Culture and Conduct Reform: A Permanent Mindset Change

March 19, 2019

Brown University Panel

William R. Rhodes

Thank you to Mark Blyth. It is a pleasure to be here at the Rhodes Center, in the Watson Institute, here at my alma mater Brown University. I am delighted to be participating in this panel. Thanks to all of you and my fellow panelists.

We are here to discuss bank conduct and culture. A subject of great importance to me personally.

I remember my more than 50 years of work at Citibank. I remember how we were taught as young trainees three things.

- Protecting the bank's reputation was key. Hard to build up but easily lost.
- Your customers are a priority. Always serve your customers in an honorable and honest fashion.
- Always remember the role of you and your bank in helping your local community.

Unfortunately, many banks lost these basics, these norms of behavior and culture. Hence the need for action by the G30.

Let me start by giving you background on my and the G30's interventions and on bank governance.

The G30 has been focused on bank governance issues since 2011, to learn the lessons of the Great Recession.

In our first report in 2012, we issued recommendations on governance structures.

Following in 2013, we called for a new paradigm in relations between financial institutions and their supervisors.

And finally, we turned to bank conduct and culture, making a call for sustained reform in 2015.

At the time of our 2015 intervention on banking conduct and culture, we promised the financial community to return 2 years later and further investigate the success of the recommendations and review progress that had been made.

For this updated review and in previous reports on this subject, we spoke to all of the major international banks and their supervisors and regulators, and this is what I want to address today. Following an extensive and comprehensive process to survey banking progress, the G30 Working Group on Culture published its final report in November of 2018.

Let me divide my remarks into three parts:

- First – A comment on repairing trust – where are we now?
- Second – Evidence of progress – There is some good news…but now is not the time for complacency and we still have work ahead of us all.
- Third – The ongoing shift in conduct and culture *must* remain a permanent part of a bank's mindset and the practice of banking.

1. Repairing Trust -- where do banks stand today?

We still have work to do to repair trust in finance and banking.

The industry's standing among voters and the public remains in disrepair. In fact, the Edelman 2018 Trust Barometer, which is prepared annually for the World Economic Forum, shows that only 54% of the general public trust financial services firms.

10 years on from the Global Financial Crisis, it remains clear that a great deal still needs to be done to repair consumers' confidence in financial institutions. This is not the time for resting on our laurels.

Meanwhile - scandals continue to rock finance.

2. **The recent example of Wells Fargo** demonstrates an incorrect incentives structure and a board that did not understand what was happening in the company. The cost of the cultural failures are still today ongoing and material to the firm, the shareholders, customers, the community, and the sector.

3. **Australian banks are in deep reputational trouble according to the Royal Commission in its recently released final damning report.**
4. **The Danske Bank Russian money laundering scandal – involving as much as $230bn siphoned through its Estonian subsidiary - has shaken the firm and resulted in the firing of the Chair and the CEO.**
5. **The Goldman Sachs IMDB scandal has tarnished that firm's reputation and led to criminal charges in Malaysia.**
6. **The Metrobank fraud case in the in the UK – raises questions about new technologies and old-school scams.**
7. **The Deutsche Bank involvement in numerous scandals, from laundering Russian cash, to the LIBOR interest rate scandal.**
8. **The $900 million money laundering scandal at ING.**
9. **And most recently the Lloyds bank mis-selling scandal.**
10. **Recently announced 135 bn euro money laundering scandal in Swedbank**

This is an indicative list. There are many others.

So, today trust remains damaged, scandals continue to occur, and costs are material to banks and banking, and their clients.

But have we seen progress since the G30's 2015 recommendations?

11. Evidence of progress

The G30 report has identified many areas of progress in the industry.

Some firms are naturally further on in their cultural journey than others.

Nonetheless now is not the time for self-congratulation.

So what has the G30 working group found?

Boards have upped their game, but need to continue their focus on conduct and culture.

Boards have begun to better understand and monitor their firm's culture. They appear more equipped to act when (not if) conduct issues arise.

Discussions of culture and conduct matters at the board level are now much more commonplace.

For instance, most boards and firms now use culture and conduct dashboards and have measured tactics in place to address concerns.

The G30 review recommends all banks create a dedicated board level committee to monitor conduct and culture.

Already, approximately one-third of banks surveyed have taken the step to establish such a committee. We urge faster progress on this.

And regardless of whether a separate committee is created, regular discussion of conduct and behavior issues by the whole board needs to occur.

We recommend board members get out of the headquarters and 'kick the tires' of the firm. Talk to employees. Observe how business is really being done. That visibility will help them gauge the firm's health and support the desired culture, as board members should constantly reference the desired norms and demonstrate them in their own behavior.

Today senior executives are more audibly setting the tone at the top. Leading by example.

Leaders are recognizing that 'signaling' matters. Repetition of a bank's norms and expectations matters in cultural transition.

The G30 review makes clear that a focus on conduct and culture is not and cannot be an 'add-on', a grudging response to regulatory demands.

Embedding culture is not easy. It is a long, arduous process. Leaders and indeed every manager within a firm needs to understand, internalize, and champion the firm's culture in their business unit or branch.

The tone from top must be heard in the middle of the firms and then repeated at the front line all the way to the teller level. After all, most employees model their behavior on their boss or their bosses' boss, not the CEO, who they will almost never see.

We find that performance management and training is improving and remains key to success.

Training should not only take place at the start of their career, but also through an employee's lifecycle at the firm.

Specific actions we have seen banks take in this regard include:

- More firms are using real life examples of decision-making in difficult grey areas. Leading discussions on approaches and tools to handle the situations.
- Annual performance reviews are increasingly being split between financial metrics and conduct and behavior, as the G30 recommends.
- Speaking up is gradually being encouraged & rewarded. And action needs to be taken to protect whistleblowers and reward them for raising red flags.

Additional work is still needed to reinforce the training and expectations:

- 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 must have consequences.
- Firms must be on alert for unintended perverse effects of incentives.

Strengthening what is known as the "three lines of defense" must continue.

The first line - that is business units themselves - needs to own culture and conduct.

The second – the risk managers - line must ensure compliance with rules, and norms of behavior and conduct.

And the third line – the auditors – must review the process and its effectiveness.

And what role should supervisors have?

The G30 review underscores that supervisors cannot make rules on conduct and culture or determine a firm's culture.

But they can and should monitor how a firm is addressing conduct and behavior issues at the board, and through other processes within the firm.

Let me reiterate: much is being done by boards and management, on conduct and culture. But this is not the time to say the job is done. Far from it.

12. A Permanent Change in Mindset

We find that the focus on conduct and culture should be part of a permanent change in mindset in banks and the banking community.

And we must all be vigilant. What might have been a cultural norm previously often is unacceptable today.

Let me conclude. I think this message of permanent change is resonating.

We have been pressing the case globally.

We have met with the leaders of the largest banks in China, and with the heads of foreign banks there. China's banking system is now the largest in the world. We were hosted by Governor Yi at the People's Bank of China. All the banks in attendance claimed now to be focused on conduct and culture and welcomed our report.

We will be presenting our findings to the leading supervisors in the world including central banking governors at the Bank of International Settlement.

We hear signals that leading banks and supervisors are now benchmarking against our norms.

These are good signs.

But I must confess I should leave you with two notes of caution.

Today regulators are loosening the post-Global Financial Crisis regulations on banks and banking. In doing so, they are permitting Adam Smith's animal spirits to reemerge.

It is precisely at this time that continued vigilance is needed to ensure risks are managed – that problematic sub cultures found and addressed. As well as all good role models publicly applauded.

After all, many young employees don't remember the bad culture drivers of the financial crisis and its aftermath. They were young people then.

So, we – experienced bankers and advisers – need to educate the new generation and instill in them the desired norms and behaviors.

Meanwhile with the new technology, artificial Intelligence, payments systems, customer relationships with their banks continue to evolve and shift.

That fast changing landscape requires us all to be clear about the type of culture we want in our firms. Clear about what this means for new technology adoption. And clear eyed about the challenges ahead.

Let me conclude, this is no time for complacency. The job of getting culture right is never over. It should be embedded within all aspects of the firm's work and operations.

This necessitates a permanent mindset change. There is much still to do. Thank you.

Appendixes

1. The Journey Thus Far

Mindset of Culture: Banks have shown a clear, rapid, and positive shift in their view of the importance of conduct and culture.

Senior Accountability and Governance: Bank boards and senior management have significantly increased their involvement in conduct and culture topics and have reorganized their governance and reporting structures to better oversee these areas.

Performance Management and Incentives: Many banks have reviewed their remuneration schemes to integrate cultural and behavioral metrics into performance scorecards.

Staff Development: Banks have expanded their training programs to help employees better understand expectations of behavior and manage gray zones.

An Effective Three Lines of Defense: Significant work remains in defining and empowering second-line oversight of conduct and culture risks and in designing appropriate audit practices.

Regulators, Supervisors, Enforcement Authorities, and Industry Standards: Regulators and supervisors globally have increased attention to, and expectations regarding, conduct and culture, though they continue to grapple with the scope of their role and responsibilities, and whether and how they can support the industry in dealing with culture and conduct issues.

2. 8 Main Themes of G30 Findings

1. Managing culture is not a one-off event, but a continuous and ongoing effort that must be integrated into day-to-day business operations.

2. Leadership always matters, and banks must embed conduct and culture messages and expectations from the top down, through middle management down to the teller in their organization. There is increasing awareness that tone from above is as (if not more) important than tone from the top, and this requires a shift in how managers at all levels of the organization are trained, promoted, and supported.

3. Conduct is not just about purposeful misbehavior, but also unintended consequences from decisions and/or lack of skills and knowledge.

4. Managing culture requires a multipronged approach and the simultaneous alignment of multiple levers, including structural elements such as processes and policies, as well as human elements such as beliefs and attitudes.

5. Diversity must become an imperative for the industry as it improves outcomes for all stakeholders.

6. Behaviors and outcomes are driven by culture and these can be measured, even if cultural norms and beliefs cannot. Reporting and active oversight are required by senior management and board members.

7. Regulation has a limited role to play given that culture cannot be mandated or defined by rules. Regulation can be an effective tool in outlining basic principles (especially related to good conduct), refocusing banks' attention on areas of persistent conduct failure, and providing insights and lessons learned from across the industry. Supervision can play a role in monitoring and providing feedback to banks that can aid the bank board and senior management in addressing culture and conduct issues.

8. Industry-wide dialogue and sharing of best practices are key to restoring trust and strengthening the entire banking industry.

3. The G30’s New Recommendations

Recommendation 1. Bank boards should reevaluate their governance structure to ensure a specific board committee has oversight of the bank’s conduct and culture.

Recommendation 2. Bank boards and senior management should work more closely with various business units and geographic and functional heads to strengthen the quality and availability of data and insights needed to manage conduct and culture.

Recommendation 3. Banks should consider the potential impact of outsized incentives in their compensation mechanisms.

Recommendation 4. Banks should remove the link between quantitative sales targets and compensation for sales staff to minimize pressure that can lead to misconduct and help staff prioritize meeting customer/client needs.

Recommendation 5. Banks should explore ways to celebrate role models in behavior, both in business decisions and in individual actions.

Recommendation 6. Bank governance structures must recognize the integral role that middle management plays in embedding cultural reforms and promoting values through lower levels of the organization.

Recommendation 7. Banks should make efforts to promote diversity and inclusion in the workplace in their hiring and staff development practices.

Recommendation 8. Banks should promote an environment of “psychological safety” that encourages employees to speak up and escalate issues or share feedback without fear of retribution; bullying or aggressive management styles must be mitigated in order for employees to feel safe.

Recommendation 9. Banks should establish credibility and enforcement through their disciplinary mechanisms for conduct breaches to ensure employees take these measures seriously.

Recommendation 10. Banks should focus on hiring people who align with the bank's purpose and values as they strive to create the right culture for their organization, recognizing that recruiting is a critical element to creating the right culture.

Recommendation 11. *Given the limited progress to date, this is a reinforcement of our 2015 recommendation*: Banks should persevere in their efforts to shift primary ownership of conduct risk to the first line of defense to ensure conduct risk is truly owned by the business and is effective.

Recommendation 12. Roles and responsibilities in banks across the various second line functions such as Human Resources (HR), Risk, and Compliance should be clear.