**<u>An Ethical Debate on Finance and Technology</u> by Andrew Hilton**

**January 31, 2019**

I have been asked to comment on Helena Morrissey's paper about ethics and finance – which I am happy to do. I have the highest respect for her, and I found much that she wrote (and said) genuinely challenging. I will also include in my comments a response to the excellent and very detailed response (to Helena) put forward by my fellow panellist, Jason Channell – who I notice served five years at Goldman Sachs before seeing the light and decamping to Citi.

As a sceptic about religion, I found it exceptionally refreshing that Helena deliberately committed the social *faux pas* of mentioning, not just Christianity, but Christ himself. This being England, He doesn't often get a shout-out – not even in Church Hall. More power to her (and Him).

But – big But – I also think there is a certain amount of pussy-footing in Helena's presentation – and a bit more in Jason's. <u>Let me try to be a bit blunter</u>.

First, I agree with Helena that there is a major problem around the world of increasingly unresponsive elites, who are cut off from the broader societies in which they live and whose privileges fuel what those same elites patronisingly (and dismissively) call "populism". I also agree that those elites have, to a greater or lesser degree, replaced allegedly knuckle-dragging national loyalties with the supranational loyalties epitomised by 'Davos Man', by George Soros, by Peter Mandelson, by David Cameron – to name a few.

I also agree with her that the visceral hatred that the coastal elites in America display towards Trump is indicative of that; *ditto* the contempt that our own metropolitan elite displays towards those benighted know-nothings who voted for Brexit.

But I am not sure that I agree wholeheartedly either with Helena's analysis of how it came about – or of what we can do to counteract it. And I am deeply sceptical about Jason's analysis – which makes the conventional case that finance is a force for good and that we are moving into an era when ESG rules, in which sort-termism is no longer the problem it used to be, and in which better corporate governance, stewardship codes, diversity and inclusion rule. I doubt it.

I think Helena is certainly right to emphasise the death of deference. I grew up in the 1950s (when my schoolmates used to go and beat for the Duke of Devonshire on the grouse moors above Bolton Abbey) and the 1960s (when it was, briefly, fashionable to be Northern and working class). I agree that things have changed – but perhaps not as much as she or Jason suggest. The UK is not a meritocratic society – and, in my opinion, it is getting less meritocratic, not more. In my view, the death of the UK's grammar school system removed an important vehicle of social advancement – admittedly, only for about a third of the population, and, admittedly, with a middle class bias. But, bias or not, grammar schools were a route out of the working class. As anyone who hires them knows, the privately-educated 5% of the population in this country is very well-educated indeed – often, well above their intelligence. My little joke is that if you send your son to Eton, he can be married for five years before his wife finds out he is thick as a brick. That comes with entitlement – the feeling that the privileges you enjoy as a result of that education are your due, and that you don't have to apologise for them.

Given that, it is inevitable that when the alternative to a public school is not a grammar school but the local comp (and I realise that there are still a few grammar schools, including the one Jason went to), people will make the necessary financial sacrifice. And, of course, when people are making a financial sacrifice, they expect a return.

I am not arguing for the return of grammar schools or the abolition of public schools. But there is no doubt that the state/private educational gap in the UK has widened alarmingly – and that the education the private sector offers is far better attuned to the way our high-tech society is evolving than the average comp. That means it is all too easy to justify hiring the OE over the state school product. That, again, fosters the conviction that you/we/me deserve the privileges we enjoy – and that we don't have to apologise for them. That, I am afraid, is a subliminal message that also came through in the written paper that Jason submitted: finance is (or, at least; can be) a force for good; financiers do good – and no one need apologise. I am reminded of Lloyd Blankfein's little joke that GS does "God's work".

There is another problem that Helena doesn't mention – and that doesn't get mentioned enough because it conflicts with the contemporary gender imperative.

It is "assortative mating"… Through until 20 or 30 years ago, the norm was for doctors (M) to marry their nurses (F), for bosses (M) to marry their secretaries (F), for lawyers (M) to marry their paralegals (F) – and so on. There were advantages to this. In particular, it was a route of upward social and economic mobility that has now been closed off. (It also, on the whole, produced more attractive children.) Now, doctors marry doctors; lawyers marry lawyers; investment bankers marry investment bankers, PhDs marry PhDs… and since that doubles the family income, parents can buy a better start for their kids. Since intelligence is, at least in part genetic, the rich also tend to get smarter – and the rest don't.

Whatever, the result is an increasingly isolated, hermetically sealed elite that floats above the more-or-less (*lumpen*) proletariat, rather like Swift's vision of Laputa.

The question then is how we bring it down to earth. It seems very clear to me from the rage against Brexit in the UK and the rage against Trump in the US that elites still haven't learned humility. Macron's genuflection before the *gilets jaunes* may suggest he has learned – but I am sceptical. The elites simply hope this wave of populism will pass, like others before it. They may well be right, but I wish they weren't – not least because, if they don't learn, I fear we are in for a long period of social, political and economic upheaval. It is worth emphasising – even more than Helena does – that the internet, instant communications and social media give the socially and economically marginalised a tool (or a weapon) they have not had before. They will use it.

That's society. <u>But what about finance more specifically</u>?

Tomorrow, you will hear from John Kay – another person whom I respect. I will borrow a bit from what (I think) he is going to say.

In my opinion, Helena and Jason are too kind to their colleagues in the financial industry – and, as a result, they avoid the elephant in the room. John will, I am sure, speak of what he calls "<u>financialisation</u>" – which is finance for finance's sake, without any underlying economic rationale. Even he accepts that finance isn't always bad. Indeed, as he points out, it is indispensable to a modern economy in four ways – it provides a payment system, it allows us to manage our wealth, it helps allocate capital, and it facilitates risk management.

Those are all worthy activities – but they are pretty marginal when it comes to modern finance, especially in complex organisations like Citi or Goldman Sachs. They are overwhelmingly dominated by trading, and, in particular by trading of synthetic obligations amongst market professionals – derivatives, often of enormous complexity, with impenetrable names and no obvious (or indeed non-obvious) economic purpose. And that's where some of the most talented people in our society go.

Why? <u>Because that's where the money is</u>. I hate to sound biblical, though I guess it is appropriate: the love of money is the root of all evil – at least, of much of the evil that goes on in the financial sphere. It is also, and perhaps more importantly, the fuel that drives the elite – that keeps them several steps ahead of the rest of society.

The fundamental problem is that <u>decent people are easily seduced by money</u> – and the financial system is where the most money is. That's why it attracts the best and the brightest – young men and women who are blinded by dollar signs. Every day, trillions of dollars flood through the FX market (in cash and derivatives) – and the same again goes through all the other derivative markets that John identifies. The BofE's Andy Haldane is frequently quoted as suggesting that much of this doesn't have any underlying social or economic value – and I am sure he is right.

So, why do people do it? <u>They do it to make money</u> – and they can make enormous amounts of money because a very small percentage of a very, very large number is still a large number. It is very, very attractive.

Unless you are deeply masochistic, finance is not intrinsically either particularly interesting or fun. But – just like commercial law and some of the other allied professions – it pays very well. And, since there is nothing else to measure success by, how much you earn is the key metric. With apologies to Jason, I am going to go out on a limb and assert that no one has ever joined Goldman Sachs without being acutely aware of – and being swayed by – the fact that it pays better than anyone else. (And that includes Brian Griffiths.) And, as we have seen in the case of Malaysia's 1MDB, that can easily push decent people to make decisions that hover between immorality and outright illegality.

Let me return to the pernicious impact of money itself.

I have said that people gravitate to the City because remuneration is 'enormous'. But <u>how much is "enormous"</u>? Well, the average *household* income in this country is around £28K a year. I venture to suggest that that wouldn't pay the wine bill for most City traders – and perhaps for many of you. (Politicians are also out of touch. I once heard a senior economic adviser to Tony Blair say that he had asked the then-PM what the average person in the UK earned – and the answer came back, "Oh, about £70K".) I have not been able to find average remuneration for UK investment bankers, but the average remuneration at Morgan Stanley in the US last year was $292K – and I guess Goldman Sachs was even more. That includes the doormen and the cleaners. Starting salaries out of business school on Wall St. are now well over $100K. It isn't that much different over here (indeed, for City lawyers, the pickings may be even fatter than in the US).

Helena's recommendations revolve around what she calls a "moral compass", and Jason uses the same phrase – which is fine as far as it goes. But it doesn't go very far. The real problem is that most people's moral compasses tend not to point in the right direction when large amounts of money are floating around. We have seen this time and time again in recent years – with Barings, with LIBOR, with SocGen, with Kweku Adoboli at UBS…even I guess, with some of the current cases around Barclays.

But it is not just fraud. Indeed, it is not fraud that is the problem. <u>It is what is considered "normal</u>" – what is considered right and proper for "people like us", for people in the financial services sector (and allied sectors like law and accounting) to pay themselves. I doubt very much if there are many people here – at least those with jobs in the City – who don't make a multiple of that figure for average earnings. Equally, I would guess that most people think that they "deserve" what they are paid – even if it is ten times what a construction worker in Sheffield, a nurse in Birkenhead or a chicken-plucker in Norfolk is making.

I acknowledge that, this isn't just a problem with finance. Lawyers, accountants, senior civil servants, even (perhaps especially) doctors make many times what the average family exists on. Now, I also know that (as Jason makes very clear), in the last few years, income disparities in the UK – at least as measured by Gini coefficients – have narrowed. A bit. But they remain very high by international standards, and the UK remains a very unequal society – and, most important, what John Kay refers to as 'financialisation' exacerbates this. I venture to suggest that few of us genuinely begrudge Bill Gates or Mark Zuckerberg or even Richard Branson their millions or billions; they have produced something we genuinely need or want – and they took risks in doing so. But a 28-year old trader at Goldman who complains because his bonus is only half a million and he wants to build a swimming pool and cinema in his

Fulham basement? He hasn't added much to the sum of human happiness, but he has certainly sucked some of the goodness out of society.

What can be done? What policies might lead finance in general to become more 'normal'? How can we change people's perceptions about finance so that someone who sits in front of a screen all day trading $CDO^2$ or whatever is no more a 'master of the universe' than a plumber or plasterer or hairdresser?

In my opinion, Helena's focus on a 'moral compass' is pie in the sky. We don't worry about devising a moral compass for hairdressers, or assembly-line workers – or, for that matters, for used-car salesmen or estate agents sleazy though they are. There are laws – and, broadly, that is enough. Their 'moral compass' is something developed at home, in their family or even (dare I say it?) in church. What we really have to do is 'normalise' financial services – not make it even more special by imbuing it with a moral compass when what it really needs is not to be treated as special, just 'normal'.

That is what I would like to discuss – how to make finance more 'normal', not how to reinforce its uniqueness by hedging it around with moral codes and compasses. The problem is that I admit that I don't know how. I have recently been thinking about writing a book on reforming capitalism; so far, I have not got much further than the title: "*Twenty hints to God*". One might be for investment bankers to leave their first born child with the regulator as a proxy for good behaviour. But most of the rest that I have come up with so far have to do with football. Maybe Brexit will help if, indeed, 20% of the City decamps to Berlin or Paris. After all, every cloud has a silver lining. Maybe (as Jason suggests) FinTech will help by democratising finance. Maybe even the regulators could help by following up on their concerns about "socially useless" financial products. But let's work to make finance, financiers, bankers, whatever we call them, less special – not more.

Andrew Hilton