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Don't forget culture

Guest view by William Rhodes

NEW YORK (Reuters Breakingviews) - The U.S. Treasury's recent 147-page report, "A Financial System That Creates Economic Opportunities," details a rollback of many of the measures imposed to make banking safe and sound after the financial crisis. The proposals include substantial weakening of the Dodd-Frank financial-reform law. At the same time, White House appointments to several bank regulatory agencies are likely to promote measures that result in reductions in bank compliance costs, capital requirements and liquidity constraints.

Right now, consideration is also being given in the euro zone to ease regulatory requirements on banks to promote more lending and add stimulus to the economy. And, in the UK, measures are also likely to lighten the regulatory burdens to incentivize banks in the City to stay in a post-Brexit Britain.

The moves toward a new era of relaxed regulation and supervision make it all the more necessary that still greater attention be given to the important issues of banking culture and conduct.

It is a decade since the financial crisis started, and public confidence in the system remains low because some large banks continue to behave improperly. A number of banks still put short-term profit maximization ahead of serving their communities and customers.

The Group of 30, an international group of public- and private-sector financial leaders, continues to monitor this situation, having published a major report two years ago that called for far-reaching reforms. The G30 has now decided to launch a further review later this year with the aim of publishing a new report in 2018. The G30's report made comprehensive reform recommendations, but implementation by a number of financial institutions has been less than satisfactory.

The UK decision to prosecute former senior executives of Barclays over alleged wrongdoing at the height of the financial crisis has again placed issues of banking integrity into the headlines. But new cases of wrongdoing abound, from recent major settlements agreed by Deutsche Bank to resolve misdeeds on both sides of the Atlantic, to the creation of fake consumer retail accounts at Wells Fargo.

The financial costs are large. Boston Consulting Group has estimated that the banks have paid $321 billion in fines since the financial crisis for all manner of violations, including $42 billion alone in 2016. And the cost is still rising in 2017, with RBS being ordered to pay $5.5 billion for mis-selling most recently. Investors should view cultural failure as material to the profitability and long-term success and sustainability of the banks.

As the wrongdoing continues and the fines rise, so it seems at times as if some bankers believe that the enormous settlements are just a cost of doing business. Bank employees and board directors who take this view should be replaced.

I believe there are bankers who do not appreciate that cultural reform needs to be a continuous process, not a single destination at which point they can announce "job done." There are also some senior bankers who make the right integrity statements in public, but their actions speak louder – especially when they appear to be more interested in their compensation.

CEOs who constantly blame a few rogue employees every time another set of illegal or unethical actions is exposed are sending the wrong message. They need to take responsibility and place more importance on the culture and conduct of their institutions.

And one crucial area that needs to be addressed is whistle-blowing. Employees who see abuse must be encouraged to believe that if they speak up they will be listened to, not victimized. They must be confident that their actions are treated confidentially, rather than fear management actions to unmask them. They can be a positive force for sound risk management, but if they believe both that they will be ignored and that they have reason to fear their supervisors, then, as happened at Wells Fargo, they will first inform the press or regulators.

Only after the full scandal erupted did the Wells Fargo board acknowledge that top management was to blame for the extensive wrongdoing that damaged customer trust in the bank and, more generally, its overall reputation.

A corporation's culture is a unique blend of tradition, history and values – it cannot be imposed by laws and regulatory decrees. But regulators, by gathering experiences from many firms, can provide insights and exchange information on best practices in this area with boards of directors and senior managers – and they need to do more of this.

The new U.S. Treasury report for financial deregulation contains a section on the Consumer Financial Protection Bureau that was established under Dodd-Frank and that took the lead in the recent Wells Fargo case. The Treasury's plans call for curbs on the CFPB's powers, its reach and its independence. But there is not a single mention in the report of the importance of banking culture and conduct.

Having worked in a major bank for my entire professional career I understand why so many bankers complain of regulatory overreach and are likely to welcome further deregulation. However, if banks do not address the deficits in reputational management and conduct, then there will be a future backlash – more regulation, more shareholder anger, and a further public decline in public confidence.

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