

SESSION SUMMARY

■ RESTORING TRUST IN THE SYSTEM

- ◆ [Panel 1: Financial Regulation and Consumer Protection](#)
- ◆ [Panel 2: Corporate Governance](#)

Tuesday 24 May 2011

Key note speaker: **Iveta Radičová**, Prime Minister, Slovak Republic

Moderator: **Soumitra Dutta**, Roland Berger Chaired Professor of Business and Technology, INSEAD, France

◆ [Panel 1: Financial Regulation and Consumer Protection](#)

Panelists: **John Hope Bryant**, Founder, Chairman and CEO, Operation HOPE

Federico Ghizzoni, CEO, UniCredit SpA

Marilena Igreja Lazzarini, Member of the Council of Directors, Instituto Brasileiro de Defesa do Consumidor (IDEC), Brazil

Ted Menzies, Minister of State, Finance, Canada

Steingrímur J. Sigfússon, Minister of Finance, Iceland

Discussant: **Renato G. Flores Jr**, Professor, Fundação Getulio Vargas/EPGE, Brazil

Iveta Radičová, while expressing guarded confidence in the future economic situation, remained deeply concerned about the consequences of the recent crisis: “Commercial transactions and economic well-being are based on trust and confidence...it is not enough to establish a new institutional framework to recover, we need to re-establish trust...[injecting] cash might not be enough to revive the world economy”. Ms. Radičová identified two main “enemies” of trust: first, the unintelligibility and obscurity of the language and acronyms of our institutions – the policy debate appears to be transmitted in “secret codes,” understood by economic analysts but “lost in translation” for most people; and second, our own past record of insufficient regulation, supervision and wrong incentives, which has undermined confidence.

How do we restore confidence in the credibility of the system? “An important element of trust is a good experience repeated over and over again”, Ms. Radičová said. She stressed the need to increase transparency, reduce corruption and cronyism, and ensure that political, business and financial leaders are seen to pay for breaching the rules. In reference to the euro zone’s ongoing crisis, Ms. Radičová argued that “the euro zone is not divided between big and small countries, but between responsible and non-responsible countries” and left a coded warning that “trust means security, but deeper debt leads to less trust”. Ending with some comments on ethics and policy, Ms. Radičová warned of the dangers of failing to build bridges between the world of ideas and the world of practice. “Without the help of active citizens, it is impossible,” she said.

Ted Menzies argued that Canada can offer a unique perspective on financial regulation and consumer protection, thanks to its remarkable resilience during the downturn, when not a single bank failed. Mr. Menzies attributed the strength of its financial sector to a regulatory framework that has since become a model to follow. Additionally, there are five Canadian banks named as among the best in the world at risk management by the World Economic Forum. In the aftermath of the crisis, the typical characteristics of the Canadian banks' management approach have significantly impacted international financial regulations, he said. The Canadian system was a model of on-the-ground superintendant supervision, "where it is always clear who is responsible for what". Mr. Menzies also commented on the "vital importance" of financial literacy and noted that "consumer protection must always be an essential part of restoring trust in the system". As financial products evolve, the impact on consumers must be monitored, he said.

Steingrímur J. Sigfússon commented humorously that Iceland has not been quite as lucky as Canada, adding "we can't do anything about volcanoes, but we can do something about banking and financial crises". Mr. Sigfússon warned that a lot of people have been hurt by the crisis and are dissatisfied and angry – "We need to go the root of the problem...paddling on the surface will not do". Mr. Sigfússon made five main suggestions: pay attention to proportions in the financial management system – "it makes no sense that a tiny economy like Iceland should allow its banks to grow out of all proportion"; promote a diverse and transparent ownership structure and avoid cross-ownership between banks and the corporate sector; separate consumer and investment banking activities; terminate certain bank functions; and review bank bonus systems from an ethical and moral perspective – "why do bankers need huge incentives when medical surgeons, whose mistakes have life-threatening consequences, don't"; he said. Finally, we need to rethink our approach to guaranteeing banks deposits, possibly by making them a priority claim on the bank, which could dispense with the need for a guarantee fund. Summing up, Mr. Sigfússon warned that "This crisis has very firmly written on the wall that we are still stuck in a system where we privatise the gains and socialize the losses" and that this cannot continue.

Federico Ghizzoni commented ironically that as the "only banker on the panel, by definition I have a problem of trust" but went on to echo the views of previous panelists that "without trust there is no sustainable growth" and agreed on the need to strengthen the regulatory and governance framework, as well the need for banks to implement more internal control, improve transparency and define better the respective roles of boards and management. That said, Mr. Ghizzoni also sought to correct the perception in "the collective imaginarium" that all bankers are highly paid, reckless risk-takers, and described the case of his own bank, UniCredit, where the average take-home pay is just €35,000, and where bonuses are linked to customer satisfaction. Mr. Ghizzoni also warned that too many rules could make banks too conservative, and gave the example of the huge stock of unproductive savings in the Italian financial system. That said, Mr. Ghizzoni warned that "this is a crisis of values...and if we don't evaluate the values of managers, and do it continuously, the crisis will come back".

Marilena Igreja Lazzarini stressed that the voice of consumers deserves more attention considering the long-standing relationship they have with banks. But in some countries, this is far from being the case. In Brazil, for example, the financial services sector suffers the second largest number of consumer complaints. Ms. Lazzarini warned that "financial services pose considerable risks for consumers and as financial products become more and more complicated, it is unhealthy that consumers should get access to most of their financial knowledge through brokers and advisors. She strongly defended the need for a concerted effort to promote financial education, arguing that "the government should assume responsibility for financial education".

John Hope Bryant announced the emergence of "the first global king: the 21st century consumer" and, more accurately, the US consumer who "drives 70% of the US economy, which is equivalent to 25% of world economic demand". But Mr. Bryant also pointed out that 70% of these consumers are living from "paycheck to paycheck" and, while admitting that "we screwed up", warned that if the US consumer stops buying, the rest of the world stops producing. Observing that this is not just a recession but a

“reset”, which will require massive new levels of financial literacy, he nonetheless concluded optimistically that “rainbows only follow storms” and the “first rainbow is consumer protection”. Making a passionate plea for the introduction of financial literacy courses in schools between grades 4 and 12, Mr. Bryant said that “in an economic age everybody has to have financial literacy and the language of money as a new civil right”.

Renato Flores noted three dimensions to the discussion: financial legislation – highlighting the way conservative rules in Brazil and Canada have underpinned the development of conservative banks; financial regulation, which Mr. Flores defined in narrower terms than legislation, warning that “the enforcement of regulation can be very costly”; and third, the strength of innovation in the financial sector, and its ability to escape the regulatory circle. Mr. Flores agreed that it is crucial to restore trust, and this depends upon what he termed the three Ts: Transparency, Time, and Top examples of leaders who are punished for breaching the rules. Mr. Flores dwelt on the importance of time, for which there is no magical substitute, just as is the case when rebuilding damaged human relations.

◆ **Panel 2: Corporate Governance**

Panelists: **David Begg**, General Secretary, Irish Congress of Trade Unions
Lord Mandelson, Former EU Trade Commissioner
Bruno Strigini, President, Europe & Canada, MSD (Merck & Co., Inc.)
Christine Varney, Assistant Attorney General, Department of Justice, United States

Discussants: **Richard Howitt**, MEP, Rapporteur on Corporate Social Responsibility, European Parliament
Anne-Catherine Husson-Traoré, CEO, Novethic, France

Lord Mandelson opened the panel discussion with the observation that trust and confidence in the economic system is not only about fair rewards, but also about fair rules. He took stock of the tremendous strides that society has seen over the past 50 years, but warned that the current mood is bad - “as we enter the second decade of this century there is a great deal of apprehension and pessimism... and I’m sorry to say, scepticism about politicians and people in business. These attitudes are corrosive...and will sap our ability to progress”.

Lord Mandelson also warned that “this lack of confidence and trust in my view is not self correcting”. Noting that much has been done for shareholders’ rights, Lord Mandelson argued that the time has come to emphasize shareholder responsibility in developing durable businesses and in correcting the inequities in executive pay, which has become “disconnected from reality”. With the average CEO in the UK earning 100 times the average salary of employees in 2008, Lord Mandelson commented “I don’t believe in the politics of envy, but the scale of recent developments cannot be justified”. Finally, Lord Mandelson made one specific policy proposal to help ensure that corporate mergers are driven by a clear strategic fit between companies, namely that shareholders of both the acquiring and the acquired company should have to vote and approve the deal.

Christine Varney provided a diagnosis of the root cause of the short-termism that motivates many corporate and economic actors - “in the US, the essence of the problem is a legal system that demands that boards of directors and executives pay attention only to shareholder value... we have a corporate structure that creates the basis to drive on a quarter-by-quarter basis for the highest possible share price.” She proposed that we address this by expanding our definition of value to include the interests of stakeholders as well as shareholders. This will involve creating a larger concept of value and, by necessity, a larger legal framework. Acknowledging the risks that accompany revamping the corporate economic

incentive structure, she asked: “How do you balance creating long-term institutions with a stakeholder focus without jeopardizing nimbleness and agility?” She concluded by observing how deeply-rooted short-termism has become in American culture. She observed that today’s youth, who out of principle are willing to commit to vegetarianism or to forgo car ownership, still insist on instant gratification. “How do you engage a young population to build long-term institutions?”

Bruno Strigini brought a business perspective from the healthcare sector to the discussion, and highlighted some of the progress Merck has made in improving transparency – such as publishing “all grants and donations [made] to healthcare professionals”– and creating internal systems where “compliance officers make sure that all of our employees behave properly.” Despite the implementation of big programmes to provide access to pharmaceuticals in developing countries and to underserved populations in developed nations, Mr. Strigini acknowledged that the pharmaceutical industry still suffers from an “image deficit.” To remedy this, he posed an open question: “What can we do? Should we find a way to involve consumers more formally into our governance process?”

David Begg argued that fundamental change is needed in order to restore trust, but that change is hampered by the path dependency of the ideas that imbue organizations and institutions, and which prevents them from recognizing when things go wrong. Mr. Begg identified three salient features of the period termed the “Great Moderation” by Ben Bernanke, chair of the US Federal Reserve: the deflationary influence of China; cheap credit; and the change in the balance of power between capital and labour. One outcome of this, he noted, is greater inequality in the workplace. Mr. Begg argued that, in contrast to past periods of high inequality, today’s growing gap is between the middle class and the top earners, which could have important repercussions. He concluded that the main challenges facing the world today are in the area of political economy, which he illustrated with a quote from the Hungarian philosopher Karl Polanyi: “the economy must be embedded in society, not the other way around”. At the moment, in Mr. Begg’s view, “we have it the other way around; therefore the system is fundamentally wrong and until we manage to rectify that balance there is no point in even approaching the question of restoring trust in the system”.

Richard Howitt observed that reforms to corporate governance were happening around the world and warned that “we miss the target if we say the existing rules are enough.... we cannot be responsible shareholders unless there are rules that help financial analysts and asset managers ask the right questions on our behalf.” Building on Ms. Varney’s comments, he argued for the inclusion of the planet and communities in our definition and perception of corporate stakeholders, and argued for the inclusion of sustainability criteria in bonus plans.

Anne-Catherine Husson-Traoré observed that the greening of the economy must not come at the expense of social or human rights. She discussed the link to socially responsible investment (SRI), highlighting the need to encourage investors to measure returns from a long-term perspective. This is “not a dream” she said, it is important to build links between how investors perceive the use of their money and real economic value.

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