where managers have a strong ethic of care, meaning they act with consideration to others, and a strong ethic of reason, meaning they think logically, perform better in terms of both staff satisfaction and the ability to attract new staff[2].

A stronger focus on care and reason are particularly important as younger workers join the industry. Research from Net Impact has highlighted the importance of working in a positive, value-driven culture for Generation Y workers born in the 1980s and 1990s.

Simply put, if your company has poor ethical structures, you will find it harder to recruit new employees and staff retention is also likely to suffer[3].

But it's not just about staff satisfaction. CMI research shows that businesses whose managers take decisions informed by empathy for others and by being mindful and logical – instead of blind compliance with rules – tend to have happier customers[4].

MoralDNA: The ethics of reason, love and obedience

[2] *The MoralDNA of Performance*, CMI, 2014
[3] *What Workers Want in 2012*, Net Impact, 2012
[4] *The MoralDNA of Performance*, CMI, 2014/2015

ETHICAL RESILIENCE

Ethically resilient businesses need a senior leadership team which reacts to unexpected issues with speed, energy and reason.

Ethically resilient cultures are becoming more and more important in a volatile world where news – particularly bad news – travels at a previously unimaginable pace.

Stakeholders in businesses are now looking beyond financial results and growth prospects. There is an increasing focus on how businesses behave when the unexpected happens; a demand that their underlying culture should be strong enough to withstand adversity and allow the business to emerge stronger and with their reputation intact. Put simply, stakeholders expect ethical resilience.

The Cattellyst Consultancy and The STANCE Partnership, working on behalf of CII, recently published research into this complex topic, highlighting the typical attributes of ethically resistant businesses[5].

Firstly, leadership is vital. Ethically resilient businesses need a senior leadership team which reacts to unexpected issues with speed, energy and reason – while they may not be in control of the event itself, they are in control of their actions. The leadership team also needs to ensure consistency between the ethical tone they set and the processes within the business – for example by ensuring that bonus schemes do not encourage unethical behaviours.

Consistency is also important when it comes to the values of employees. The most resilient companies tend to be those where there is no disconnect between the values expected in the workplace and the values in their employees' personal lives.

Finally, when mistakes are made, ethically resistant businesses fully engage with them, rather than sweeping them under the carpet. Staff feel able to raise issues in the knowledge that they will be dealt with openly and fairly. The business needs to learn from these mistakes and work to ensure that they are not repeated.

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[5] http://www.cii.co.uk/media/7089125/creating_and_sustaining_an_ethically_resilient_culture.pdf

HOW WELL ARE COMPANIES AND MANAGERS PERFORMING?

At an organisational level, there is clear evidence that managers are aware they could do better in terms of defining the ethical position of their organisation.

CMI asked managers about their company's definition of its values and the way that it determines success[6]. These answers were combined into a 'Purpose' scale which provides a measure of whether an organisation, at a basic level, has a clear ethical compass.

Less than half of managers rated their organisation positively when it came to specifying its Purpose, suggesting that there is a fundamental issue at a company-wide level. How can staff understand what is expected of them when the company itself doesn't understand or communicate those expectations? This is borne out by further research which found that less than a fifth (17%) of UK workers were aware of their organisation's values[7].

CMI also found that almost a third of managers (29%) said that their organisation was mediocre or plain poor when it comes to standards of ethical behaviour and this was a particular issue in larger organisations[8]. The financial services fared badly as a sector, with its managers giving it amongst the lowest rankings in terms of ethical performance.

29%
of managers said their organisation was mediocre or plain poor when it comes to standards of ethical behaviour

[6] For the Commission on the Future of Management and Leadership, 2,113 managers (split almost equally between CMI members and non-members) were interviewed
[7] *Managers and the Moral Maze*, CMI, September 2013
[8] *The MoralDNA of Performance*, CMI, 2014/2015

LEADER INTERVIEW: ETHICS IN CONTEXT

Where do ethics belong in the context of the wealth management industry? Here the director of audit for one of the UK's biggest wealth management firms explains why having the right culture is crucial when you're entrusted to manage other people's money.

Ethics has been a focus for all financial services organisations, including wealth management firms, since the financial crisis struck. "Unless you're an ethical organisation, I don't think you will survive," says the director of audit.

"Organisations are made up of people and people have choices as to whether they interact with your organisation in a way that sustains its existence over the long term. If you're not careful, you can turn people away from you. Also, an unethical organisation is unlikely to exist without running into the rule of law at some point."

He adds that besides incurring heavy penalties from regulators, financial firms that do not behave ethically could suffer substantial reputational damage. "There will be a group of people, particularly your staff, whom you depend upon to keep your business going. If they don't feel that they are being treated ethically, they can organise themselves very quickly and very publicly against you, which can impact your business. This risk has become much more pertinent and immediate for businesses in the age of the internet."

Culture needs to be cultivated

Having worked for various different financial services institutions over the years – and having witnessed some major cultural failings during that time – the director of audit believes that organisations need to be proactive about taking care of their cultures.

"If organisations don't maintain their own cultures, they can end up with 'a wisdom of crowds' where ordinary employees come up with their own rough-and-ready, but perfectly acceptable, culture of ethics. I have known other firms that altered product types in ways that the bulk of the people in the organisation did not agree with. Those products never met sales targets, because advisers wouldn't get involved in selling them or recommending them to the customers that they interacted with."

Setting the tone at the top

It is down to senior leaders and managers to set the official culture in a financial services firm. The challenge for them is to set the right culture, particularly since this is a sector where people are heavily incentivised to bring in large profits.

"It's much easier for senior leaders to create a culture that has bad outcomes for the organisation and wider society, as opposed to a positive culture," says the director of audit. "That's because management is subject to pressures that need to be dealt with in the short and medium term, which can lead to them cutting corners and turning blind eyes.

"So leaders must have a very clear idea of what their own personal values are. They've also got to publicise those personal values, and test things against them, particularly when they're engaging with their immediate leadership team. They need to be consistent."

The director of audit compares the creation of company cultures with the formation of stalactites and stalagmites. "Single drops of water make these mighty structures in caves. In the same way, culture is created by a series of actions and comments by leaders, who are in a very powerful position within companies."

Changing for the better

According to the director of audit, his firm knows it must be clear on what it likes and dislikes about its culture.

"As an industry, we need to be prepared to part with the wrong people, even if those wrong people are doing well according to some metrics. In financial services, that means dropping your star trader if there is incriminating evidence against him or her. We also need to be careful about preserving and nurturing the good parts of our culture."

The firm has a code of ethics that is at the front of all of its staff handbooks, beneath the CEO's signature. "The code is described as a touchstone for reflection and a guide to action and its main purpose is to assist the members of our community to align themselves with our values and beliefs. A good example is that we ask people to show respect for everyone they work with, and consider what impact their actions will have on their colleagues and their welfare, balancing the need to achieve or gain from a situation with respect and care for one another. I don't recall seeing a description like this elsewhere in my commercial career."

In addition, the firm sends its clients a questionnaire asking them what they think about the firm and how they would characterise their interactions with it. "We also communicate with them about the way in which they should expect to be treated. This has some very practical business benefits. If clients have been treated in a way they don't like, they've got something to refer to. Rather than just taking their business to another organisation, they have got a route through which they can come to us and say, 'I don't think I'm being treated properly'."

WHY DO SOME MANAGERS BEHAVE UNETHICALLY?

The question of why some managers have poor ethical standards at work is complex and the MoralDNA series of reports from CMI[9] and EY have looked in depth at these issues.

There will always be those who seek to use – or misuse – the system for their own personal gain. But it's not as simple as that. There are three headline points that are worth bearing in mind when thinking about how you and your colleagues approach ethical issues:

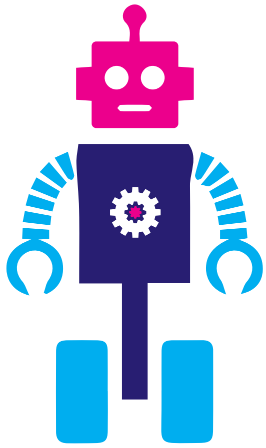
1. There are strong links between a manager's personal background and their ethical behaviours
2. Many managers behave more ethically in their home life than they do at work
3. Financial services leaders suppress empathy and are less concerned with outcomes

1. Managers' personal backgrounds and ethical behaviours

CMI's MoralDNA research has shown that a wide range of background factors influence managers' core approach to ethics. For example, as managers grow older their tendency to follow rules decreases and they tend to think more independently. At the same time they become more likely to follow their own moral principles. Another example is gender: women demonstrate more empathetic qualities than men and political affiliations and religious beliefs also correlate with different ethical approaches.

As such, the ideal business is made up of employees of different backgrounds, genders and belief systems to ensure a balance of ethical approaches – a company where everybody robotically follows rules without applying any critical thinking is likely to run into problems, as is a company staffed only by loose cannons and blue sky thinkers. There is always a balance to be found.

Senior leaders and boards – and their companies – would benefit from stepping back and asking whether their business has the diversity that it needs to find this balancing point. Are the employees at risk of falling prey to flocking behaviour when push comes to shove on ethical matters? And is their own background or life stage subconsciously influencing their approach to ethics?



A company where everybody robotically follows rules without applying any critical thinking is likely to run into problems

[9] *Managers and Their MoralDNA / The MoralDNA of Employee-Owned Companies / The MoralDNA of Performance,* CMI, 2014/2015

2. Managers are more ethical at home than at work

Another key point from the MoralDNA research is that there is significant dissonance between managers' ethical behaviours at home and at work. In the workplace managers become more compliant and less caring in their ethical decision-making than they are in their personal lives. This is a phenomenon which occurs across almost all segments of the managerial workforce, regardless of gender, age or occupation.

This is an important point, particularly in the financial services sector, because the regulatory response to wrongdoing in business is often to create more rules that must be obeyed. To some extent, this approach is based on the false assumption that people have no conscience, cannot be trusted and therefore must be told what is 'right' to a level of detail that overwhelms them. Sadly, history demonstrates clearly that when people 'follow orders', then human beings are capable of the most appalling atrocities. Again, there is a balance to be found.

This prompts a number of questions. Does the moral compass of you and your colleagues shift direction on the journey from home to work? If so, why? To what extent has your business adopted a command and control approach to ethics rather than seeking to ensure that your staff actually understand the importance of ethical behaviour?

3. Financial services leaders suppress empathy and are less concerned with outcomes

Looking specifically at the financial services sector, the research by Roger Steare and EY shows that the heavily regulated culture of the financial services industry drives compliance with rules and consideration of principles, but suppresses empathy[10]. It appears that 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. The question is whether this is the culture that regulators and firms really want.

Focusing specifically on the role of senior management, 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, do we need to think more deeply about the examples being set by those appointed to senior roles?

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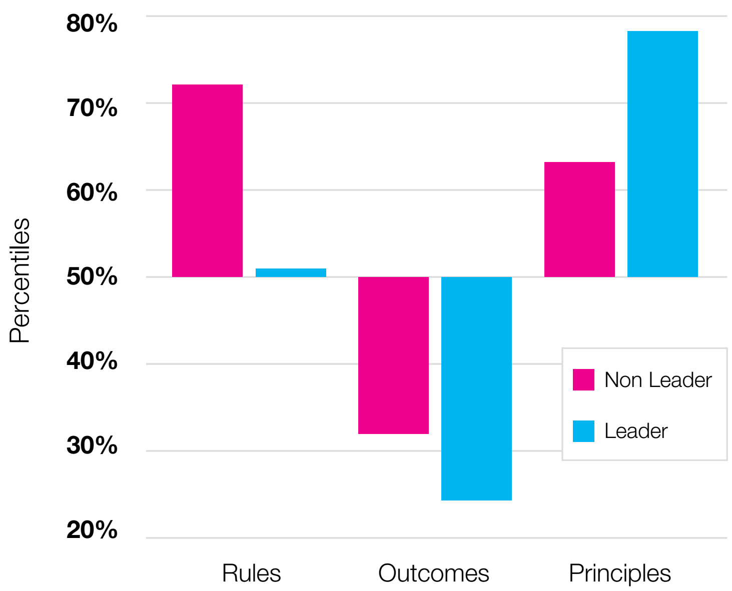


MoralDNA findings July 2016

[10] *The challenges of risk, culture, behaviour and corporate integrity in financial services – Findings from the MoralDNA™ of culture and conduct in global financial services*, Roger Steare & EY, 2015

SPOTLIGHT ON CORPORATE CULTURE

Professor Roger Steare

Professor Roger Steare is Corporate Philosopher in Residence at Cass Business School and founder of MoralDNA™. He has extensive experience in working to improve corporate cultures in the financial services sector. Here he explains what a good working culture actually means and how it can be improved.

Culture at work is human

Culture at work is a human phenomenon that is best understood through the human sciences, the social sciences and the humanities – not through the simplistic binary lenses of either the accountant or the auditor. Rather than being about power, hierarchy, ego or robotic compliance, working cultures are about purpose, meaning, values, creativity and humanity. The question is what insights can we gain from psychometric instruments that might explain why people behave in a certain way.

Culture at work is local

It is experienced in the 'here and now' of our teams and in our teams' decision-making meetings. Culture can't be captured in a single 'culture dashboard', in which people become pixels that are red, amber or green. For example, it's not possible to see a retail branch team mis-selling products or a trading desk manipulating indexes at the macro level. It takes a whole other level to be able to understand what goes on on the work floor.

Culture at work is dynamic

Every one of us and our teams are 'at our best' some of the time. So the trick is to find out when, how and why are we at our best: when we are the compliant robot or the thoughtful human?

Culture at work can change rapidly

It is a widely held assumption that culture change takes years. This assumption is false because culture is neither static nor uniform. We know for example that a new leader can impact culture rapidly, particularly in their immediate team. So what could happen if the focus was on helping every leader of every team to be their best more often?

Workplace culture at its best

The best possible working culture is close to the one we experience with family, friends and neighbours. Our working life should also have purpose and meaning, where we share a set of moral values that we believe in with our teams and leaders. We should feel safe enough to debate and argue our differences and speak truth to power, and serve others rather than ourselves to build firms that pull in long-term, profitable customers.

Case study

The new CEO of a UK firm assessed cultures in the bank and discovered strong correlations between sustained high performance and a values-based, customer-focused micro-culture within the bank. Working initially with his Executive Committee and then with the entire leadership cohort, over 3,000 leaders spent two days exploring their purpose, values, decision-making and behaviour in a safe learning culture. Improvements in cultures coincided with a 50% increase in profits in two years.

THE TONE FROM THE TOP

Ian Muir

Recent research by Ian Muir CCMI of Keeldeep Associates Ltd looked at the role of boards in providing ethical leadership. It underlined the critical role of a 'tone from the top' in setting the ethical framework in many organisations[11]. Key findings are:

Ethical risk cannot be eliminated…

…but it can be minimised by strengthening recruitment and assessment processes to reduce the number of bad apples; training staff to avoid inadvertent ethics breaches; and building moral backbone to reduce the number of staff who feel pressured into poor ethical behaviours.

A good ethical tone starts with a good board

Good boards are made by good chairmen, so the starting point is a chairman with strong professional skills and high ethical standards. If executives respect the board, the signals the board gives will have more effect and will have more traction further down the organisation.

Strong governance is part of tone from the top

Executives need to feel that the board is interested and knowledgeable through visibility, open dialogue and strong processes of governance and reporting. There should be awareness that the board is likely to find out what is going on one way or the other.

The tone must be led by the CEO

The board cannot replace the CEO in setting the tone but should rather demonstrate the importance of good ethics by devoting time to the topic and monitoring progress.

[11] *The Tone From The Top,* Ian Muir, Gower Publishing, June 2015

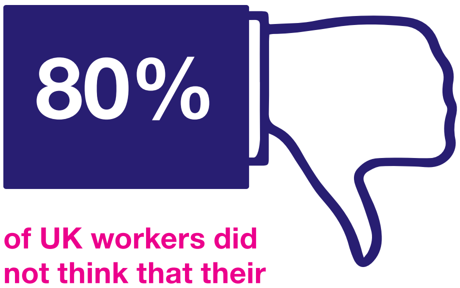
The ‘tone from the top’

One thing to keep in mind is that messages to employees, or the ‘tone from the top’, need to be well-calibrated – otherwise it can have unintended consequences. A study by PwC and London Business School of 2,431 managers across financial services companies argued that rule enforcement systems can create the very behaviour they seek to avoid[12].

The study found that negative instructions or punishment made managers twice as likely to behave unethically. The report states: “A ‘get tough’ approach to poor employee performance in terms of behaviour and reaching targets risk creating a climate of fear and breeding more unethical conduct in financial service – the opposite of what regulators, businesses and the public want.”

Clearly any regulatory directives need to be reinforced by positive leadership direction and guidance. This was also evidenced in CMI’s latest research report *Bouncing Back,* in which destigmatising failure was found to be one of the main conditions of an open, positive and fearless working culture[13]. There is also a raft of evidence that shows that the issue extends beyond lack of direction at an enterprise level, and that there is significant underperformance from individual managers in terms of ethical leadership. Research by CMI found that a staggering 80% of UK workers did not think that their manager sets a good moral example.[14] These findings were echoed in research conducted by the Chartered Institute of Personnel and Development (CIPD), which showed that only 37% of employees trusted their organisation’s senior management.[15]

Those in senior management positions tend to have a much more positive opinion about the ethical standards of their organisation than those in more junior roles (with 48% and 22% respectively assessing their organisation as ‘excellent’ in term of ethical behaviour). If the leadership falls out of touch with current expectations in terms of ethics, this again poses clear threats in terms of staff recruitment and retention, not to mention customer satisfaction.



of UK workers did not think that their manager sets a good moral example

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[12] *PwC\London Business school* “Why you can’t scare bankers into doing the right thing” June 2015
[13] *Bouncing Back* – Leadership Lessons in Resilience, CMI, June 2016
[14] *Managers and the Moral Maze,* CMI, September 2013
[15] *Are organisations losing the trust of their workers?*, CIPD, December 2013

THE CHALLENGE FOR LEADERS

It is rare for ethical cultures to just 'happen'. They demand time and effort. Frequently they will require investment in training, whether in the form of Chartership or more basic in-house courses. The necessary actions will vary from business to business, depending on the culture and staff that are currently in place. However, we believe that all financial services business can benefit from the following process:

1. Discuss and re-define the values of your business, with input from the board and senior managers as well as more junior staff. Determine what the current ethical values of your organisation are and what the leadership team wants and needs to ensure the future success of the business. Consider how the personal values of the leadership team are influencing these decisions and exit those who do not engage appropriately. Inform these discussions by seeking examples of good practice from outside your company as well as from within.

2. Ensure that there is clear leadership on these values from the management team, both in terms of words and deeds. The tone must be set from the top before it can truly be embedded across the whole organisation.

3. Assess the skills of your employees and upskill where necessary. Ensure that employees have the necessary skills and knowledge to understand what is and what is not acceptable from an ethical standpoint. Invest in ethical champions. Soft skills are also important – staff need to interact with their colleagues with empathy as well as direction. Chartership, with ethical practice at its heart, is an important pathway to better management skills.

4. Ensure that ethical behaviours and key management skills are professionalised from the start of a career. This can be achieved by fostering new talent with apprenticeship programs that embed ethical leadership behaviours, such as the new Chartered Management Degree Apprenticeship offered by CMI.

5. Foster a culture that engages with the spirit of regulation rather than resentfully box-ticking. In the long term things tend to end badly for organisations that are preoccupied with pushing the boundaries of regulation.

6. Reward and recognise ethical behaviour through both bonus schemes and promotions.

7. Look at how you recruit and promote staff from the perspective of diversity. Ethics are, to some extent, determined by background. If everybody in your organisation is from the same background, ethical flocking behaviour is more likely to occur – your business needs people with different perspectives.

8. Ensure that employees feel able to discuss difficult issues without fear of recrimination. Embed 360° feedback systems. Cultures of silence and fear disengage employees and lend themselves to catastrophic failures.

9. Constantly review and communicate the company's ethical structures and principles to your staff. Ensure that there is ongoing feedback from all levels of the business. Organisations are constantly evolving; what worked six months ago will not necessarily work now.

While relatively few businesses ever suffer from the titanic lapses outlined at the start of this report, it is important not to be complacent when it comes to your ethical values. There may even be a degree of solace to be found in the failures of other organisations; a sense of reassurance in the knowledge – or misplaced assumption – that the behaviours of your own business are less problematic.

We hope that this report will inspire you to avoid any such complacency and to think about the issue of ethics in a new light.

APPENDIX – SOURCES AND REFERENCE MATERIAL

CMI papers

Management 2020 – the report of the Commission on the Future of Management & Leadership (2014)
www.managers.org.uk/insights/management-2020

The MoralDNA of Employee-Owned Companies (2015)
www.managers.org.uk/campaigns/moraldna

The MoralDNA of Performance (2014)
www.managers.org.uk/insights/research/current-research/2014/october/the-moraldna-of-performance

Managers and their MoralDNA (2014)
www.managers.org.uk/insights/research/current-research/2014/march/managers-and-their-moraldna

The Quality of Working Life (2016)
www.managers.org.uk/insights/research/current-research/2016/january/quality-of-working-life

CII papers

Ethical culture: building a culture of integrity (2013)
www.cii.co.uk/media/4824442/ethical_guidance_building_a_culture_web.pdf

Ethical culture: a practical guide for small firms (2013)
s/27327

Ethical Culture: Developing a culture of responsibility in a regulated environment (2016)
www.cii.co.uk/ /39598

Ethical Culture: Changing the story-Reasons To Believe (2014)
www.cii.co.uk/knowledge/policy-and-public-affairs/articles/ethical-culture-changing-the-story-%E2%80%93-reasons-to-believe/32573

Speaking Up: Information for CII members about whistleblowing (2016)
www.cii.co.uk/media/5464774/ethical_culture_whistleblowingvf.pdf

Ethical Culture – the Challenge for insurance marketers: *www.cii.co.uk/41828*

Your practical guide: Code of Ethics
www.cii.co.uk/media/5383337/code_of_ethics_-_a_practial_guide.pdf

Roger Steare/EY papers

The challenges of risk, culture, behaviour and corporate integrity in financial services – Findings from the MoralDNA™ of culture and conduct in global financial services (2015)
www.ey.com/Publication/vwLUAssets/EY-moral-dna-in-fs/$FILE/EY-moral-dna-in-fs.pdf

Chartered Management Institute (CMI)

The Chartered Management Institute (CMI) is the only chartered professional body for management and leadership, dedicated to improving managers' skills and growing the number of qualified managers.

Our professional management qualifications span GCSE to PhD equivalent levels, including the unique Chartered Manager award, which increases earning potential and improves workplace performance.

We provide employers and individual managers with access to the latest management thinking and with practical online support that helps them to embrace change, create high-performing teams and keep ahead of the curve.

With a member community of more than 120,000 managers and leaders, we promote high standards of ethical practice through our Professional Code of Conduct, and help managers to build their expertise through online networks, regional events and mentoring opportunities.

Visit **www.managers.org.uk/businessethics** for more information, and follow us on Twitter **@CMI_managers #CMIethics**

The Chartered Insurance Institute (CII)

As the premier professional body for the insurance and financial planning professions, the CII promotes higher standards of integrity, technical competence and business capability.

With over 125,000 members in more than 150 countries, the CII is the world's largest professional body dedicated to these sectors.

Success in CII qualifications is universally recognised as evidence of knowledge and understanding. Membership of the CII signals a desire to develop broad professional capability and subscribe to the standards associated with professional status.

The CII works with businesses to develop bespoke, company-wide solutions that ensure competitive advantage by enhancing employees' technical and professional competence.

Individually, CII's members are able to drive their personal development and maintain their professional standing through an unrivalled range of learning services and by adhering to the CII's Code of Ethics.

Visit **www.cii.co.uk for more information,** and follow us on Twitter **@CIIGroup**

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