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New York Federal Reserve Bank's Workshop on Reforming Bank Culture: Thoughts on the G30 Report

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The Group of 30s new report – "Culture and Conduct: A Call for Sustained and Comprehensive Reform" - was stimulated by discussions with members of the Financial Stability Board, the BIS, Governors of the Federal Reserve Board, and other major central banks, and leaders of the banking community who believed that far more needs to be done to strengthen culture and conduct at financial institutions. We undertook nearly 80 interviews in 17 countries. Overwhelmingly, those interviewed recognized that when it comes to banking culture and conduct, then the bar must be raised. The reputational costs to banks themselves could threaten their viability.

The reforms that we recommend are not only important for the stability and soundness of the financial system as a whole, but for the bottom line of every individual bank. Banking with integrity is good for business. It drives trust and confidence among current and potential customers. It builds a firm's brand and reputation. It reduces risks within institutions. Simply stated, culture and conduct reform is essential for ensuring a sound and healthy balance sheet.

Over recent years the G30 has published three related reports[2] that stress that there needs to be a prevailing paradigm of roles and responsibilities, where there is a significantly stronger engagement by boards of directors and where there is deeper engagement between boards, senior managers and regulators. We believe this triangle of responsibility is central to strengthening culture and conduct.

Let me emphasize that within this triangle our conclusion on regulation is that corporate culture is unique to each institution, representing its traditions, character and core values and that culture cannot be imposed by regulators, or determined by detailed new regulation. We do, however, advocate that senior supervisors and regulators be highly active in monitoring progress and discussing this with senior managers and boards of directors on a regular basis.

The many interviews conducted for this report show that some banks have gone further than others in moving towards reforms of culture and conduct; that some leaders of major banks have publicly affirmed the need for cultural change; and, that there is widespread understanding

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[1] Mr. Rhodes is the author of: *"Banker to the World: Leadership Lessons from the Front Lines of Global Finance."*

[2] This latest report from the G30 is part of a trilogy of G30 reports on Governance – *Toward Effective Governance of Financial Institutions (2012). *A New Paradigm: Financial Institution Boards and Supervisors (2013). *Culture and Conduct: A Call for Sustained and Comprehensive Reform (released on July 30, 2015).

in the industry that changes in culture and conduct are essential. However, improvements have been piecemeal, and the good rhetoric has often not been followed by effective implementation.

Banking with in integrity demands actions that go beyond regulatory compliance. The key points are that reforms:

- must be comprehensive;
- they must be driven and communicated by the board of directors and senior managers;
- they must be consistently implemented at all levels in the bank down to the lowest level employees; and,
- changes must be efficiently monitored.

Our core challenge is to find practical ways to define the key pillars of a comprehensive reform approach to culture and conduct. Let me highlight recommendations in three areas that go towards meeting this challenge:

1. The tone at the top set by **senior management** is key. The executive team must recognize that a major priority on a continuing basis is to promote the corporation's values, to ensure that good conduct is rewarded, and that those guilty of bad behavior be disciplined and that processes exist to correct weaknesses. In every aspect of their work, senior managers must demonstrate their commitment to the core cultural values of the institution –values anchored in serving the customer, serving the community and doing the right thing.

   CEOs have to focus on and be persistent and highly visible and committed to comprehensive actions to make sure the firm's stated values and desired conduct is understood, reinforced, and built into who gets promoted and into compensation decisions. They need to ensure that there is a thorough process that reviews the bank's brand and reputational standing with the full scope of internal and external stakeholders. The CEO and his senior executive colleagues need to manage processes that implement corrective initiatives when they are needed. To do this effectively demands that a bank introduces a comprehensive set of indicators to monitor and assess individual and team adherence to firm values and desired conduct.

2. This takes me to the second broad area of recommendations concerning **Policies and processes.** Banks need to appreciate that reputational risk management is as important as other forms of risk management and that robust processes must be vigilantly managed at all times.

   Compensation systems are important in this context. The changes we recommend are based on our survey findings that suggest that at many institutions the performance metrics used to determine compensation have not adequately taken conduct into account; that there is insufficient attention to encouraging good conduct; and that there have been just too many instances in management evaluations where "willful blindness" related to conduct has been evident. We propose a scorecard approach that ensures that misconduct and violation of bank culture is determined early and that there are appropriate sanctions. This scorecard approach must be applied in large institutions across the board and that this needs to include regular reviews of the top 200 to 400 most senior executives. Executives must be dismissed if necessary, even at the most senior levels, which places an important responsibility on boards of directors.

Another key area for attention relates to recruitment policies and staff development approaches, where a far greater emphasis on culture and conduct needs to be introduced. We propose that banks emphasize diversity (cognitive, gender, racial, background) throughout the organization as a key contributor to improved values and conduct and sustained behavioral change. Moreover, we recommend that when banks recruit individuals from other banks, there needs to be more focus on how the recruit behaved relative to the values of the previous employer, and whether the recruits separation from the previous employer was conduct related.

3. The third key area of our proposals relates to the **Boards of Directors.** Boards need to be more engaged on ensuring that issues of culture and conduct are assigned the highest priority. This means boards should spend more time on this issue, asking whether progress in being made, ensuring the bank has the right leadership team and holding CEOs and the senior team to account for delivering on the focussed persistent leadership on culture and conduct that is essential.

   Boards need to be vigilant in setting the right cultural policies and then monitoring performance. Scorecards for this purpose are necessary; they should be subject to regular Board discussion and serve as critical components in discussions involving the Board, senior management and regulators. We believe that there is merit in diversity in that a diverse Board can bring a range of experiences that are healthy for the development of corporate culture. Boards need to be well informed when there are staff complaints and actions by whistle-blowers that relate to conduct.

A key question for this meeting is how to ensure that agreement on what needs to be done is translated into comprehensive action that is consistently and efficiently applied?

For too long issues of culture, conduct and reputational risk have taken a backseat to matters that senior managements and boards have considered more urgent. I think that clearer statements by regulators and supervisors can be helpful. I believe that boards off directors must now step up and make it absolutely clear to senior managers that there is zero tolerance for further major episodes of bad conduct. I also believe that institutional investors can and should be influential in underscoring their concerns about reputational risk management at banks.

Finally, we should all understand and recognize that Culture and Conduct are as important to a bank’s survival and well-being as capital and liquidity.

Thank you.