Closing Keynote Address

FT BANKING STANDARDS CONFERENCE

Changing business behaviour for the better

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Remarks by

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Banker to the World: lessons from the Front Lines of Global Finance

Good afternoon. I am delighted to add a few comments to what is one of the most important issues facing the global financial system. Cultural change in banks that restores public confidence is vital not just for the financial system, but also for economic growth itself.

The constant public reports of prominent misdeeds by banks have diminished public confidence. Restoring public trust and confidence relates explicitly to issues of reputational risk; and actions in this area require forthright leadership by corporate boards. Banks must deal with four major areas of risk: credit risk, market risk, operational risk, including cyber risk, and reputational risk. I believe that reputational risk is by far the most important, because if a corporation loses its reputation, it can go out of business.

Embedding a strong culture of integrity unquestionably strengthens staff morale, which is a vital ingredient for a successful business.

Confidence & Costs

The failure to pay sufficient attention to reputational risk in the United States has been the prime reason for the decline in public confidence in banks, with the resulting rise in banking regulation and increasing demands to break up the banks. Public trust in banks fell sharply as a result of the sub-prime mortgage crisis and the financial crisis that it triggered. While the balance sheets of major U.S. banks have been improved and the U.S. banking system is in fairly good health, there remain grounds for concern about public trust.

This is not altogether surprising. A study by the Boston Consulting Group[1] that was published in March found that over the last eight years the world's largest banks paid $321 billion in fines for all manner of violations, including $42 billion alone in 2016 and it is still rising in 2017.

Who pays as a result of these violations and fines?

It is shareholders, the employees and the customers, as became so evident, for example in the recent Wells Fargo case.

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[1] The Boston Consulting Group – "Global Risk 2017: Staying the Course in Banking," March 2, 2017.

The scale of the fines and the range of activities that led to these fines highlights how absolutely crucial the issue of cultural and behavioral reform in banks is today. There is no one size fits all – there is no prescription for exactly what the contents of an institution's culture should be.

Key Values

When I started in banking, I was taught to believe that the highest priority was to defend the reputation of the bank and to serve our customers and our community. The banking culture I grew up in was driven by this priority and demanded that we spare no effort to earn the trust of the public and ensure that we maintained it.

But that priority was rudely set aside and replaced by a drive for short-term profit maximization. Despite all the fines, all the efforts to strengthen regulations and compliance and to improve training in banks, I continue to believe that we still have a long way to go before we can be assured that banking has again placed all of its activities on a solid foundation of integrity.

Highlighting this perspective are a range of recent events: from the extraordinary activities to create fake accounts at Wells Fargo, to the whistle-blowing affair at Barclays, to major fines recently agreed by Deutsche Bank to resolve misdeeds on both sides of the Atlantic.

In my book, *Banker to the World*, and in a number of articles that I have written for *The Financial Times* and others, I have underscored the need in banking for sound risk management. Working with the Group of 30, and serving as its co-chair of the working group that published an important report in 2015 -- *Banking Conduct and Culture: A Call for Sustainable and Comprehensive Reform* – We have stressed the need for a reset in the conduct and culture at many of the most important banks.

Group of 30 Report

Our report has been discussed at a series of fora organized by leading central banks and bank supervision authorities and it has been well received. For example, Group of 30 Executive Director Stuart Macintosh and I presented our report at the end of November at a meeting of Japanese banks, securities firms and supervisors hosted by, Governor Kuroda at the Bank of Japan. Then, we made a presentation in China, hosted by Yi Gang, Deputy Governor of the People's Bank of China (PBOC), for the Chinese and foreign banks, which included bankers at the chairmen level, as well as senior financial regulators.

But, the continuing problems in the banking arena have convinced us in the Group of 30 that we need to build on our efforts in this area. We shall start work on a follow-up report in the final quarter of this year with a view to publishing our findings in 2018.

We will use the first report and its survey findings as benchmarks against which we can determine the progress that is being made to embed reforms in culture and conduct in major banks. As the G30 developed its last report – supported by an excellent team from

Oliver Wyman - it conducted 80 interviews in 16 countries with central bankers and senior supervisors, bank board chairs and members, CEOs, and senior managers.

We found broad acceptance that cultural change is important, but widespread acknowledgement that too little had been done to secure this goal. More specifically, there is widespread understanding of the need to assign priority to managing reputational risks, but there has been insufficient effort in some major firms to translate this into effective measures.

We concluded in our report, for example, that banks must make greater efforts to promote corporate culture in disciplined ways, imposing sanctions on pay and terminating staff when necessary, even at the highest levels, when there has been wrongdoing. The bar must be raised as the failure to adequately address reputational risks is costly and over time it undermines the viability of institutions. This is not just right and good ethics, it also makes good business sense, and it is essential for ensuring a sound and healthy balance sheet.

Four major areas of recommendations:

Our recommendations fall into four broad areas:

1. The tone at the top is of paramount importance. It needs to be set by **senior management** and it must go right through middle management and down to the teller level. The executive team must recognize that a major priority on a continuing basis is to promote the corporate values, to ensure that good conduct is valued, and that processes exist to correct weaknesses.

The approach must go well beyond what is just required in legal and regulatory terms. The approach must be driven by a clear sense of serving the customer, serving the community and doing the right thing. Managers must be assessed in the determination of their performance and compensation to a considerable degree on the basis of their adherence to the corporate culture.

2. Indeed, **Policies and processes** must be in place that use the compensation system to incentivize good conduct and penalize bad behaviour. Executives must be dismissed if necessary, even at the most senior levels.

Recruitment policies and staff development approaches need to assign far higher priority to culture and conduct. Employee training to strengthen understanding of corporate culture and its importance needs to be a priority in banks.

Effective whistle-blower protection policies need to be in place. Recent events have underscored how important this issue is. A sound approach to whistle-blowing can add importantly to risk management. Policies that protect employees in this regard need to be monitored on a continuous basis by top management and the Board of Directors.

Strengthening corporate "conduct and culture" needs to embrace ways to set the institution's risk appetite so that it is clear to all employees that profit maximization needs to be consistently viewed within a context that places the interests of customers and the reputation of the firm in top positions.

3. **Role of Boards of Directors** is key – need to be vigilant in setting the right cultural policies and then monitoring performance. Scorecards for this purpose are necessary. A diverse board can strengthen the focus on all elements of culture. Those firms that understand that culture is core to their business and central to their internal and external messaging throughout the company do better than those that are addressing culture from a regulatory or reactive standpoint.

Banks need to establish board governance committees with explicit responsibilities to monitor corporate ethics and culture. We are seeing some progress in many banks, which is encouraging – but not yet sufficient. Recent serious cases underscore that there is a need for further substantial progress.

A reputation, values, and conduct dashboard is necessary – and many boards are now adopting the cultural dashboard approach that we have urged. This screen can have various factors displayed, from survey results, to whistleblower complaints, to customer feedback, to salary claw backs, and to internal evaluation data.

The key here is to have a screen for culture and behavior, with performance judgments being made on where the firm stands. Over time a sense of direction, of possible dangers, or areas for improvement should become clear.

Let me also stress that we recognize that a diverse board can strengthen the focus on all elements of culture. I believe that there is some progress here, but again much more can and should be done.

Boards of Directors that emphasize repeatedly the importance of culture as a core driver of the business are most likely to find that their institutions perform better than those where issues of conduct and culture are driven primarily by compliance and regulatory requirements.

4. What we do not need is more regulation or the breaking up of the banks. We have called previously for a far more robust, high-level, exchange of views between senior management, boards and **official supervisors**.

Supervisors cannot make rules for culture – every institution is unique in its history, traditions and operations. We do believe, however, that supervisors need to acquire the skills to fully be able to address cultural issues and to regularly engage at the highest levels of banks in constructive discussions about conduct performance, and about the effectiveness of monitoring the system.

Our report is winning a great deal of attention worldwide. The journey is long and the risks significant. I believe that reduced banking regulation, which is under discussion now in Washington and in Europe, needs to be handled carefully so that it does not send the wrong signals to banks and to other financial firms when it comes to imprudent behavior and excessive risk-taking.

Need for a sound culture

I want to emphasize again, that the commitment to building a sound culture and excellent conduct must run absolutely throughout an institution. Our G30 research found that even when there is a good tone from the top, it is often the case that the majority of middle management fail to adequately take cultural and conduct matters into account and often revert to traditional performance criteria (such as revenues, profits, return on equity); and, there is often a lack of progress in improving culture and values due to entrenched behaviors and an insufficient buy-in on conduct and values initiatives.

The G30, many banking authorities, here in the UK - including the Financial Conduct Authority, the Bank of England, and the Banking Standards Board, - and in the US and beyond, are now supporting a strengthened focus on improving culture as essential to a healthy banking and financial system.

Finally, allow me to underscore that it is in the interest of all those responsible for the financial system and for all stakeholders in banks to come together in promoting comprehensive conduct and cultural reform. Resistance to change needs to be overcome.

As I have noted, there are some absolutely key requirements for establishing and securing a banking culture that wins respect, that guards against reputational risks and that strengthens the balance sheet. The starting point is an exemplary tone at the top by the CEO and Board of Directors. It is essential that the Board is most active when it comes to oversight of every aspect of reputational risk, consistently monitoring performance, and using compensation and promotion to incentivize excellence in this area.

We face a formidable challenge in this area, but I am confident that it is one that can be met.

Thank you.

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