

Why have corporate governance and risk management failed to prevent frauds and financial crises?

# Collapses

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- Organisations lending to people who couldn't repay, leading to the global financial crisis (2007)
- The collapse or near-collapse of AIG, Alliance & Leicester, Barings, Bear Sterns, Bradford & Bingley, Dexia, Fannie Mae, Fortis, Freddie Mac, Goldman Sachs, HBOS, Lehman Brothers, Lloyds TSB, Merrill Lynch, Morgan Stanley, Northern Rock, RBS, Washington Mutual, etc. (2008-2009)
- Pension fund collapses at the Maxwell Group (1992), BHS (2016)

# Rogues

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- The rogue traders at Barings (1995), Sumitomo Corporation (1996), Allied Irish Bank (2002), Société Générale (2008), Nav Sarao Futures (2010), RBS (2011) UBS (2011) and JPMorgan Chase (2012)
- The Libor and Euribor manipulation led by Barclays and involving Citigroup, Deutsche Bank, HSBC, JPMorgan, Royal Bank of Scotland and UBS (2005-2013)

# Mis-selling

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- The mis-selling of interest rate swaps by Barclays, HSBC, Lloyds and RBS (2013), and Santander (2015)
- The mis-selling of payment protection insurance by Alliance & Leicester, Barclays, Capital One, Egg, HFC, HSBC, Lloyds, RBS and other lenders (2001-2011)

# Frauds

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- The frauds at BCCI (1989), Maxwell (1991), Enron (2001), Tyco (2002), WorldCom (2002), Madoff (2009), Stanford (2009), Olympus (2011), Serco & G4S (2013), GSK in China (2014), Tesco (2014) HSBC's Swiss branch (2015), and Volkswagen (2015)

# Insecurity

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- The security breaches at Yahoo (2013), TalkTalk (2015) and Tesco Bank (2016)

# Reputational damage

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- The reputational damage by Ratners (1991), Members of Parliament (2009), BP (2010), News International (2011), Mid Staffordshire NHS foundation trust (2012), the Financial Conduct Authority (2014), and Sports Direct (2016)

# The last resort

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- Government is governance too and governments are the lenders of last resort so the following failures were particularly serious:
  - The inability of Greece, Portugal, Ireland, Spain and Cyprus to repay or refinance their debt (2009 - 2013)
  - The Asian financial crisis (1997-1998)

# A question

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- Is there any evidence that corporate governance and risk management are useful, or that their cost is less than their benefit?
- Most of the time there aren't governance problems; however it's impossible to prove whether this is because no-one's doing wrong or because no-one's noticed wrong-doing or because of corporate governance and risk management
- Here are some of the possible causes of the failures

# Impersonal

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- Is it true that corporate governance and risk management
  - Are the concern of only a few people
  - Try to stop people doing things
  - Pay insufficient attention to incentives
  - Don't take human factors into account
  - Work against psychology
  - Provide no defence against self-interest
  - Are over-complex and obscure

# Expensive

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- **Corporate governance and risk management**
  - Take up the time of regulators, external auditors, the executive team and the finance, internal audit, regulation, risk management, and HR functions
  - Have uncontrolled costs because no-one calculates their cost

# Reactive

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- Are corporate governance and risk management reports
  - Retrospective
  - Out of date
  - Unchangeable
  - Obscured by detail
  - Incomplete
  - Manipulated
- and don't
  - Tell you whether the rules are being followed
  - Tell you whether the rules are likely to be followed
  - Say how the organisation will perform in future
  - Mitigate risks
  - Regulate behaviour
  - Support decision-making

# Your turn

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- In small groups, share your opinions of the possible causes of the failures
- Try to reach a consensus
- Within 20 minutes, Direct Message divergent opinions to [https://twitter.com/moxey\\_paul](https://twitter.com/moxey_paul)
- DHWIFI password dhconn3cT
- Please ensure that your message is less than 35 characters so that it fits the voting system slide
- Our reasons for using Twitter are to
  - encourage concise statement of opinions
  - increase the diversity of views
  - avoid transcription effort, time and errors
  - try something new

What needs to change to make corporate governance and risk management effective?

# Are we flogging a dead horse?

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# The response to the problems

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- More laws, regulations and standards
- More money and resource
- More regulatory bodies or renaming of old ones
- You can't solve a systemic problem with money!
- It's crazy to do the same sort of thing over and over again and expect different results
- If you keep doing what you've always done, you will keep getting what you've always got
- Should we challenge assumptions?
- Should we try something fundamentally different?

# Something fundamentally different

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- In a future forum, would you be interested in seeing a system which makes governance
  - **Integrated** - everything an organisation needs to produce, do and employ is linked and displayed at all levels for all stakeholders
  - **Inclusive** - everyone is empowered and required to say how they will measurably contribute to the organisation
  - **Transparent** - anyone, internally and externally, can see what everyone intends to employ, do and deliver, and their progress
  - **Predictive** - the causes of success are identified and the probability of people achieving their outcomes is predicted, mitigating the risk and fear of failure

# Your turn

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- In small groups, share your opinions of the possible ways of preventing the failures
- Try to reach a consensus
- Within 20 minutes, Direct Message divergent opinions to [https://twitter.com/moxey\\_paul](https://twitter.com/moxey_paul)
- Please ensure that your message is less than 35 characters so that it fits the voting system slide

# Lunchtime

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- At 1.30 we'll vote on the answers to the questions:
  - Why have corporate governance and risk management failed to prevent frauds and financial crises?
  - What needs to change to make corporate governance and risk management effective?
- and on the following question
  - Would you be interested in seeing a system which makes governance effective?
- We'll use the prioritised answers to inform a discussion of 3 scenarios

# Voting

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- Vote for the answer which you think best answers the question *Why have corporate governance and risk management failed to prevent frauds and financial crises?*
- We'll remove the most popular answer and ask you to vote twice more to find the second and third most popular answers
- We'll repeat the process for the answers to the question *What needs to change to make corporate governance and risk management effective?*
- Then vote yes or no to the question *Would you be interested in seeing a system which makes governance effective?*