

# Financial Markets and the Investments of the Church

by David Pitt-Watson

This address was given to the [Church Investors Group](#) at their November 2011 meeting

Markets, particularly financial markets, need morals.

That is not a statement of doctrine. It is a basic fact of economics, which, through most of history would have been self evident to economists. Indeed for most of its history, economics saw itself as a branch of moral philosophy.

So when the protesters discovered that they were occupying cathedral property, rather than that of the London Stock Exchange, they pulled the church into a debate which was both about economics and about morality. That is territory which the Churches should be happy to occupy. And, since markets need morals, it is one of immense practical significance for the financial world that the churches, and society more generally might wish to build.

## Economics, Ethics and the Church

If we go back to medieval writings on economics, they are found in the manuals of confessors struggling with issues of the morality of wealth and exchange. Adam Smith was a professor of moral philosophy, his first great work, "The Theory of Moral Sentiments".

But economics has become unhitched from its moorings in moral philosophy. The so called laws of economics, aimed to create a "science" like that of physics. That suggests that economic phenomena are like physical ones. Not moral or immoral, but amoral.

That assumption is very dangerous. It is certainly not one that Adam Smith would have condoned. Indeed, if Smith were alive today, he would find it extraordinary that we give money to other people to manage. Here's what he said about the idea of the joint stock company, where you own shares of companies which others manage:

*"The directors... Rather being the managers of other people's money than their own, it cannot be expected that they will watch over it with the same anxious vigilance with which owners watch over their own. Negligence and profusion, therefore, must always prevail more or less in the affairs of such a company."*

If that was what would happen with just one agent, imagine how Smith would have regarded today's system of investing. A saver puts their money in a pension fund, which hires a fund manager, which buys the shares of an investment trust, which invests in small Japanese companies, the name of whom the original investor doesn't even know.

Yet that is what happens. So how were we able to overcome Smith's problem; how did we manage to get the "agent" to act on behalf of the "principal" and not in their own self interest? That was a question which the great doyen of classical economists, Alfred Marshall, tried to address when he wrote at the beginning of last century. He noted the marvellous growth in companies, and the prosperity which they created. But how could this be possible when those who owned the company, the shareholders, we're "almost powerless".

*"It is a strong proof", he declared, "of the marvellous growth in recent times of honesty and uprightness in commercial matters...If (the officers of these companies) showed an eagerness to avail themselves of wrongdoing at all approaching that of which we read in the commercial history of earlier civilisations, their wrong uses of the trusts imposed in them would have been on such a scale as to prevent the development of this democratic style of business."*

In other words, markets need morals. And if the church aims to provide some moral compass to the nation, here is an area where we are desperately searching for solutions.

### Fiduciary Duty

So what are the morals which markets need? The answer, I think, does not require doctrine, but rather a reflection on what are the minimum ethical norms necessary if we are to have a successful system of investment; where we can trust others to manage our money.

At heart, it would seem to me that it must have something to do with the notion of behaving as a fiduciary; that is that you use your expertise to do what you believe to be in the best interest of the person for whom you are working; not for anyone else, particularly yourself. We find, and accept such duties in all walks of life; the doctor and patient; the parent and child; the pastor and his flock.

So fiduciary responsibility is well understood. It allows us to entrust power and resources to those who have the wherewithal to use it to best effect. That in turn facilitates the specialisation which characterises a modern economy, and which has created, as Adam Smith would have noted, enormous increases in productivity and wealth. But none of this wealth can be generated unless it is safe to entrust our assets to others. If we delegate to others because of their greater expertise, we need to know they will not use their expertise to their own advantage at our expense. If we wish to benefit from a successful modern economy, this is only possible if we have good governance; that we can be assured of "the proper use of entrusted power".

So, a fiduciary model lies at the heart of any financial system which is successful in doing its job.

Let me expand further. True fiduciary responsibility is both what savers want, and it produces much better returns. Over the past three years the RSA, Britain's most venerable think tank, has sponsored a programme known as "Tomorrow's Investor". It undertook market research amongst savers, about what they would like from the financial system. They didn't have a long list of demands. They just said they would like to give their money to someone whom they knew will look after it as best they could on their behalf. In other words what people want is fiduciary management.

Further, they are right to. The RSA looked at two pension systems, that of Holland, which is based on fiduciary principles, and that of the UK which is increasingly moving towards a contractual system (that is one where, if the agent meets the letter of the contract his duties are fully discharged). The result? If a typical Dutch and a typical British saver were so set aside the same amount of money over their lifetime, and retire on the same day, the Dutch person would have a 50% higher pension in retirement. Fiduciary management allows huge increases in productivity.

Which then raises the question, how can we best promote true fiduciary management? (Note the need to qualify fiduciary management as "true". There are all too many people who offer "fiduciary management" which has no fiduciary protection, either in the letter or the spirit.)

My immediate response to the church would be this; you have to show it in your own actions. The churches of Britain have billions of pounds in investments to look after their clergy in retirement, for the upkeep of the glorious buildings they own, to further their social mission. The church should be demanding that its investments are managed on behalf of the mission and purpose for which they are invested.

Indeed I would go further. It seems to me that if the church does not do this, there is a real danger that, when it tries to express some of the frustration which our society feels towards the financial community, it will sound platitudinous. It is against greed. Fine. So what is it demanding of its own investments that ensures that as far as possible the financial community is not tempted into behaving greedily?

What might church investors do? Here would be a few suggestions, which I hope are constructive, and which I hope will encourage church leaders and church members into this debate, in a practical fashion.

First: be clear with all church trustees that they should use their fiduciary powers. If they are challenged refer them the legal work done by the UN Finance Initiative or by Fair Pensions.

Second: Have confidence in your own judgement. Many feel the need to defer to experts. One result of this that we have far fewer self-managed pension funds than in the past, as trustees have contracted out their fund management functions. But here is the surprising thing. Over the long term, in-house funds perform better than those which have been contracted to experts.

Third: Be clear about your traditions and what you stand for, and work with others to secure them. It is not just the churches who are investors, and recognise the need for change. So be distinctive where you need to, but join with others where you can. On the issue of Fiduciary Duty in the UK, Fair Pensions would be a good place to start.

Fourth: Make sure that what can be in the contract you write is indeed in contract. The International Corporate Governance Network, has just published an interesting document which details those issues which should be in the contract terms between asset owners and their fund managers. It's worth making sure that your fund manager undertakes the duties outlined in that document.

Fifth: Make use of the fiduciary promises which fund managers have promised to exercise. One important milestone in this is the Stewardship Code, sponsored by the government which outlines the duties of ownership which managers will undertake. Make sure you get a full report on what your fund managers are doing. And complain to the Financial Reporting Council of any breaches. The same should be true for any fund manager who is a signatory of the UN Principles for Responsible Investment.

In summary then, "knock, knock, knock, it shall be opened unto you". Too many think that the operations of the City are a black box. That they cannot be sensibly challenged or changed. But pension funds, fund managers, company boards are fiduciaries. They should be acting in our interests. But it's only if we ask that we can expect a response.

Markets need morals. And if the church, with all its investments, is to be fully relevant to that debate, it needs not just to preach morality, but to practice it in the way it manages its money.

I hope this short talk may have given some indication, of how it might express itself, and better undertake that task.

# Value and Values: Where the Problems Lie

by Revd Andrew Studdert-Kennedy

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In general conversation, the outcome of asking one question is almost always the wish to ask another. The more interested we are in the person we are talking to or the more complex the area we are enquiring about, so that desire will grow.

[St Paul's Institute's survey](#) of 515 professionals working in the Financial Services sector in London, shows that the truth which applies to conversation applies equally to the results of opinion polling. The outcome in almost all areas of the survey is the wish to know more. Such frustration is unavoidable given the nature of an on-line poll but it should not detract from the much greater value of bringing such important issues to our attention and whetting our appetites.

Commissioned to coincide with the 25<sup>th</sup> Anniversary of the deregulation in the City known as Big Bang, the poll provides a fascinating insight into the attitudes and understandings of people currently working in the financial services sector. If those who claim that a market is no more ethical or efficient than the people who participate in it are correct, then at a time when entire systems are being questioned, it is all the more valuable to learn about these very participants.

One of the most helpful aspects of the survey is that it offers a manageable amount of information rather than swamping us with too much. This makes it easier to reflect on what can be learnt and will no doubt allow the survey to speak to people in a variety of different ways.

Three particular areas struck me:

**First, the lack of interest in financial services history.** Whether it is an ignorance of the Stock Exchange's motto, 'My word is my bond', a misunderstanding of the nature of Big Bang or uncertainty about past economic recessions, the overriding impression is of people absorbed by the present. It is hard not to think that there is a link between such apparent lack of awareness of the past and the short-term thinking that seems to be such a weakness of current practice.

However, we should not necessarily conclude that lessons in economic history would help cure some of the failings of the system. Those with experience of past banking crises and especially students of economic history are curiously accepting of the frequency of their occurrence. A visit to the IMF website which identifies 125 systemic banking crises in 95 countries between 1975 and 2007 suggests that participants in the banking system are reluctant learners from the past, even when they have an awareness of it!

**A second area the research highlights is the difficulty of accepting where responsibility actually lies.** A majority of financial service professionals think that bankers, lawyers, bond traders, FTSE Chief Executives and stock brokers are paid too much and 75% of the survey agreed that the gap between rich and poor is too great. Add to this the finding that 51% think deregulation has resulted in less ethical behaviour and we get a clear sense of a system that is not at ease with itself.

Yet interestingly participants reveal strongly (82%) positive views about the high ethical standards their own companies maintain, which standards are broadly aligned with personal standards of morality. Add to this that ethical behaviour is discussed and incentivised and that a small (58%) majority think companies should invest directly in deprived communities and you get a sense of a system that is at ease with itself.

By unearthing these attitudes and allowing us to place them alongside each other, the survey shows a familiar human trait; recognition that there is a problem but resistance to thinking that we ourselves might be part of it. No wonder we would have liked the survey to ask supplementary questions.

**Thirdly, the place of the church.** It should not be a surprise that 76% of the survey disagreed with the statement that the 'City of London needs to listen more to the guidance of the church'. In part the statement may have been too bald, but the outcome suggests that if the church is to have a voice it will have to earn the right to be heard and certainly not assume it. Listening and conversation must precede any comment.

Having said this, the roots of such a negative attitude to the church's involvement are laid bare in the survey. The dual convictions that 'my company maintains high ethical standards' and the feeling that 'the financial services sector is not valued for the role it plays in the wider UK economy' suggests plenty of scope for misunderstanding - from both the participants in the system and the observers outside it who may or may not be making helpful suggestions.

So where does the survey leave those of us who believe that the church does have a contribution to make to the debate about the great financial issues of today?

The statement that 'The return to shareholders should be the top priority in business decisions' received only 54% agreement, whilst 39% disagreed or strongly disagreed with it. For me these were the most illuminating responses of the whole survey. The need to maximise returns is a mantra so frequently trotted out for both businesses and charities, that I was surprised that the numbers of those agreeing with it were not much, much higher.

Once again I long to ask a supplementary question - if only 54% think that returns to shareholders is not the top priority, it begs the question what else might be. In other words this part of the survey suggests that there is room to ask fundamental questions about what business decisions are actually *for*.

Such a discussion is one to which the church should be equipped to contribute. For it is a debate about values and purpose and allows a conversation from a bigger perspective than the short term with which many participants in the financial services are so immediately absorbed.

Furthermore to ask of any activity, 'What are you *for*?' is subversive, for it assumes nothing. In this way such a question can also be a necessary part in the dethroning of a system or set of values and thereby prevent it from becoming an idol.

For all of us, financial service professionals or not, who have been beholden to the power and influence of money far more than we might care to acknowledge, the conversation about what money is actually for has taken on considerable urgency in the past three years. This survey suggests that the church's role in such a conversation of principle might be welcomed by more people than we realise.

Revd. Andrew Studdert-Kennedy is Rural Dean and Team Rector of Marlborough.