

Making Ethical Decisions in Risk Management

Patrick McClure, AO
the Centre for Social Impact (CSI), UNSW

Ethics

What is Ethics?
Why is it relevant?



Relevance

- Risk management
- Company sustainability (leadership, governance, decision-making, culture, transparency)
- Accountability to shareholders, regulators, industry, staff, public
- Reputation

What is Ethics?

“ETHICS IS ABOUT RELATIONSHIPS.

IT’S ABOUT STRUGGLING TO DEVELOP A WELL-INFORMED CONSCIENCE.

IT’S ABOUT BEING TRUE TO THE IDEA OF WHO WE ARE AND WHAT WE
STAND FOR.

IT’S ABOUT HAVING THE COURAGE TO EXPLORE DIFFICULT QUESTIONS.

IT’S ABOUT ACCEPTING THE COST.”

Dr Simon Longstaff

St James Ethics Centre

Values and Principles

Influence of:

- Family
- Education
- Life experience
- Role models
- Colleagues

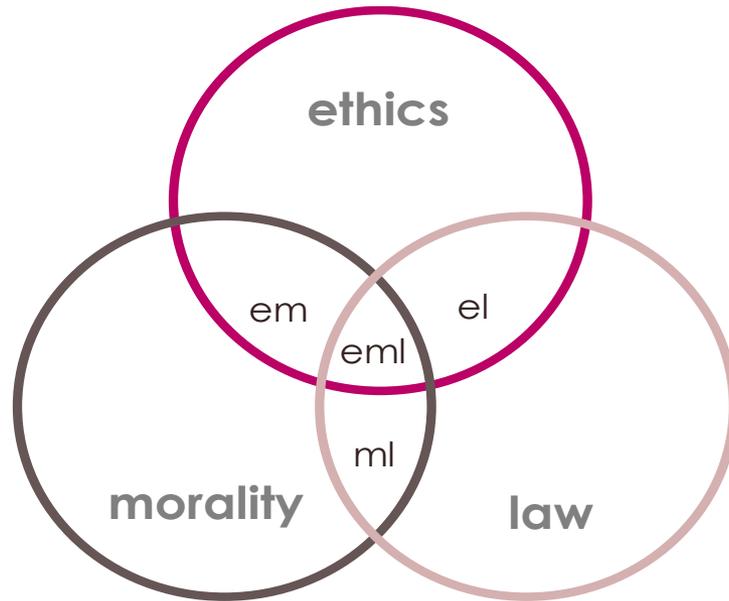


Ethics, Values and Principles



living a **worthwhile** life

Ethics, Morality and Law



Example: Martin Luther King Jr



Threats to Acting Ethically

- Legalism: the inability to see any moral obligations beyond the law
- Tribalism: the belief that the organisation is always right
- Moral relativism: excusing unethical practices because values and principles are relative
- Authority: that is not subject to questioning or dissent
- Unthinking custom and practice: this is the way we do things

Threats to Acting Ethically

- Cognitive bias: leader's overconfidence, arrogance ("Gorilla of Wall Street"), suppressing dissent, covering up mistakes (Lehman Bros)
- Organisation structures: bonus and compensation systems that reward short-term profits, high- risk strategies at the expense of long term values and performance (Enron)

Global Financial Crisis

- “The intellectual edifice of modern risk management has collapsed”
(Alan Greenspan, Testimony to Congressional Committee on Oversight and Government Reform)
- Superiority of unregulated financial markets and their ability to self-correct (prevailing authority)
- Repeal of the Glass-Steagall Act: removing the prohibition on commercial banks owning investment banks (legalism)
- Collusion of ratings agencies with investment banks: AAA* ratings (moral relativism)

Global Financial Crisis

- Low interest, sub-prime loans to individuals with poor credit histories (unthinking custom and practice)
- Originate and distribute model (CDO, MBS): from mortgage brokers to hedge funds (moral relativism)
- US sub-prime loans rise from \$160b in 2001 to \$600 b in 2006
- High interest rates, housing demand, prices soar
- Asset bubble bursts across global institutions linked to mainstream commercial banks, superannuation funds

Developing an Ethical Culture

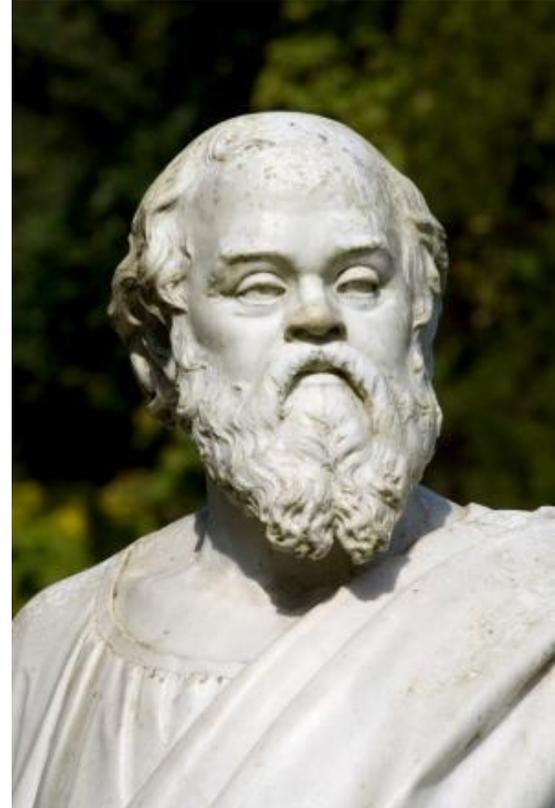
- Corporate Social Responsibility (CSR): measurement and reporting of company economic, environment and social performance
- CSR codes:
 - United Nations Global Compact (7,700 companies, 130 nations)
 - International Organisation for Standardisation (ISO)
 - e.g. AS/NZS 31000: Risk Management – Principles and Guidelines
 - Global Reporting Index
- Next wave of CSR: risk components of business averted by investment in 5 types of capital: reputation, social, environment, financial and human capital (Young, “The World that Changes the World”, 2010)
- BP Deepwater Horizon

Developing an Ethical Culture

- ASX Best Practice Corporate Governance Principles
- Leadership from the top (risk manager's relationship to CEO)
- Code of Ethics integrated in culture
- Ethical Decision-Making Model
- Complaints mechanism (whistleblowers)

Ethical Approaches

Socrates: What ought one do?



Outcome-based Approach

- Outcome or consequence of an action
- Utilitarianism: maximises benefit over harm
- Commercial companies (profit, shareholder value)

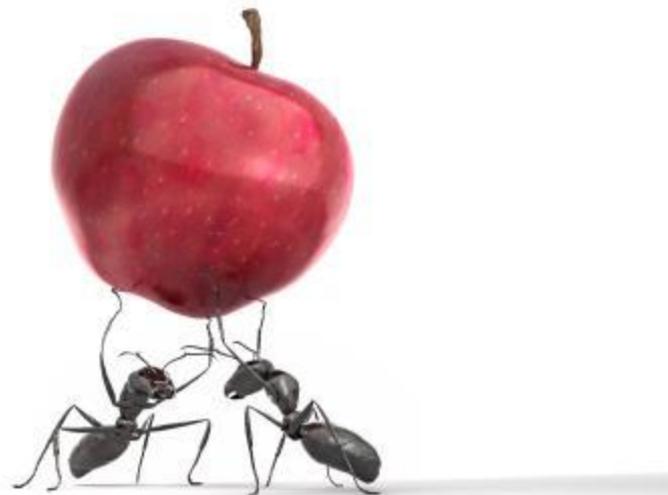
Duty-based Approach

- An act is ethical if it is a good general rule for people to follow
- Principles guide behaviour
- Codes of Ethics, ASX/ISO31000

Character-based Approach

- Aristotle
- Character of the individual: practical wisdom, integrity, good judgement
- Golden mean

Making Your Decision



Overview

- Frame the story
 - What are the facts
 - Who are the stakeholders? What would they want?
- Identify the dilemma
 - Frame as A versus B
 - Choice between options
- Evaluate
 - According to norms and principles
- Act

Evaluate

Consider the following:

- Norms: what is usually done in this situation?
- Laws/codes: do any apply in this situation?
- Duties: what duties do you have in this situation?

Evaluate

1. Which alternative generates the best outcome i.e. maximises benefit over harm?
2. Which alternative makes a good general rule for people to follow?
3. Which alternative would a person with practical wisdom choose?

Evaluate

4. Which alternative promotes best practice in risk management?
5. Which alternative reflects your company's values and principles?
6. Which alternative would you be prepared to support in public?

Final check

Sunlight test:

Would you be happy to defend your decision if it was printed on the front page of the newspaper?

Act



The unexamined life is not worth living

Socrates (5th Century BC)