

Can law institute an ethical culture in organisations?

What do we do when law and markets fail? When we hear the suggestion we need to transform the culture, or ensure there is a better tone from the top, should we reach for a pistol or, as I prefer to think of it, a dagger dipped in cynicism? More pertinently, can regulators do anything with concepts as nebulous as culture or as contested as ethics?

These questions were posed by the first in [Centre for Ethics and Law](#) series of events around law and the ethics of capitalism by Dan Awrey, HHJ William Blair and David Kershaw. Their answer to the question is regulators should get tougher but also, perhaps surprisingly, as Professor Kershaw put it, they should get fluffier. Drawing on the model of Treating Customers Fairly, they advocate that the Financial Services industry should be required to develop their own meaningful internal processes for understanding and evaluating ethical problems and that this should apply to their understanding of risk and their treatment of counterparties (the Muppets of Goldman Sachs fame whom the economists refer to as sophisticated purchasers). The aim is to institutionalise more ethical thinking in financial organisations. It is an ambitious aim. Under their idea, regulators set the broad parameters of such processes and then get the firms to take responsibility for evolving their own ethical culture and processes. Crucially, whilst requiring firms to give ethical frameworks room to breathe within companies, it has to be backed by rigorous enforcement. So regulators need to enforce and use reputational sanctions to police both substantive breaches of regulation and failures to implement an ethical framework within the organisation.

Hence there is a large degree of ambiguity – the main aim is to require firms to think about the ethical consequences of their actions, rather than simply about profits, but do so in a meaningful way only loosely prescribed by regulators. The ambiguity is important: only by the firms taking responsibility for being ‘ethical’ will genuine change occur; they have to be given room within which to take responsibility; ambiguity means they cannot simply comply on paper; and enforcement means they have to take it seriously. It is a model which has some interesting research evidence backing it up but, as Awrey et al acknowledge, one which faces a number of challenges. One of these is incentives; the stronger economic incentives to behave in one way are, the less ethical considerations have room to influence decision-making. Another is corporate governance structures. There would need, they think, to be a loosening of the grip of shareholders, and especially short term value seeking by shareholders, on corporate thinking. They propose various ways of doing that. As such, creating a system of process-based regulation, as they call it, within companies also requires addressing a range of more entrenched problems alongside the significant challenge of getting the Finance industry to take ethics seriously.

It’s very interesting idea and one to be taken seriously. There is [already research from Sharon Gilad](#) suggesting that there is potential in the approach. It is not so different from principles based regulation (or outcomes focused regulation). The emphasis in the ethics literature on the importance of firms demonstrating how they think about their impact on others; how they make ethical risk both tangible, proximate and serious when people take decisions; how they prime their staff to think ethically and make time for proper – and not self-serving - reflection; are all sensible ideas, the question is whether this process-based regulation can make it more likely that firms do make space to think in this way (and do so proportionately of course). Enforcement is clearly a key problem: enforcement against ambiguous standards leaves a regulator open to both legal challenge and procedural justice concerns. On the latter, if regulators push too hard, against ambiguous standards, they lose legitimacy with the regulated community who then feel justified in misbehaving; if they push too gently, the approach is not taken seriously. On the former, regulatory frameworks need to be given room to breathe by the judges who police through judicial review. Another way of looking at this is to suggest it is likely to be a quite demanding process for regulators and regulated: the broad principles that make up a process-based approach might be relatively stable, but the interpretation of those principles will need to evolve if institutionalising an ethical framework is not simply to revert to a compliance regime where boxes are ticked and minds closed. The structure might remain stable but the thinking would have to evolve.

You can read Awrey, Blair and Kershaw (2012) Between Law and Markets: Is there a Role for Culture and Ethics in Financial Regulation? [Here](#).