INTEGRITY: THE FOUNDATION FOR A STRONG FINANCIAL SECTOR

SPEECH BY

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Introduction

Distinguished Guests, Ladies and Gentlemen, I am very pleased to be here today to share with you my views on this important issue of the integrity of the financial sector. The Oxford Dictionary defines integrity as "the quality of being honest and morally upright and firm in your moral principles". Traditionally, integrity of the financial sector relates to financial institutions and affiliated persons and institutions' adherence to standards that are rooted in laws, regulations, guidelines and recommendations issued by the supervisory and/or regulatory authority. Financial sector integrity also relates to codes of conduct drawn up by the financial institutions or sector themselves, and socially acceptable unwritten rules of conduct.

As we all know, the financial sector is a critical component for economic development in any country. It is the lubricant that oils the wheels of an economy, contributing to prosperity and wealth creation through the provision of financial resources. Governance is therefore a critical issue for the financial sector as they operate in a substantially regulated environment.

The Global Financial Crisis

Ladies and Gentlemen, I would like to set the tone of my address on the integrity of the financial sector with a brief reflection on the recent global financial crisis. As we all know, the global economy is currently going through its deepest crisis since the Great Depression of 1929. Around the world, politicians, economists, policy analysts, investors, bankers, etc., are engaged in discussions on the impact of the crisis on their respective countries and global economic growth.

The financial crisis, by common consent, broke in summer 2007 against a backdrop of strong global economic growth. That growth had been fuelled by what Alexander termed as a **"financial super highway",** linking east and west - which saw the huge savings of the emerging economies in Asia, Russia and the Middle East invested in the West.

The influx of investment increased the price of assets and gave rise to ever cheaper credit, as banks gained the confidence to lend more against the collateral of rising property prices.

As interest rates increased in 2006 and 2007 in the United States, many of the debtors began to default, putting at risk the value of all housing loans. Thus, as the so-called "sub-prime" borrowers in the United States started falling behind on their mortgage payments, the holders of these mortgage-backed securities started to question just how exposed they were to the increased risk of default of hundreds of billions of dollars in "sub-prime" loans.

And as they looked closer, these institutions found that they could not even quantify their level of exposure because of the proliferation of complex securities and derivatives.

First designed to spread risk, these derivatives in fact increased the systematic risk inherent with bad debt, firstly by fooling lenders into thinking they had avoided such risks altogether, and secondly by reducing transparency and making it unclear just how exposed individual banks were. Banks announced over half a trillion dollars of sub-prime and related losses, but the growth in securitization made it unclear who would bear the cost at the end of the chain. The failure of Lehman Brothers in September led to a collapse in confidence and almost every company or institution parked out deposits from banks perceived as even marginally at risk. This in turn brought the global financial system to the brink of collapse, sparking the worst global financial crisis for generations.

What really triggered the current world financial crisis? The answer is simple: a lack of confidence in the global financial sector, stemming from the significant depression of its integrity. In fact, all markets are built on confidence, and the financial market is especially dependent on confidence. Confidence in every layer and link in the system: confidence in reliable figures and sound people, and in well-enforced laws against fraud and corruption.

The lack of confidence in the global financial sector points to the failure of the supervisory and regulatory authorities to provide effective leadership.

Ladies and Gentlemen, I think that leadership is the sum of two vectors: competence and integrity. Competence relates to your specialty, your know-how, whereas integrity relates to your identity, your character, your attitude.

In a nutshell, leadership is about skills and integrity. When companies and people get stuck, they tend to apply more steam, i.e., more competence, the very tool that got them into the trouble in the first place.
The fact is that when you are stuck, you are not likely to make progress by using competence as your tool. Instead, progress requires commitment to two things: first, you need to dedicate yourself to understanding yourself better; second you need to change your habits of thoughts, how you think, what you value, how you work, how you connect with people, and what you expect from life. In other words, progress requires commitment to two things: integrity and skills.

Ladies and Gentlemen, I would like to believe that, perhaps when the financial sector grew in size, and volumes of business became complex in the eighties and nineties, leadership in the sector thought that building human capacity and acquiring quantitative skills in derivatives, securitization, etc., would make the management of the complexities more effective. The issue of integrity which should have been at the core of financial sector management was not stressed. The human resource function focused on the recruitment of young people, talented in quantitative methods and very skilful in financial engineering techniques, securitization, swaps, etc., leaving the identity and values of the people unattended. The failure of the leadership to first allow integrity to foster growth and stability of the sector and then utilizing skills and competencies to achieve efficiency and effectiveness could be the prime cause of the global financial crisis.

Generally, the financial sector supervisory and regulatory authorities have the administrative, legislative and institutional power to effect changes in the industry and also the capacity to generate and align resources to support their discourse. Unfortunately, the authorities have not utilized the power and resources at their disposal to define the dimension, growth trajectory, and stability of the financial sector. In many instances, when circumstances changed, the financial sector was unable to flex and adapt. The institutions and systems have been left to become captive to the industry and are therefore unable to effect and sustain the required changes. This underscores the length of time it is taking the global financial sector to transform, despite the existence of plethora of international standards and codes of conduct.

Integrity of the Financial Sector

The financial sector needs to demonstrate that it has embraced integrity as its cornerstone. It should also realize that sound conduct goes beyond strict compliance with the laws and regulations. The laws and regulations reflect the prevailing social norms and values. Since regulations codify norms and values, it is vital that the financial sector keeps abreast with the changing views in the society on what integrity involves and what type of conduct is worthy of confidence.

Ladies and Gentlemen, solvency and stability of the financial system, accountability and transparency are also crucial for maintaining confidence in the financial sector. The sector also needs to observe business integrity in a way that the society finds admissible and acceptable.

Monitoring and safeguarding business integrity is the job for the supervisors. Here I am referring to integrity of supervision: personal integrity, organizational integrity, relationship integrity and market integrity. If the supervisory authorities do not target risks that have the potential to affect activities of financial institutions and harm their reputation, then the integrity of supervision would be grossly undermined. For financial institutions, the personal integrity of the leadership, i.e., the directors in the broad sense, is crucial for business integrity as it is with the conduct of individual employees.

The trustworthiness, sense of responsibility, law-abidingness, honesty, uprightness, etc., of directors and those who determine policy should be beyond doubt.

Highest standards of integrity are also required from the employees of financial institutions. Sharp awareness of integrity at all layers of the organization, not only through rules and regulations, but also through training sessions on integrity at the work place, is also crucial. Such sessions lend the employees greater insight into the integrity dilemmas that may arise in their work and also offer them the opportunity to discuss integrity and what it means for the growth and stability of the financial sector.

Ladies and Gentlemen, besides the integrity of supervision, the supervisory and regulatory authorities should also concern themselves with the integrity of the entire financial sector. Here too, integrity goes beyond compliance with statutory rules and regulations. Unsound conduct can damage the sector as a whole, even if no violations have occurred. Wrong incentives, such as transaction-related bonuses, could induce sound people working in sound companies to exhibit behaviours that impact negatively on market integrity generally.

The issue of integrity of the financial sector also needs to be tackled internationally. This is because globalization has removed the borders in the financial sector. Since financial risks have become marketable and borders between countries have become blurred, financial crises and the associated losses are spread quickly and more widely. Countries not only reap the rewards of globalization but also the costs, because everybody is affected when things go badly wrong. That is why there is the need for global discussions and actions on matters such as integrity of the financial sector.

Conclusion

In conclusion, Ladies and Gentlemen, we need to recognize that the financial and economic crisis confronting the world today is in large part the failures of national and cross-border regulatory and supervisory regimes in assessing and managing the build-up of risks in financial institutions and systems. This crisis was the result of the failure of the leadership to drive change by inspiring people, institutions, and systems to do new things fast and the belief that the solution to the financial crisis lies in complex mathematical permutations and secrecy. The absence of effective leadership in the global financial sector undermined the sector's integrity, which in turn eroded confidence in the institutions and systems.

The Bible says in Psalm 78 verse 72: "And ***David shepherded them according to the integrity of his heart, and guided them by the skilfulness of his hands".***

Coming out quite clearly from this passage, Ladies and Gentlemen, is that integrity and skills are critical and indispensable traits of effective leadership. The Bible, however, places integrity at the fore front of the leadership traits because it is integrity that FEEDS the people whereas skills LEAD the people. Integrity is therefore required to foster growth and stability before skills can follow to achieve efficiency and effectiveness. Integrity should therefore be regarded as the foundation for a strong and sustainable financial sector. Thank you.