“Doing the Right Thing: The Role of Banks in Society and the Economy”[1]

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The crisis has led a wide public to ask how was it that the banking sector had become so risky, to the point that it had required large-scale public sector support in order to keep it functioning. The image that occurred to many people was that banks had become public utilities with casinos attached to them. In particular, banks that were expected to serve an essential function in intermediating between saving and real investment had taken on additional, non-essential speculation in proprietary trading and dealing in opaque instruments such as CDO’s, CDS’s and complex OTC derivatives. For many, the immediate impulse guiding reform efforts has been to assure that banks fulfil their essential tasks by greatly reducing the chances that risky trading can disrupt banking.

Crisis has also created the awareness that the wider public is very directly affected by what goes on in banking. A wide array of would-be stakeholders have begun to voice a wide variety of views about how banks should go about their business and to insist that banks need to be held accountable for fulfilling their responsibilities to all of their stakeholders. The days when senior bankers could say that they were guided principally or even only by shareholder value maximization are over.

But what are the “essential functions” of the banking sector and what are activities that are too risky for banks to carry out? Those are questions that policy makers have been grappling with in developing the numerous regulatory reforms that have been introduced since the onset of the

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crisis. The guiding principles for many of these reforms have come from the G20's programme of reform adopted in the Pittsburgh Summit of 2009 and aimed at strengthening the international financial regulatory system. Last November at the Brisbane Summit G20 leaders declared that they had "…delivered key aspects of the core commitments we made in response to the financial crisis."

Speaking on behalf of the Financial Stability Board, a major new institution created by the G20 programme, Mark Carney has set out what has been accomplished and what work remains.[3] He argues that the financial system is **safer, simpler** and **fairer** as a result of the reforms. **Safer** because banks, especially the systemically important ones, have more capital and are subjected to a much more stringent regime of capital and liquidity regulation and are much more resilient as a result. **Simpler** because disclosure standards are better, effective exposures are being placed on balance sheets, and wholesale markets have been given more solid and transparent operating frameworks (e.g., mandatory clearing of standard derivatives). **Fairer** because the Too-Big-To-Fail problem is being dealt with through credible special resolution regimes and the proposals for Total Loss Absorbing Capacity of GSIFI's.

He calls for more work to assure the financial system fulfils its essential functions without risk of disruption of a major crisis. These essential functions include: *a reliable payments infrastructure, giving companies continuous access to working capital, transforming liquid savings into long-term loans allocated efficiently to the most productive uses across the globe.*

One particular area where he argues more progress is needed is in **restoring trust in banks** and other major financial institutions. This theme was developed further in by Bill Dudley, President of the New York Federal Reserve Bank, who argues that the recurrent bad behaviour by banks (manifested by the more than $100 billion of fines paid by the largest banks) has destroyed the

[3] "The future of financial reform" at the Monetary Authority of Singapore Lecture, 17 November 2014. http://www.bankofengland.co.uk/publications/Pages/speeches/2014/775.aspx

public's trust in banking.[4] Without that trust in banking there will be strong pressure for ever more invasive regulations. The result will be ham-strung banks that are unable to develop new products, to deal with complex problems, and generally to fulfil their essential functions in changing globalized economy. How can banks restore public trust? Dudley and many other feel that changing the culture of banks is crucial.

In my experience, if you raise the issue of culture with experienced bankers they are generally quick to acknowledge that they have a serious problem and that "bank culture needs to change." But how? There seems to be a general view that this needs to be viewed as a top priority for senior management…that we need the right "tone from the top". But beyond that it is hard to point out other clear points that are very widely shared. And there seems to be a fair amount of scepticism about the culture issue. The Salz review of Barclays was perhaps one of the most elaborate and publicly visible pieces of soul-searching by a bank.[5] It reports that 70% of the employees interviewed did not believe that leaders "lived and breathed" the values that Barclays espoused. The review went on to underline the issues of conflicting objectives within the bank and the difficulties of establishing a shared set of common values within a very large, very complex, universal bank. These are descriptions that seem to fit as well other leading global banks.

So those are some of the issues that we want to discuss this afternoon. And we have an excellent group of panellists lead off the discussion.

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[4] "Enhancing Financial Stability by Improving Culture in the Financial Services Industry" October 20, 2014. http://www.newyorkfed.org/newsevents/speeches/2014/dud141020a.html
[5] "Salz Review:An Independent Review of Barclays' Business Practices," April 2013 http://www.euromoney.com/downloads/2013/Barclays-Salz-review.pdf

Robert Priester is currently Deputy Chief Executive of the European Banking Federation which he joined 10 years ago. Since completing his law studies at Leiden University he has work on regulatory matters with industry groups in insurance and fund management. After 25 years in Brussels it is safe to say he knows most of the ins and outs of making financial services policy in Europe.

Richard Raeburn is the Chairman of the European Association of Corporate Treasurers. Until 2008 he was the Chief Executive of the Association of Corporate Treasurers. So he has spent a lot of time working to understand the financing needs of the companies that create jobs and otherwise make our economy grow.

This leads to a number of questions I would propose for the panellists:

1. Would you agree with the general assessment that the regulatory reforms since the crisis have been broadly going in the right direction? That they have resulted in a "safer", "simpler" and "fairer" banking sector.
2. What about the idea that in the run-up to the crisis banks had loss their focus on the client and were too much focussed on "doing the deal" and getting the short-run profit. Have the reform efforts been helpful for the clients of the banks?
3. Several commentators have argued that banks have loss the trust of public authorities and of people generally and this lack of trust is a major impediment to banks' fulfilling their core functions. Do you agree? Is it an important objective for banks to try to regain the trust of the public? How can it be achieved?
4. Can a bank change its culture from within? How? What resources are needed to bring about cultural change? Can progress in changing culture be measured? Many say that "tone from the top" is crucial. How far can top bank management drive the process of cultural change?
5. On the issue of simplicity, the objective seems to be to get banks to focus on providing basic payments and intermediation functions. But as many commentators point out even these basic functions involve transforming risky long-term illiquid loans into safe

short-term riskless deposits. This process involves risk transformation and risk shifting by its very nature. How far can the derisking of banks go while still allowing them to perform their core functions? How much risk taking do we want in our banks?

6. The notion that banks should shed inessential risky practices and be more like public utilities raises the whole issue of structural reform. The US has its Volker Rule which was included in the Dodd-Frank Act of 2010. Europe has had Liikanen and UK has had Vickers. But legislation has been slower in coming. Is there too much or too little structural reform in Europe?

7. What about the proposed Capital Markets Union? If the CMU objective is to address the funding shortcomings in EU markets is the approach/agenda 'fit for purpose'?

8. For some, cultural change is mostly or even entirely a matter of changing incentives. Do you agree? How have incentives toward risk taking in banks changed since the 2007-08, in particular with respect to compensation? Should shareholder involvement in compensation matters be increased?