Can Complex Firms Be Ethical: an Argument for Simplicity of Financial Institution

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Between 2009 and 2013, some of the world's largest banks were fined nearly £150 billion, with the totals into 2015 set to take this amount to over £200 billion (Sterngold, 2014). Regulators in the United States and United Kingdom especially have focused on the culture within firms and imposed heavy fines for instances of misconduct. A recurring question, however, is whether or not the various methods of regulatory scrutiny and punishment are really improving ethics within the financial industry. If not, is the current strategy appropriate, or even sustainable and what are the possible alternatives? As the global economic recovery begins to strengthen, financial firms will look to improve their balance sheets while complying with increasingly stringent regulations. The focus of these regulations appears to be reactive punishment of firms' misdeeds, rather than making substantive strides to improve ethics.

The regulators' apparent priority, illustrated by the current Conduct regime, is flawed in that it views "ethics" as either motives-based or consequence-based, without adequately factoring in firms' structural complexity. In other words, regulators seem to judge a firm's ethics by its ability to conform to vaguely defined standards of corporate responsibility or by the outcomes of its actions. Both of these may ignore the critical issue in banking ethics cases—complexity. After an overview of recent regulatory approaches, I will show that regulators, while well intentioned, have failed to significantly improve financial ethics because their efforts have failed to deal with the complexity within the industry.

Une question qui revient sans cesse consiste à savoir si les méthodes actuellement utilisées pour examiner, surveiller et sanctionner augmentent le niveau éthique dans l'industrie financière. Si ce n'est pas le cas, cette approche est-elle adaptée par ailleurs, voire même défendable et quelles sont les alternatives possibles ? Alors que la reprise économique se renforce, les entreprises financières vont chercher à renforcer leurs bilans tout en respectant les régulations les plus exigeantes qui sont destinées à punir les entreprises de manière réactive plutôt que de les amener à faire des progrès en matière éthique.

L'attention des régulateurs, illustrée par le régime actuel du Banking Conduct Regime repose sur la fausse prémisse selon laquelle l'éthique serait soit celle des conséquences, soit celle des motivations (vertus), mais elle ne tient pas compte de manière adéquate de la complexité des institutions. Les régulateurs donnent l'impression de juger l'éthique des

In section one of this paper, I will define the Conduct agenda, its relationship to corporate ethics and related regulatory trends . I will also define consequential and deontological evaluations of ethics, giving an overview of the evolution of Conduct in what I will call a motives-based and consequence-based view of regulatory expectations. In sections two and three, I will examine the shortcomings of a Conduct regime founded on either motives- or consequence-based evaluations, pointing out that while each approach helps to establish levels of transparency and accountability, neither approach does much to improve ethics. Finally, I will argue that, in order to improve the ethics of financial firms, the complexity of the businesses involved must be taken into account, concluding with the premise that streamlining, or downsizing, is the best way for firms to improve ethics within the industry while meeting increasingly stringent regulatory requirements.

What are ethics?

"Conduct", "ethics", "fairness"—these words are used often in regulatory language, especially in the wake of the financial crisis and instances of misconduct in the banking industry (Benedict, 2014). Attempting to provide holistic definitions of each is beyond the scope of this paper, though I will define how these terms will be used to frame the argument which follows. By Conduct, I refer to a focus by regulatory bodies over the last decade on better behaviour in the financial industry. International regulators like the Financial Stability Board (FSB) and in turn the Financial Conduct Authority (FCA) and a number of US regulators (Robson *et al.*, 2013) have been the main drivers of the Conduct agenda. Regulators have intentionally avoided defining Conduct for firms, though one can loosely see Conduct as a broad focus on customer outcomes, and fairness and integrity within financial markets ("Culture and Conduct: Putting the customer at the heart of your business model," 2013; Financial Services Authority, 2012; Robson *et al.*, 2013).

Trust us—A Motives-Based Approach

The aim of the Conduct agenda, whether rightly or wrongly, is to improve the behaviour of financial firms and reduce incidents of risky practices through increased regulatory scrutiny and industry-defined Conduct standards. Although oversimplified, this definition does help clarify that Conduct as an initiative can be judged as successful by three criteria: 1. Changed business culture, 2. Fewer fines and 3. Clear conduct definitions within the financial industry with banks—rather than regulators—the "drivers" of the agenda. Conduct more broadly has had what I will identify as two major approaches before and after the 2008 financial crisis: a motives-based agenda and a consequences-based agenda.

entreprises d'après leur conformité aux standards vagues de la responsabilité sociale des entreprises ou d'après les conséquences de leurs actes. Chacun de ces critères passe sous silence un aspect crucial de l'éthique bancaire, à savoir la complexité.

L'objectif du Conduct Regime est d'améliorer la qualité du comportement des institutions financières et de réduire les incidents des pratiques risquées au travers d'une surveillance accrue de la part du régulateur et des standards du Conduct Regime définis par l'industrie. Il s'agit là d'une présentation simplifiée de ce qui a été réalisé au prix d'un immense effort au moment de la crise financière. Cette définition permet de montrer que l'initiative du Conduct Regime a été couronnée de succès si l'on en juge selon trois critères : 1. Le changement dans la culture des affaires, 2. La réduction des amendes et 3. La définition plus claire des comportements dans l'industrie financière

"Those of us who have looked to the self-interest of lending institutions to protect shareholder's equity (myself especially) are in a state of shocked disbelief." Alan Greenspan[1]

The two definitions of ethics correlate to two distinct approaches to regulating financial firms: one approach relies on a degree of self-regulation and the other on strong regulatory intervention. The first approach, based on self-regulation, mirrored the gradual move to deregulation in financial markets in the 1980s and 1990s. Financial institutions were effective at lobbying governments, especially in the U.S., to relax a number of regulations on the industry (Komai & Richardson, 2011). These institutions, along with a number of economists, argued that this deregulation could spur continued economic growth and improve competition within a less stringent regulatory environment (Ibid).

As financial regulations receded, firms were more or less able to police themselves within the limits laid out by the law. These limits grew more blurred, especially in the United States, as acts meant to separate banking and non-banking (*i.e.* investment banking) activities like the 1933 Glass-Steagall act were repealed (Sherman, 2009). In effect, the "free market" became the ethical standard to which firms were expected to adhere. Financial institutions were operating within the confines of the law, and therefore were not acting "wrongly". Thus, ethics and legality became very closely related within the financial industry. As long as the motives of financial firms were "pure"—in other words, as long as the banks were simply taking advantage of favourable economic and regulatory environments as opposed to actively ripping off customers—then the firm's ethics were more or less acceptable. Of course, the line between simple and predatory practices began to blur as economic growth in the 1990s and early 2000s caused ethics to give way to profitable, risky behaviour.

Homeownership and Motives

One example of the hands-off regulatory environment and its effect on ethics is the growth of homeownership in the United States from the mid-1990s. President Bill Clinton was a driving force in expanding homeownership in the United States and helping to change government policy to help make this happen. This shift built upon an already tangible, "American" idea of homeownership and formed a key plank of the "American Dream" (Watkins, 2008). Government policy, academic reports and economic research generally showed positive effects of homeownership and of increasing access to credit among populations with low rates of home ownership, particularly minorities and first time borrowers (Aaronson, 1999; Green & White, 1997; Timiraos, 2015; Watkins, 2008). In response to the growing expectations of the American dream, the American

1 (Custer, 2012)

avec les banques – et non les régulateurs – dans le rôle proactif. Plus largement, le Conduct Regime a utilisé successivement deux approches, avant et après 2008 : une approche par les motivations et une approche par les conséquences.

La première approche de l'éthique, basée sur l'auto-régulation, reflète la tendance à la dérégulation des marchés en vogue dans les années 1980 et 1990. Au fur et à mesure que la régulation perdait de sa vigueur, les entreprises se sont avérées être plus ou moins capables de se discipliner dans les limites imposées par la loi. Celles-ci sont devenues plus floues, spécialement aux Etats-Unis, avec la révocation des lois (comme celle du Glass-Steagle Act de 1933, en 1991) qui séparaient les activités bancaires des activités non-bancaires, à l'instar de la banque d'investissement. A cette époque, la référence au libre marché est devenue la norme éthique à laquelle les

government and private financial institutions began to incentivise homeownership both directly, through tax incentives, and indirectly, through low mortgage rates which were in turn enabled by the low interest rates of the early 2000s (Bajaj & Leonhardt, 2008; Denning, 2011; Gopal, 2013).

In this regard, the strategies of the largest banks were able to dovetail with an arguably "good" motive—getting more Americans into homes which they owned—even if there were obvious profit motivations. In order to help drive this change, banks began making riskier loans to previously unqualified buyers and casting this expansion in home ownership as a goal of a redefined Corporate Social Responsibility (CSR), a marked change from how the concept had been previously understood (Herzig & Moon, 2012; Visser, 2010). This change is something that continues to be seen today, as home loans and mortgage approvals are still typically seen as one element of CSR for many financial institutions (Shen & Chang, 2012; Visser, 2010).

In hindsight, the motives of the bank were obvious—profit was good at almost any cost, social or otherwise. But because there was no real ethics regime in place, or at least no regime which had not been repealed in the era of deregulation which dominated the 1980s and 1990s, financial institutions were able to engage in increasingly reckless and risky behaviours. The era of self-regulation and self-policing of motive had collapsed into an "ethic-less" system which prized good economics over good ethical choices.

As the money sunk into subprime mortgaging in the United States grew, lending standards fell dramatically. The number of subprime loans offered by banks to those with below average credit increased by almost fifteen times between 1998 and 2007 (Bernake, 2009; Visser, 2010). By the time the housing bubble burst in the United States in 2006 and the subprime loans made began to go into default, the financial industry was left holding too much bad debt to remain viable (Holt, 2009). This led to massive government bailouts in both the U.S. and United Kingdom in order to prevent the collapse of the broader financial system (Barker, 2008; Darling, 2008; Paulson, 2008; U.S. Senate Committee on Banking Housing and Urban Affairs, 2008). The light touch "motives" approach to regulating financial institutions was a significant cause of the 2007-2008 financial crisis and led to staggering losses for both consumers and financial institutions. The failure of ethical controls within banks would eventually result in multibillion dollar fines for shoddy lending practices, poor controls and misdeeds in the lead-up to the greatest financial crisis since the Great Depression. The failure of this approach signalled the beginning of a broader shift to a more strict, consequences-based regulatory environment (Braithwaite & Nasiripour, 2013).

entreprises étaient supposées adhérer. Par conséquent, tant qu'elles opéraient sans enfreindre la loi, elles ne pouvaient pas agir mal. C'est ainsi, que la loi et l'éthique se sont entremêlées.

Les stratégies des plus grandes banques ont réussi à faire coïncider la bonne intention d'ouvrir largement l'accès à la propriété avec leur soif de profit, mais au prix de crédits plus risqués aux acheteurs immobiliers peu solvables. En résumé, les motivations des banques étaient évidentes: les bénéfices étaient bons et à n'importe quel coût social. Comme il n'y avait pas de référentiel éthique en place, ou du moins qu'il avait disparu avec la dérégulation des années 1980-90, les institutions financières ont pu se comporter sans scrupules et l'ère de l'auto-régulation et de l'auto-contrôle s'est effondrée pour donner lieu à un système sans éthique où la quête de résultats économiques prévalait sur toute considération éthique.

The Consequence-based approach

"Treating customers fairly (TCF) remains central to our expectations of firms' conduct, that firms put the well-being of customers at the heart of how they run their businesses." Financial Conduct Authority[2]

The shift towards a consequences-based view of regulation has been based on three defining aspects: stiff financial penalties for wrongdoing, increased capital requirements to hedge against future downturns and more robust Conduct rules to address the lack of a strong ethical framework for the industry before the financial crisis.

In the wake of the financial crisis of the last decade, regulators have moved from allowing self-regulation to requiring more stringent regulatory requirements on financial institutions. In addition to billions of dollars in financial penalties, negative public perception and remediation efforts, firms have also seen increasing regulations and government rules enforced by strong regulatory bodies in the U.S., European Union and U.K. (Zarroli, 2015). American and British regulators have been especially muscular in their approach to punishing perceived misconduct, with almost $65 billion paid in penalties by American and European banks in 2014 alone (Sterngold, 2014). As fines continue to be levied against both institutions and individuals, regulators are laying clear markers of the standards of behaviour expected of financial institutions.

In addition to fines, regulators have focused on forcing banks to hedge against risk through higher capital requirements (BIS, 2010; Jochen *et al.*, 2011). The Basel III reforms are the most visible example of this approach as they define the required minimum capital buffers for financial institutions, though there is potential for these capital requirements to increase further on a country by country basis (Bank for International Settlements, 2014; Onaran, 2013). American regulators have taken such an approach by requiring banks to hold minimum leverage ratios of 5-6% (Armour & Tracy, 2014). Banks have been able to weather the increased capital requirements, cutting costs, reigning in dividends and bonuses, though whether this achieves the goal of reducing overall risk remains to be seen (Barth & Prabha, 2013; Cohen, 2013).

The final pillar of the recent regulatory approach has been the release of requirements on business Conduct, either by building on post-crisis legislation like the 2010 Dodd-Frank Act or by releasing standalone codes of business Conduct like the FCA's Conduct of Business Sourcebooks which came into force from 2007-2009 (Building Societies Association, 2013; Financial Conduct Authority, 2007; Financial Services Authority, 2014)[3]. Through these sourcebooks and similar guidelines, regulators

2 (Financial Conduct Authority, 2006)

3 By sourcebooks, I refer to the FSA/FCA's Business, Mortgages and Home Finance, Insurance and Conduct of Business sourcebooks (BCOBs, MCOBs, ICOBs and COBs respectively.

Le déplacement du régime de régulation vers la prééminence des conséquences repose sur trois composantes: des amendes salées en cas de mauvaise conduite, des exigences accrues de fonds propres pour couvrir les risques de retournement de conjuncture et des règles continues dans le Conduct Regime plus robustes pour pallier l'absence d'un cadre éthique contraignant dans l'industrie, avant la crise. Toutefois, bien que cette approche ait été adéquate lors de la montée de la crise, on doit constater aujourd'hui qu'elle est plus efficace que celle basée sur l'éthique des motivations (conviction ou vertus) pour renforcer l'éthique au sein de l'industrie bancaire. Les coûts pour l'industrie du Conduct Regime ont atteint des sommets en 2014 et il n'y a pas de raisons qu'ils décroissent de manière significative dans un avenir prévisible comme des nouveaux délits ne cessent d'apparaître. Toutefois, on a de la peine à dire si ces coûts accrus ont contribué à faire progresser l'éthique.

have attempted to outline the expectations placed on firms in the provision of service to customers . In an almost legislative fashion, regulators have set out guidance on how firms must behave in the market, putting fines or other punishments in place for those which fall short of the listed regulatory expectations. Through a combination of regulatory guidance and legal requirements, the financial industry has moved towards satisfying regulatory expectations with a renewed focus on Conduct and creating sustainable, positive outcomes for customers (Bank of England, 2014; Robson *et al.*, 2013).

Improving ethics through accountability

A key concern of the growing number of regulations is improving clarity on what is expected of firms and increasing accountability within the financial industry. One example of this focus is the Senior Managers Regime (SMR) being developed by the Prudential Regulatory Authority (PRA) and FCA (Bank of England, 2014). The SMR has an overall objective of increasing responsibility and accountability within financial institutions (Bank of England, 2014). Designated senior managers will now be held responsible for acts of misconduct in their business areas. When Conduct failings are reported, these senior managers will need to go beyond stating that they had no material knowledge of the fault—the onus will be on these managers to prove that they exhausted all options to either prevent or mitigate acts of misconduct (Rands & West, 2014). Whether rightly or wrongly, regulatory focus has been primarily on holding senior management accountable for the potential consequences of their actions, namely actions which result in significant customer detriment. But if the aim is to improve ethics within financial institutions while ensuring an environment where they can grow, is this approach effective?

The SMR is a positive step towards improving accountability within the financial industry, making a clear link between the decisions people make, the risks inherent in those decisions, and ultimate outcomes(Financial Conduct Authority, 2015; Jones, 2015). Does this approach, however, actually improve ethics or does it merely strengthen accountability—and clarify blame—in instances where banks fail to meet their ethical objectives? If the goal, as mentioned, is to improve culture, increased accountability only enhances a consequence-focused view of Conduct without necessarily improving ethics. In other words, the Conduct agenda thus far has been defined and driven by regulators without driving a substantive change within firms *because it further incentivises a "box-ticking" approach to Conduct management* to satisfy those outside of the business looking in (Rands & West, 2014). In this light, the approach represented by the SMR seems to improve regulatory scrutiny, but does little to improve ethics. Thus, firms would not be addressing potential

La régulation ancrée dans une approche conséquentialiste se justifie en période de crise, mais il n'est pas prouvé aujourd'hui qu'elle soit plus efficace que l'approche par la motivation pour améliorer le cadre éthique de l'industrie financière. Malgré les coûts plus élevés du Conduct Regime et ses exigences accrues en matière de gouvernance pour le top management, les résultats concernant l'éthique se font toujours attendre.

L'approche actuelle renforce plutôt la vision de l'éthique comme relevant du fait de "cocher des cases", plus adapté pour satisfaire les exigences de régulations qu'à produire des changements culturels et éthiques. C'est seulement en s'attaquant à la complexité des structures des entreprises, des produits et des processus, que les régulateurs et les entreprises financières peuvent progresser effectivement en matière d'éthique et restaurer la confiance du public dans l'industrie financière.

ethics problems, but would rather seek to comply with existing rules, potentially leaving firms open to new risks and new ethics problems.

The consequence-based approach to regulation, while understandable in the wake of the financial crisis, has yet to prove that it is more effective than the motives-based approach in improving ethics within the banking industry. Conduct costs rose to record levels in 2014 and these costs are not set to decrease appreciably for the industry in the foreseeable future as additional wrongdoing is brought to light (Sterngold, 2014). Yet the fact that additional wrongdoing has to be punished in itself questions the efficacy of a consequence-based approach. While it is generally easy to say that a financial institution has committed a wrong—whether by violating sanctions, misselling to customers or by violating standards of product suitability—it is less easy to say that fines address the root causes of these violations. The results of both the motives and consequences-based approach of regulation have shown that there is clearly an element missing in the formula to bring banking ethics to a higher standard. That missing element is one which neither approach has adequately addressed: complexity. Only by addressing complex business structures, products and processes can regulators and financial firms make concrete steps to improving ethics and restoring trust in the banking industry.

Defining Complexity

"This proposal encompassed multiple, complex credit trading strategies, using jargon that even the relevant actors and regulators could not understand." Senate report describing a proposal made to JPMorgan Chase senior management approving the London Whale trades.

Firms must manage the complexity of their business in order to improve ethics within the industry. In the wake of the financial crisis, regulators have focused on large "megabanks" as "too big to fail" or "too big to manage", both from an economic and regulatory point of view (Collins, 2014; Federal Reserve Bank of St. Louis, 2012). As banks become larger and more complex, it becomes harder to both adequately evidence motive and create enough transparency that regulators can effectively regulate (Collins, 2014; Denning, 2013). In other words, it has proven hard to improve the ethics of financial institutions because it has become harder and harder to understand the inner workings of these businesses (Santoro, 2013; Tett, 2012; U.S. Senate Permanent Subcommittee on Investigations, 2013). Whether the complex derivative products which helped fuel the sub-prime mortgage bubble or the complex company structures which allowed billions of dollars of trading losses to go undetected, complexity within the financial industry has frustrated both motive and consequence-based approaches to regulatory scrutiny.

Comme le "too big to fail" devient "too complex to regulate", les entreprises financières, tout comme les régulateurs, se trouvent en difficulté pour prévenir l'inconduite dans les parties les plus opaques de l'industrie. En 2012, l'épisode du Requin de Londres montre à l'envie à quel point même ceux qui sont internes à l'industrie peinent à comprendre la portée des engagements pris par les directeurs. Ce qui frappe dans ce cas, c'est la conjonction de la surveillance dans la logique des conséquences avec celle ancrée dans la logique des motivations. Des règles existaient pour limiter les transactions du type de celles qui ont eu lieu; l'entreprise s'était aussi engagée à suivre ces règles; les sanctions étaient également prévues pour punir les vio-

The 2012 London Whale episode provides an example of how complexity within financial institutions can hide potentially unethical actions from both regulators and the firms themselves. Traders in JPMorgan Chase's London office engaged in risky trades, often at a loss, over a sustained period (Hurtado, 2015; Norris, 2013; Santoro, 2013). What is striking here is that this case is the perfect marriage of motive and consequence-based scrutiny: there were rules in place to restrict the types of trades which occurred, a company commitment to follow these rules and consequences in place to punish failure to follow listed regulations. Yet, in this case, both the bank and regulators failed to notice the loss-making trades for a sustained period because of changes to the "Value at Risk" (VaR) risk management tool used by the firm (Hurtado, 2015; Kopecki & Son, 2013; Santoro, 2013). In turn, regulators in the United States failed to detect the increasingly skewed risk profiles of the firm's trading portfolio and the potential danger those trades could cause to the broader financial system.

In addition to suffering billions of dollars in losses, JPMorgan Chase agreed to pay over $920 million in fines to American and British regulators in 2013 (Robson *et al.*, 2013; Scheer & Kopecki, 2013; U.S. Senate Permanent Subcommittee on Investigations, 2013). Perhaps more importantly, the episode exposed a serious flaw in both regulatory and industry efforts to identify and contain risks. Agreements to improve internal oversight by financial institutions and fines levied by regulators are failing to achieve their goal of inducing true change and a more ethical industry (Admati, 2014).

Changing Priorities—Enforced Ethics?

As fines fail to have the desired effect, legislative and regulatory efforts in the US, UK and EU have focused on ways to reduce the size of financial institutions and regulate the types of activities they can conduct. American regulators in particular have taken a lead in placing more scrutiny on how banks grow, most recently in the 2010 Dodd-Frank Act which places more reporting requirements on financial institutions of a certain size and restricts their trading activities (Barth & Prabha, 2013; U.S. Senate Permanent Subcommittee on Investigations, 2013). In addition, the act prohibits mergers of financial institutions of a certain size and requires "living wills" from the largest banking institutions, giving regulators a way to deal with banking failures in an orderly fashion ("Banks Must Show They Can Die Quietly," 2014). The aim of these regulations is to protect consumers and the wider economy while ensuring that investors bear the brunt of the resulting fallout ("Bank resolution: Pre-empting the next crisis," 2015; Hamilton, 2014). Similar efforts to separate areas of big banks, whether the UK's "ringfence" approach or the EU's efforts to have lations de ces règles. La complexité est le véritable enjeu dans ce cas. Cette dernière, plus que l'absence de conséquences assignées ou de motivations floues, est au coeur des problèmes éthiques auxquels les entreprises financières sont actuellement confrontées.

Les exigences des régulateurs en matière de fonds propres et de cloisonnement des activités sont des éléments importants d'un puzzle de plus en difficile à mettre ensemble. Ces mesures ne sont toutefois que le prolongement des efforts destinés à améliorer le standard éthique de l'extérieur. Or, le véritable changement dans l'industrie doit être initié et conduit par les entreprises elles-mêmes. Il doit se concentrer sur la simplification des processus et des entreprises, par ailleurs trop complexes. Le chemin vers une culture articulée autour de l'éthique ne peut commencer que si les régulateurs et les entreprises elles-mêmes comprennent vraiment ce que font ces dernières.

banks create separate legal entities for proprietary trading and other activities are also underway in other jurisdictions(Barth & Prabha, 2013). These actions will create some change in financial institutions, however, these changes are too recent to demonstrate that they have had a clear impact on ethics within the industry. Legal or structural separation of banking activities can help make banking activities more transparent to an extent, but it is unclear that simply breaking up a complex whole into a series of smaller, still complex parts will improve ethical considerations within banks (Baily, Elliott, & Swagel, 2014).

These steps are important, however, in terms of improving ethics this is another example of "outside in" requirements ("Bank resolution: Pre-empting the next crisis," 2015). Outwardly, both financial institutions and regulators have made concrete steps towards managing risk, reducing incidents of misconduct and putting forward a desire for an image of ethical behaviour and trust. In reality, however, these steps have proven inadequate in the face of a complex financial system where misconduct can go unnoticed on a grand scale. In order to substantively improve ethics or Conduct within the industry, a massive effort to simplify and streamline financial institutions is required. This is the only viable method to ensure that financial institutions are not overly large and complex enough that management cannot understand and control what is happening under their watch. Streamlining and simplification must be the next "approach" used by regulators and financial firms alike to improve and embed ethics within the banking industry.

Where do we go from here?

Simplification, whether reducing the number of legacy systems present within banks or creating simpler business models, is integral to establishing an environment for better ethics. The key question is how to make a streamlining agenda work and actually change the industry in a way which positively impacts its ethics. While this is a complicated question and an even more complicated process, there are four key principles in this new approach: changes must be industry led, they must dovetail with a substantive change in business culture, they must strengthen risk functions and they must lead to a retreat from risky markets, behaviours and processes.

First, any change must be industry led. While this may seem like a return to self-regulation, true change will need to come from within financial firms in order to ensure the best outcomes for customers and the industry. If financial firms are forced into streamlining or downsizing, the approach chosen for the banks may be more painful and against more aggressive timelines than a plan designed within the industry itself. One only needs to look at the massive efforts around ringfencing in

La simplification est indispensable pour la mise en place d'un environnement favorable à l'éthique. Elle doit être obtenue, aussi bien par la réduction du nombre de régimes différents – souvent hérités du passé – présents au sein des établissements, que par la simplification des modèles d'affaires. Ce changement doit concerner toute l'industrie, il doit être ancré dans l'engagement en faveur de la nouvelle culture et de l'éthique. Il doit être centré sur l'abandon de certains marchés, produits et stratégies risqués.

the UK, and the associated costs, to see that an effort developed, led and implemented by banks will lead to a smoother transition to the streamlining agenda (Fleming, 2014).

In addition, changes need to be founded on a commitment to a new culture and commitment to ethics. In part, the Conduct agenda achieves this, but only to an extent—staff within financial institutions need to be able to link complexity, risk and business detriment in a clear way. Using examples from past misdeeds, banks must show that the movement to a simpler, streamlined business is both a regulatory focus and a necessity in order to continue to grow as an industry in a sustainable way. This type of cultural change will require more than emails and memos on improving conduct. Rather, senior management must get involved in a tangible way, defining the dangers of a complex business, laying out a roadmap for substantive change and defining the "end state" of a simpler, better business.

Senior management visibility is key in any streamlining agenda, especially senior risk managers and governance structures. In short, risk and ethics management must be front and center within firms and, to as great an extent as possible, need to be independent with robust powers to execute their duties. One major lessons from the London Whale case was that in multiple instances, risks raised to senior management were either ignored or never received an in-depth follow up as needed (U.S. Senate Permanent Subcommittee on Investigations, 2013). This type of scenario needs to be addressed with stronger risk functions within banks and a greater degree of coordination and communication between risk managers and heads of business.

Once an industry-led, Culture focused change programme is in place, with robust support from risk, the final step in the streamlining approach is to responsibly retreat from certain risky markets, products and strategies. In the years following the financial crisis, low interest rates and fragile balance sheets have caused banks to search out markets and products with higher returns. At times, this search for higher rates of return have led to increasingly risky bets and complex products which are hard for consumers, regulators, and sometimes the firms themselves to decipher (Norris, 2013). In implementing a streamlining strategy, financial firms must move to reduce potential risks by avoiding risky strategies, like acquiring seemingly profitable competitors in areas with looser regulatory standards, and winding down complex products and trading activities. Again, in part, this has begun to be addressed by ringfencing initiatives, but as mentioned, simply breaking up a complex whole into smaller but still complex pieces will neither improve ethics nor create positive outcomes for customers.

En effet, le chemin vers des standards éthiques plus élevés et vers l'amélioration des performances pour leurs clients, passe par la réduction de la complexité inhérente aux entreprises financières. Cela ne veut pas dire que tout produit ou transaction complexe doit être abandonnée, mais que les entreprises ont le devoir de s'assurer que leurs stratégies et leurs produits sont en ligne avec les attentes des régulateurs et des consommateurs en matière d'éthique.

The final (ethical) frontier?

The question remains on whether any financial firm can be ethical. After all, banks are primarily institutions whose primary purpose is to create positive returns for shareholders, and this role has become more apparent as these institutions grow larger. At some point there is a limit to how much good regulation can actually do in a corporation with thousands of individual actors, each of which make an unknown number of decisions per day and face innumerable opportunities to either do the right thing or not. Changing the ethics of a firm becomes harder as more and more possible actors are added who, in turn, bring personal views on how best to help the firm and the ethical considerations—or lack thereof—which need to be made in their actions. Complexity of the institutions being regulated is one reason "ethics" within the industry is so hard to define and strengthen. Regardless, there is a standard of right and wrong actions which, at the risk of sounding utilitarian, either hurt or help customers and fulfil broader socio-economic purposes.

So can large financial firms be ethical or must they be broken into smaller, more manageable chunks by regulators? For now, it is unclear whether such a stance is either achievable or desired in the foreseeable future (Baily *et al.*, 2014). And even with this approach, there are gaps in how well ethics within large financial firms can be policed. In the short and medium term however, the streamlining agenda is the best hope for banks wishing to retain their place as major international players and deliver the ethical outcomes which shareholders, regulators and consumers expect. There are arguable benefits to consumers in a reformed financial system with large banking players, especially in terms of the price benefits of an economy of scale (Baily *et al.*, 2014; Federal Reserve Bank of St. Louis, 2012; Hughes, 2013; Wheelock, 2012)[4]. Given past experiences with large financial institutions, however, legislators remain open to the idea of breaking up large, complicated financial institutions into smaller, more easily understood units (Morrison, 2015; Slater, 2014). If the streamlining and simplification agenda fails, then this type of enforced downsizing will follow motives-based, consequences-based and complexity-based scrutiny as the next era in financial regulation.

4 There are a range of academic studies on whether large banking firms really achieve economies of scale at their current levels. For more information, see Feng & Serletis, "Efficiency, Technical Change, and Returns to Scale in Large U.S. Banks, Hughes & Mester, "Who Said Large Banks Don't Experience Scale Economies," among other works

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