Foreign Policy Association Centennial Gala Dinner

May 31, 2018

William R Rhodes

Thank you Paul for your introduction. Your outstanding career in Public Service, both at the US Treasury and as chairman of the Federal Reserve System is an example for many young people who are planning their future careers.

I would also like to thank the Foreign Policy Association for awarding me their Foreign Policy Association medal in their centennial year. As a longtime member of the FPA, and a board member, it is a special honor to receive this award. I would also like to congratulate my fellow honorees, and I would like to thank all my friends, and especially my daughter, Liz for being here tonight.

I confess when I was considering what my brief comments should be about tonight there were a profusion of challenges and worries that are all worthy of discussion.

- The crisis in Italy. What could this mean for the stability of the Euro and EU project?
- The looming trade war with China and the EU and the deadlock in NAFTA negotiations with Canada and Mexico. Are we seeing the abandonment of a rules-based global trading system that the United States largely created?
- The erosion and divisiveness that exists in the governments of much of the so called developed world particularly in a number of G7 countries

These topics, and many more, are worthy subjects for the Foreign Policy Association, but in my limited time I would like to take up the issue of <u>trust</u> that is facing the leadership of the US banking and financial community, a number of whose institutions are represented here tonight.

Almost ten years on from the start of the global financial crisis, banks and the financial sector are seeing the loosening of the financial regulatory rules placed on them since 2008.

Financial sector bonuses are up.

US banks – though perhaps not some European banks – are on the mend.

The US economy is experiencing one of the longest periods of growth in modern times.

Full employment has been achieved in America, with the real possibility that unemployment might get as low as 3 percent in the next year.

But this only tells part of the story.

Trust in the financial and banking sector has still not been fully restored.

And without trust, voters' belief in the pillars of our system fails.

Trust in government and in politicians continues to fall in this country and in many of the so called countries of the developed world.

In response, anti-establishment populism is rising across many of these countries.

To be sure, we here tonight cannot fix trust in government.

That is not our job.

But we can and should continue to work to repair trust in finance and banking.

I am focused on and chairing a study of the G30 assisted by Oliver Wyman on a report that discusses best practices towards: Repairing bank culture and conduct; Ensuring we learn lessons from past failures; and in doing so, strengthen firms and the sector's reputation among the public.

We can work to ensure our own firm's cultures are strong, resilient, and sustainable, supporting the long-term growth of the firm and the social and economic purposes that underpin banks and banking.

And we need to maintain that focus.

Because trust in finance and the banking sector still remains at a below acceptable level.

The Edelman Trust Barometer is an annual survey of trust across industries in 28 countries and released to coincide with the Davos World Economic Forum. The 2017 Edelman Trust Barometer showed-

- An all-time low for CEO credibility, with declines in all countries.
- In a positive finding, trust in US finance has increased six percent to 60 percent.

- But look elsewhere and the picture is much bleaker.
- Trust in finance in the UK stood at only 45 percent.
- Trust in finance stand at only 35 percent in Germany.

A lot still remains to be done to repair trust in finance even now ten years from the Global Financial Crisis, even though much has been accomplished and is being done by the firms in this room.

Scandals however continue to rock finance.

In the case of Wells Fargo, the cost of the cultural failure has been materially damaging to the firm and its shareholders.

Australian banks are also in deep reputational trouble.

These banks were for a period the most profitable banks in the world. Over performance always make one ask: 'What is really going on here? Are there hidden risks being taken that should not be?' History shows us that this is often the latter case as few of us are geniuses.

The Royal Commission has unearthed widespread culture and conduct failures, across all firms, from widespread mis-selling, to massive AML failures, to charging dead customers for years for services – one can assume – they did not use.

I hardly need to note how expensive the cost of conduct failures is for firms and the shareholders.

Bloomberg (which has several representatives here tonight) estimated that by early 2017 banks had paid out $321billion, since 2008 for conduct and regulatory fines (this figure is obviously larger today).

Many of the firms here tonight have felt the pain of those fines and regulatory action.

And because of those failures, reputations that have taken decades and the work of thousands of hard working employees to construct, have been seriously damaged.

Boards need to continue their focus on conduct and culture.

Bank boards' must understand and monitor the firm's culture – ready to act when issues arise.

Discussions of culture and conduct matters at the board and should not be the exception but the rule. Just as there are safety records (in oil firms) or hazard analysis (in pharma firms), there needs to be this type of accountability in banks and financial firms in general.

Senior executives must set the tone at the top. Lead by example.

Executives must repeatedly address culture and conduct in their discussion in the firm. Some might respond 'well this is tiring; I have already said this X times.' Wrong response. Repetition is key.

Successful firms embed their culture deeply within their business strategy and DNA. It becomes 'the way employees do business' when their manager is not visible.

Focus on conduct and behaviors that constitute the building blocks of culture is not and cannot be an 'add-on', a grudging response to regulatory demands. It cannot work that way.

It must be a permanent part of how a firm does business. It is a form of crisis prevention.

Performance management and training is key.

Stories and real examples of decisions taken in difficult grey areas are key.

Through annual performance reviews - which should be split between financial metrics and conduct and behavior – the what and the how of business at the firm.

If employees break cultural norms in a serious manner, bonuses and promotion must be impacted. Serious breaches should lead to firing.

Willful blindness or failure to speak up when breaches are taking place must have consequences.

Speaking up must be rewarded not punished.

Signaling matters is key in all firms and especially in large financial firms where senior managers cannot possibly know all that is going on.

Strengthening the three lines of defense must continue.

The first line needs to own culture and conduct. To embed the desired behaviors and conduct. To ensure conduct and culture is not a compliance tick-box matter but central to how the firm does business all the way from the top through the middle management down to the teller.

The second line must ensure compliance.

And the third line must audit the process.

Let me conclude.

Trust is central to our societies and our industry.

At a time when regulatory rules are being weakened, firms need to redouble their focus on conduct and culture.

This focus should be a permanent part of managing financial firms.

It is not easy, it is sometimes (perhaps often) tiring. But we are on this journey and we have no option.

We cannot fix the problems of trust in all of society.

But we can and must fix trust in our own firms.

For surely, if another series of severe, interconnected financial crises erupt, the voting population, already angry and disillusioned, will not be generous but unforgiving.

Thank you.