NOVEMBER 19, 2015

REFORMING CULTURE AND BEHAVIOR IN THE FINANCIAL SERVICES INDUSTRY: WORKSHOP ON PROGRESS AND CHALLENGES

In October 2014, the Federal Reserve Bank of New York hosted a workshop on reforming culture and behavior. That meeting ended with a challenge from Bill Dudley, the President of the New York Fed, to the banking industry: Get to work. On November 5, 2015, at Mr. Dudley's invitation, the public and private sectors reconvened for a progress report from the industry. This year's workshop focused on leading practices, common challenges, and the opportunities for industry collaboration.

Key themes included:

- The goal of cultural reform should be the alignment of public expectations, firm values, business strategy, and actual behaviors. A bank's culture must promote decisions and behavior that take into account the firm's many stakeholders, including the public, because of the special role that banks play in the economy.

- Leadership is indispensable, but culture cannot be changed by fiat. In word and deed, managers of all levels must play an active role in promoting a greater sense of personal responsibility and stewardship among employees.

- Culture cannot be regulated like capital and liquidity, but it is just as important. Supervisors can monitor progress and make recommendations, but firms must take responsibility for reforming their own cultures. Industry collaboration may be valuable, but dialogue cannot substitute for action.

- Culture is hard to change, but there are ways to do it. A good starting point is to identify and address early warning signs of problems—silos, disregard for controls, and outsized tail risks, for example.

- A firm should acknowledge culture as it is, and explain where it would like to be. Mistakes and failures should be openly discussed. Training and communication is most effective when led by senior bankers.

- The middle layer of an organization is critical to the reform of culture. "Middle managers" are immediate role models for the majority of a firm's employees and provide a gloss on any message from senior management about the firm's values. Any program seeking sustainable cultural change should involve all of a firm's managers.

- The flipside of accountability is recognition. Firms should identify good conduct and support employees who put the long-term interests of the firm ahead of short-term financial gain. Whether to offer financial rewards for good conduct is a decision that will vary from firm to firm.

- Diversity of thought and background are cultural assets because they can generate better questions and outcomes. Rotating talented bankers through different lines of business and control functions is one way to prevent "group think" and may yield broader, valuable perspectives.

- A positive, constructive culture can be a force multiplier in a firm's success. Culture must be treated as a risk; ignoring it is reckless.

Opening Remarks and Keynote Address

Mr. Dudley[1] and Christine Lagarde,[2] the Managing Director of the International Monetary Fund, set the tone for this year's workshop in their opening and keynote remarks. They emphasized that the goal of the conference was neither criticism nor praise. The byword was candor. This was essential, Mr. Dudley argued, because reform of bank culture and banker behavior is both "formidable" and inseparable from other enhancements to financial stability in the aftermath of the financial crisis. Indeed, he posited, recent banking scandals suggest underlying causes that "overlap with those factors that contributed to the financial crisis."

Madame Lagarde noted that misconduct is not unique to banks, but the stakes are higher because of the integral role that trust plays in finance. She explained that, owing to their roles as custodians of savings and recipients of special operating benefits, bankers must uphold the highest standards of trustworthiness. Mr. Dudley too described reciprocity—framed by Gerald Corrigan as a *quid pro quo* between banks and the customers and communities they serve[3]—as a foundational principle of banking.

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[1] Mr. Dudley's opening remarks are available at http://www.newyorkfed.org/newsevents/speeches/2015/dud151105.

[2] Madame Lagarde's keynote address is available at http://www.imf.org/external/np/speeches/2015/110515.htm.

[3] E. Gerald Corrigan, "*Are Banks Special?*," Federal Reserve Bank of Minneapolis Annual Report, January 1983, *available at* http://www.minneapolisfed.org/publications/annual-reports/ar/annual-report-1982-complete-text.

Both Madame Lagarde and Mr. Dudley emphasized the importance of context in shaping conduct. Addressing misconduct without questioning underlying patterns or causes offers only temporary solutions to enduring problems. Madame Lagarde pointed to two root causes of misconduct: a misalignment of purpose (*telos*) and norms of practice (*ethos*), and a tendency to treat people as a means to an end. The well-being of society, she argued, must be the ultimate goal of finance. Business schools and other educators may have a role in promoting this understanding of finance—of teaching what *should* be done, as opposed to what is merely permitted.

Personal integrity and accountability are pillars of finance, and they can be powerfully shaped by environment. Citing Warren Buffett, Madame Lagarde shared the observation that firms assess prospective employees for three qualities: integrity, intelligence, and energy. If the first is lacking, the latter two are dangerous. She encouraged participants to consider how material risk-takers can become more socially responsible. One idea is to require individuals to bear the tail risks of their decisions as well as the potential rewards. Another idea, already implemented in the Netherlands, is the requirement of a "banker's oath"—a commitment that, like oaths sworn in many professions, can remind bankers of their broader social obligations. Mr. Dudley also cited the global focus on culture and conduct in banking. He stated that U.S. and foreign supervisors "have a lot to learn from each other," and proposed that the lessons of the workshop should also apply to conduct and culture at the New York Fed and the broader regulatory community.

Industry responsibility for culture and conduct was another theme in the workshop's opening remarks. Mr. Dudley pointed out that the Federal Reserve's industry advisory panel had described recent banking scandals—especially the manipulation of LIBOR and foreign exchange rates—as "hard evidence that there remains work to be done."[4] Madame Lagarde noted that the push for reform is global and beneficial to a bank's business model. She observed that retaining talented employees becomes harder when bankers have to choose between remaining in an unethical environment and leaving a firm. She also noted that banks have an opportunity to distinguish themselves from competitors in other areas of finance by establishing a reputation of trust. Similarly, Mr. Dudley urged participants to see individual accountability "not only in the sense of being 'held accountable,' but also in the broader sense of promoting responsibility and stewardship." He praised Madame Lagarde's call for "financial leaders [to take] values as seriously as valuation, culture as seriously as capital."[5]

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[4] Federal Advisory Council and Board of Governors, Record of Meeting, May 8, 2015, *available at* http://www.federalreserve.gov/aboutthefed/fac-20150512.pdf.

[5] Christine Lagarde, "Economic Inclusion and Financial Integrity," Address to the Conference on Inclusive Capitalism, May 27, 2014, *available at* http://www.imf.org/external/np/speeches/2014/052714.htm.

Discussion with Stanley Fischer

Following her keynote address, Madame Lagarde joined Stanley Fischer, the Vice Chairman of the Board of Governors of the Federal Reserve System, for a conversation about the themes of market ethics, leadership, and culture. Mr. Fischer read an excerpt from *Phishing for Phools*, a new book by George Akerlof and Robert Shiller, who argue that unregulated markets do not reward restraint. So long as there is a profit opportunity, market forces may require a sacrifice of ethics "in order to compete and survive."[6] Madame Lagarde responded that this description of markets underscored the need for strong leadership, clear rules, and open discussion about what behavior is unacceptable. Cross-generational discussion within firms is a technique that can reflect these three principles. Madame Lagarde further proposed that banks review their compensation incentives to ensure alignment with the public role of finance.

Both discussants observed that firm size and complexity might hinder efforts at reform. Mr. Fischer noted that the leaders of a large bank cannot possibly know what happens at every level of their organization. Madame Lagarde agreed, but posited that good management could create concentric circles of responsibility—a system that allowed delegation, but not blind delegation.

Trust continued to be a theme through this portion of the workshop. Mr. Fischer expressed his view that breakdowns in trust are a danger to financial stability. Madame Lagarde noted that there was perhaps a higher expectation of trustworthiness from banks than from other industries. Both agreed that an increased focus on individual prosecutions could be a powerful deterrent against an abuse of trust, but must be one of many levers to improve culture and conduct in banking.

Panel Discussions

The workshop featured five panels following the interview between Madame Lagarde and Mr. Fischer. An agenda and attendee list are available on the New York Fed's public website.[7]

The following summaries of panel discussions are based on remarks and questions offered by moderators, panelists, and audience members—all of whom are described below as "participants." Because the focus of this year's workshop was a report from the industry, the summaries largely reflect comments from bankers. Participants from the official sector asked questions, but did not present information.

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[6] George A. Akerlof and Robert J. Shiller, *Phishing for Phools: The Economics of Manipulation & Deception* xi-xii (2015).

[7] http://www.newyorkfed.org/newsevents/events/banking/2015/1105-2015.html.

These summaries do not reflect all the views that were expressed at the workshop, but attempt instead to identify key themes in each topic of discussion. No portion of the panel summaries is attributable to a particular speaker. Quotation marks are used for emphasis, not to indicate verbatim statements.

The views expressed in the following summaries may not reflect the views of the Federal Reserve Bank of New York or the Federal Reserve System.

Panel One: Group of Thirty Report on Banking Conduct and Culture

The first panel discussed the recent report by the Group of Thirty entitled *Banking Culture and Conduct: A Call for Sustained and Comprehensive Reform* ("G30 Report").[8] The report recommends ongoing, active management of culture as part of a firm's business strategy. Culture is not a project. It does not have an end. Success requires relentlessness, self-assessment, and adaptation.

Panelists acknowledged that culture is often characterized as a "soft" subject, but is nonetheless central to stability and performance for at least two reasons. *First*, clients can and do distinguish among firms based on their reputation for integrity. *Second*, employees know whether they work for an institution with integrity and can gauge the authenticity of a firm's cultural change agenda. They will respond only to genuine efforts. One panelist argued that, for these two reasons, culture is *more* important to survival and success than capital.

There was broad agreement that culture—the implicit norms that govern conduct—exists in a firm whether or not the firm's leaders recognize it. As one panelist put it, culture is free. The question is whether culture is a positive or negative factor within a firm. It can be a positive force—perhaps even a force multiplier. But culture cannot be changed by fiat. Reform requires participation by all levels of the organization—"tone from the top," "echo from the bottom," and the "mood in the middle." One panelist observed that managers of all levels have to be recognized and treated as part of the firm's leadership in order to facilitate the transmission of information both up and down an organization's hierarchy.

Panelists also agreed that the unique reciprocal responsibility of banks to society make them "special"—to borrow Gerald Corrigan's term. Failure to live up to this responsibility has damaged the long-term relationship of trust between the public and banks. The relationship between banks and employees has also been damaged. Incentives too often encourage short-term thinking. Many employees no longer see their interests as aligned with a firm's interests, and no longer place importance in the long-term reputation of a firm that is only a temporary

[8] The G30 Report is available at http://group30.org/images/PDF/BankingConductandCulture.pdf.

career stop. Firms should see culture as an investment. It improves a brand, reduces risk, and can lead to a healthier balance sheet. Indeed, an investment in culture might be rather inexpensive if those benefits materialize.

Direct measurement of culture is difficult. There are, however, proxies available through both hard data and qualitative assessments. As a start, persistent efforts by firm leaders can be observed and compared. Of course, the motivation for those efforts—whether it is merely an attempt to appease supervisors or born of a genuine commitment to public responsibility—is harder to detect. Patterns in employee behavior are also observable and can add insight about a firm's culture.

Supervisors can play an important role by providing feedback that firms can use in assessing their reform efforts and employee behavior. Supervisors might also help identify aspects of culture that should be common to the industry, recognizing that each firm will apply those principles in its own way.

Some degree of variation may be unavoidable within the same firm, especially among specialized divisions. Panelists acknowledged that it is not easy to manage the culture of different lines of business. They reminded participants that, if management proves inadequate, the decision to exit a particular business is a real option. They also observed that a trading desk and a consumer lending desk carry the same brand. If their cultures are inconsistent, the brand faces an identity crisis. The same principle applies to individual employees. Dismissal has to be a valid consequence for employees whose conduct is inconsistent with the firm's desired culture. Employees, too, carry the firm's name.

All panelists acknowledged that reforming culture takes time and is not an easy task, but that the tools to accomplish demonstrable change are accessible. Success will depend on the degree of a firm's commitment. Just as integrity is an all-or-nothing concept, a firm's agenda for cultural change must be comprehensive. A partial effort is almost guaranteed to fail.

Finally, panelists urged participants to focus on ethical gray areas—difficult questions that may involve a choice between competing values. In these situations, a process of issue spotting and elevation will be critical to reaching the right outcome.

Panel Two: Engagement – Diagnosis and Communication

The second panel began where the first panel left off. Although the techniques of cultural assessment and change are known, figuring out the right mix and sequence for using them is an ongoing challenge. Included among the levers for reform are surveys, external advice, employee interviews and focus groups, and training on issue spotting and escalation.

Surveys and external advice could provide helpful benchmarking—within a firm, throughout the financial sector, and across other industries. In particular, surveys that blend historical questions (those repeated year after year) with new, targeted inquiries could yield great insight. This mix may enable firms to observe trends and understand different dimensions of questions. For example, a firm might ask each year whether employees believe that their organization possesses integrity. Integrity, of course, can mean different things to different people. More targeted questions on the fairness of HR policies, the willingness of employees to "raise their hands," and a focus on customers might illuminate aspects of "integrity."

Interviews and focus groups were discussed as particularly helpful in assessing how effectively messages from senior management flow through an organization and become internalized. Panelists and participants emphasized the importance of checking every stratum of the organization. Some reported surprising findings. For example, interviews and focus groups at one firm revealed confusion over conduct expectations, performance evaluations, and promotion decisions—especially the role of non-financial factors in promotion. These issues were clear to senior management, but not to the rank-and-file.

Panelists also discussed a firm's ability to look for smaller signs and symptoms of cultural problems. These may include the untimely completion of compliance training or validation of the P&L in a trading book, routine violation of risk limits, an unusually high number of order cancellations on a trading desk, and an abuse of permissions to access systems. One banker added that his firm looks for employees who never take a vacation, which in the past had been associated with rule-breaking. None of these factors will be dispositive. They must be interpreted in context. Sometimes this information may be compiled into a "big data" assessment of conduct risk in real time. But data need not be aggregated to provide early warning signs of problems that could become scandals. Panelists encouraged their peers to review prior scandals to identify patterns that may predict future micro-cultures primed for similar incidents.

Panelists and participants agreed that principles only matter if they are demonstrated in action. Several reported on a practice of requiring senior business executives to lead training exercises and participate in other opportunities to share stories. One executive noted that training is a critical art of management and had become an expectation of managers at his firm. Another banker described a practice of recording videos of his firm's leaders speaking about difficult decisions they faced in their careers, and how they resolved them—or how they wished in hindsight they had resolved them. Once available on the firm's intranet, the videos went viral and generated valuable discussions among employees outside of traditional training sessions. Other participants observed that a key message from leaders must be that employees are not expected to resolve every problem in isolation. They should seek guidance. Indeed, one firm reported that it changed its code of conduct to require escalation of issues. Another common message was that it is acceptable (although never easy) to say no to clients when the circumstances merit that response—for example, when agreeing to a client request would harm the firm's reputation.

Several panelists and participants encouraged firms to hold candid discussions about mistakes regardless of legal risk. Firms should not shy away from acknowledging what went wrong and soliciting employee input on how to identify and avoid similar problems in the future. One senior executive noted that his firm had developed a new practice of escorting employees fired for misconduct out the front door, rather than quietly ushering them out the back. The purpose of this exercise was not to shame or to spread the word about a "bad apple" among peer institutions. Instead, the audience is current employees, who should understand that good conduct is expected of every member of the firm and that the code of conduct is binding, not aspirational. Another executive added that a firm must also demonstrate that its internal discipline process is fair. One way to accomplish this is to be more transparent about the reasons for employee termination.

Finally, panelists urged all participants not to keep best practices to themselves. Scandals in the industry harmed the reputation of all its members.

Panel Three: Accountability – Performance Management, Controls and Metrics

This panel opened with a discussion of history's influence on the present. Panelists agreed that firms cannot ignore their cultural legacies—often inherited through mergers of firms with very different cultures. The leaders of the resulting entity may confront contrasting cultures that long outlast predecessor firms. Still, it helps to start with identifying common ground. One such premise is a view of accountability as stewardship: the responsibility of every employee for the firm and its employees. Not every employee has the same degree of responsibility, of course. But a sense of common purpose helps in promoting other beneficial practices, like asking for help and challenging decisions.

There was a consensus that accountability must be seen as a new way of doing business, not as a compliance fad. One participant raised again the need for a firm's leadership to speak to employees in high-risk areas using examples of actual problems that the firm has encountered. Employees will take greater accountability for the firm if they believe that senior management will support employees who identify potential issues and seek guidance.

Some firms have strengthened their control functions by requiring attorneys and compliance officers to be in the room when decisions are made, and knowing in detail what business managers—the "first line of defense"—are doing. One banker proposed that empowering the second line of defense—through adding attorneys and compliance officers and giving them titles equal to the groups they oversee—is a key method in improving controls. Other firms have appointed a chief compliance officer for every line of business, and have charged that officer with understanding in intricate detail the nature of the risk posed by their area of specialization.

Some participants urged each other to confront two issues. *First*, banks should reject the notion that misconduct is limited to trading or investment banking. Some large firms have been fined as much if not more for retail offenses than for wholesale scandals. *Second*, employees should not see control functions as the enemy. They must understand that control functions exist to protect them as well as the firm. Treating attorneys and compliance officers as partners rather than adversaries has become especially important since the Department of Justice announced a new emphasis on individual criminal accountability.[9]

Several times during the day, the discussion returned to a recommendation in the Group of Thirty's report for a "50/50" treatment of financial performance and behavior in performance reviews.[10] No banker reported that their firm used a 50/50 division in annual reviews, although several noted that the framework used in their promotion processes—especially to senior positions like managing director—considers both sides of the proposed equilibrium. One senior banker described his firm's practice of monitoring tail risk over the course of an employee's career. Although not strictly a conduct measurement, the data provides insight into the quality of decisions beyond their immediate financial return.

Incentives were another recurring topic. One participant quoted from a book by Alan Blinder, a former Vice Chairman of the Board of Governors of the Federal Reserve System: "If you give smart people go-for-broke incentives, they will go for broke."[11] A representative of one bank described a new approach to remuneration that requires bankers to be paid according to their balance sheet—both upside and downside. That approach must be tempered, though, with a message that mistakes will happen, and people need to seek help. Many trading scandals occur when traders attempt to manage smaller problems on their own, but fail. A banker from another firm suggested that firms should highlight specific examples of desirable conduct—like "raising one's hand"—in messages from management.

Panelists and participants were divided over the wisdom of rewarding employees financially for good conduct. Some argued that paying employees for good conduct muddles the message about why conduct matters (duty, not dollars). Some thought non-financial rewards could be a

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[9] *See* Memorandum of Sally Quillian Yates, Deputy Attorney General, Sept. 9, 2015, *available at* http://www.justice.gov/dag/file/769036/download.

[10] G30 Report 49.

[11] Alan S. Blinder, *After the Music Stopped* 81-82 (2013).

powerful incentive. For example, time with senior management might be more valuable than a small cash bonus. Indeed, one participant recalled that the most lasting benefit of his own promotion to vice president was that newly promoted officers spent two hours in a small group discussion with the firm's CEO—a reward in a different coin. The CEO used the opportunity to explain his view of a banker's professional responsibility to clients and the firm. That might be a good way to counter the tendency toward "short-termism" that many see in banking today.

Many participants and panelists acknowledged that metrics are difficult. Several speakers referred to a suggestion raised during previous panels that banks look for smaller indicators of problematic behavior, which one banker described as a "broken windows" strategy.

One participant argued that firms should not hide metrics or other measured results (surveys, for example) that management does not like. Being honest about the status quo is essential to establishing credibility about culture. If management says that firm culture is terrific, when in reality it is somewhat brutal, employees will conclude either that management does not know what is really going on, or they are dishonest. Instead of hiding or "spinning" results, management's message should be, in essence, "This is where we are, but it is not where we want to be. Here's how we will change."

Panel Four: Skill Development – Recruiting and Developing Talent to Sustain Change

Culture exists, and is manifest in the behavior of employees. There is no question about whether a firm has a culture. It does. The question for managers is, will an individual employee make it better or worse? In other words, is the employee culturally accretive or dilutive?

Those were the opening theses and questions for this panel. How firms develop good conduct and get rid of misconduct occupied the remainder of the hour.

Much of the discussion concerned the benefits of the "bankers' registry" that Mr. Dudley proposed at last year's workshop. Several participants noted a problem of blind recruitment and argued for a searchable database as a solution. Of course, the tool would only be as useful as the accuracy of the information reported. To promote accurate reporting, the registry would have to be created with a safe harbor for reporting. Concurrently, the rights of individual employees would need to be protected, so as not to create a system of rough justice. Employee challenges would need to play a key role in ensuring accurate reporting.

Participants debated what information should be included in the registry. Some thought the registry should focus exclusively on the cause for an employee's departure—whether through termination or resignation. Others wanted the database to include official warnings and reprimands that occur during the course of employment. The latter suggestion recognized that many employee departures occur after a series of smaller incidents that result in a loss of confidence in that employee, rather than a single large mistake.

One senior banker suggested that a registry cover non-bankers too—compliance or IT personnel, for example. He observed that banks have become especially concerned about information security and cyber-vulnerability. Reviewing past conduct of prospective employees entrusted with the firm's information systems or control frameworks is as important in today's environment as knowing the prior history of traders or loan officers.

No participant raised an objection to the registry. Indeed, the discussion turned to the practical: How can a registry be built? One participant suggested a federally administered system modeled on the software platform already used by FINRA.

The discussion of recruiting moved beyond the registry to other means of exchanging information. For example, some noted that recruiting efforts begin before candidates sit for an interview. The firm's culture needs to be clear in how a firm promotes itself. Another banker reported a significant reassessment of recruiting by his firm, which broadened the firm's historic base of recruiting.

Recruiting differs depending on the nature of the role: an entry-level analyst recruited on campus versus a more senior, lateral employee recruited from a competitor. One firm reported that, for entry-level employees, it uses highly structured interviews and personality tests to gather information on ten factors. One of the ten is personal ethics, and others address a prospective employee's attitude toward reputation and compliance. That firm had concluded that, even before any orientation or training occurred, an employee needs to have an acceptable baseline in terms of personal principles and beliefs. Not every person can be trained. Another technique was to ask entry-level employees to describe a success and what factors brought it about. An experienced interviewer can listen for signals on teamwork and motivation.

Panelists and participants conceded that there were more restrictions on information when recruiting lateral candidates. There were, however, ways of obtaining data points directly from the candidate. One senior banker shared his technique of asking a lateral candidate to describe a time when his own integrity was challenged. The answer could reveal what the candidate thought about ethics and reputation. Another senior banker observed that, in his firm's experience, a lateral employee's insistence that the firm hire an entire team is a potential warning sign for conflicting loyalties. That firm was keen to avoid silos or micro-cultures—team members loyal to each other, but not to the firm. One solution was to explain the concern to the lateral candidate, and offer to consider additional candidates in stages—every six months or a year, for example. Another technique concerned rumors. When a firm hears through backchannel chatter that it is considering a lateral candidate, it may be cause to reconsider the candidate's discretion and judgment.

An investment in training was arguably more important for senior employees. One participant observed that terms like "indoctrination" make people cringe. Firms needed to find other ways to say that basic operating principles and values are non-negotiable. Another key aspect of senior employee training was promoting an acceptance of challenge. This is particularly important if a firm inherited a culture in which junior employees were not expected to test ideas and question decisions.

Several participants emphasized again the value of "lessons learned" or "post-mortem" analysis. Every employee should be able to derive some benefit from a mistake. One senior banker argued that, in any such exercise, firms should identify times when elevation of a problem should have occurred but did not. Another post-mortem technique was to involve employees from different groups in the analysis, who might offer different perspectives on key decision points. One participant reported that post-mortem assessments tended to reveal universally applicable lessons. For example, regardless of whether a mistake occurred in trading or in wealth management, the mistake may have been driven by unmanageable performance pressure, hyper-competitiveness, or ego—ordinary human flaws and foibles. Possible solutions, however, varied based on the line of business. Hearing multiple inputs was helpful. In particular, hiring people with military backgrounds in addition to people who moved directly from college to finance.

Some participants also observed that culture is dynamic, not static. This is due, in part, to generational differences that develop independent of employers or industries. The potential for change should be encouraging, because it means that culture can be responsive to active management. But this also demands reassessment of training programs that address emerging issues. If the same training program used today was used ten or fifteen years ago, managers should question whether it is still effective.

Many participants observed during this panel and throughout the day that, regardless of the level of the employee, the involvement of more senior personnel will make a training session more effective. It sends a signal that the person who evaluates an employee believes the content of the training is important enough to spend time on it. One banker reported that compliance training at his firm involved a senior business line leader, while technical training involved someone from a control function.

Panel Five: Leadership – In the Firm and Across the Industry

Although the theme of leadership was a topic discussed throughout the day, panelists and participants offered a number of fresh insights during the final panel.

One such insight concerned a CEO's natural tendency toward optimism. Most CEOs view their firm's culture favorably. Panelists saw this as necessary and good. Indeed, it was no different at banks than in other industries. The qualities of leadership—including a capacity for dealing in hope—tend to be the same for banks as for other companies. Firm to firm, leadership styles may differ. But deeper, fundamental elements must be the same. The challenge at banks can be different because the nature of the industry's products and services is complex. But management fundamentals are the same regardless of the industry. Integrity is integrity.

Although corporate management techniques may be the same, firms cannot ignore their individual histories. Most of today's leading banks were formed from mergers accomplished in the last thirty years. The predecessor firms often had very different cultures—in part because they performed different kinds of financial services. Panelists discussed the tension between homogeneity and diversity. While certain principles must be universally accepted, banks need to attract people who do not look, think, or act in quite the same way. Assuming that diversity continues to be a goal of recruiting, this means the burden falls more heavily on a firm's training in ethics and culture to establish a group identity based on common values, rather than on personal background.

Diversity of experience should also be a goal of developing the next generation of the firm's leaders. One panelist spoke of the merits of a long-term employee development program that moves talented bankers around divisions of the firm. A banker might "major" in mergers and acquisitions, but "minor" in project finance, for example. A rotation through control functions would also be beneficial, particularly for those viewed as potential future leaders. The practice of rotating good employees may help to reduce the problems of "group think" and silos and, in that sense, is an important risk management technique. It may also help to restore some of the discipline that is associated with partnerships, in which the managers of the firm are its owners. In partnerships, it is acceptable for one partner to inquire how another partner assesses risks, since every partner bears the downside risk to the firm's clients and creditors. Giving future leaders a broad base of experience can help develop their ability to ask good questions of colleagues in other divisions. That experience may also promote a greater sense of the firm as a single entity, rather than a loose confederation of varied businesses.

The panel delved further into one of the themes of Mr. Dudley's opening remarks: Are banks special? One panelist observed that banks are different because small mistakes can have a disproportionate impact on the franchise. Some areas of banking—wealth management, for example—resemble organizations like the military in the sense that if one piece fails, the enterprise keeps going on. Other areas—lending, for instance—do not have the same built-in safeguards. If a key compliance tool fails, the firm may face serious consequences. Identifying the different risks posed by different lines of business is a key element of bank leadership.

Some questioned the degree to which a firm's leadership—especially its CEO—can personally change a culture. Can a CEO walk out the door and take the firm's culture with her? If so, what does that say about the firm's culture? And what degree of impact on a firm's culture can any one person, even its CEO, really have? Answering these questions will require ongoing discussion.

Industry collaboration was another topic of discussion. One panelist noted that while many firms face the same questions, and while collaboration can be helpful, firms should not look to industry groups or to consultants to supply the principles that govern their organizations. Changing and managing culture cannot be outsourced. Another panelist observed that while industry collaboration is no substitute for firm leadership, there is a role for collaboration beyond the discussion of reform techniques. The industry should work together to develop a set of aspirational standards above minimum regulatory requirements. Those standards would not reflect the state of the industry's culture as it exists, but where the industry wants to be in five or fifteen years. This is also a step toward thinking of banking as a profession—a group of people with a valuable skill who perform socially valuable services and hold themselves accountable to a high standard of practice.

The panel also discussed the role of a bank in society. Several metaphors were employed. Banks were described as the "backbone of the economy"—both in providing structure and in being a core component of the central nervous system. Banks were also described as part of an economic ecosystem. The laws of nature dictate that if they do not fulfill their role, they will not flourish.

Regardless of the analogy, the consistent message was that banks must act in a manner that reflects their public role. A manager's fiduciary obligation to the corporation must not ignore the firm's obligations to society. These obligations resonate in fundamental fairness: fair pricing for products, and fair treatment of customers and employers. One panelist suggested that banks embrace their role in society and focus their communications on the contributions that they can make to society. They might learn valuable lessons on communications from each other, and from other industries that serve an important public purpose.

Another panelist observed that the goal of a bank's reform agenda should be to improve trustworthiness. The panelist attributed to Onora O'Neill a theory that individual trustworthiness depends on three personal qualities: honesty, reliability, and competence.[12] Those values may

[12] *See* Onora O'Neill, "What we don't understand about trust," TED Talk (June 2013), *available at* http://www.ted.com/talks/onora_o_neill_what_we_don_t_understand_about_trust?language=en ("And I think that [assessing trustworthiness] requires us to look at three things. Are they competent? Are they honest? Are they reliable? And if we find that a person is

fairly be projected onto a corporation, including a bank. So, bank leaders may want to ask themselves: What are we good at? Can we deliver consistent performance in our areas of strength? And are our assessments truthful?

Following up on this last question, the panel discussed how boards can be confident that they are receiving information that is sufficient to assess management's performance. One panelist observed that a bank's directors will never be able to acquire the same expertise as a bank's managers. For one thing, many directors do not have banking backgrounds. This can be valuable, as those directors can provide points of view from other professions. But as a whole, the board must have a balance of experiences that can lead it to ask the right questions. And perhaps the most important question for directors to ask themselves is, "What haven't we asked that we should have asked?" Diversity on boards lessens the probability of unasked questions.

The panel closed with some reflections on regulator relations. One panelist commented that a forum for discussion like the workshop is constructive and should be repeated. Another panelist commented that one challenge bank leadership faces is to manage a firm globally, taking account of political and regulatory developments around the world. And another panelist observed that regulators have worked more closely across borders, but could still improve their international coordination.

Closing Remarks

Mr. Dudley concluded the workshop with three reflections on the day's proceedings.

First, he restated his view that the private sector must be responsible for changing its culture and curbing misconduct. He encouraged the industry to explore how best to exchange emerging practices. Still, while it is helpful to share ideas, discussion is not sufficient to achieve reform. Mr. Dudley noted that the Group of Thirty's paper called for comprehensive and sustained change, and suggested that the industry take seriously the paper's suggestion that progress should be demonstrable within two years.

Second, workshop panelists and participants had shared many strategies and techniques for reform. This work supported Mr. Dudley's view that culture is neither immutable nor immeasurable. The guiding principle for reform is integrity—from the Latin *integer*, or complete. Applied in the corporate context, integrity means an alignment of public purpose, firm values, business strategy, incentives, and behavior. Integrity is supported by an environment of accountability—not only in the sense of being "held accountable," but also in the affirmative

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competent in the relevant matters, and reliable and honest, we'll have a pretty good reason to trust them, because they'll be trustworthy.").

sense of promoting stewardship and guaranteeing fair treatment. He commented that a bankers' registry might be one tool to promote all of these meanings of the word, and encouraged the industry to pursue the idea.

Recruiting could also play an important role in actively managing a bank's culture. Mr. Dudley noted his concern that young bankers with a few years' experience in finance are opting out of the industry when they attend business school. One factor in this decision might be the questions that so many criminal investigations raised about ethics of the financial services industry. He posited that there might be a lag of a few years—that is, today's pleas and fines might reflect previous misconduct, not current behavior. If so, there should be a drop in enforcement actions in a few years' time. Until then, the leaders of the industry had to maintain their efforts to improve culture. A relentless focus on culture is important to combat the long-term problem of self-selecting out of finance.

Third, the official sector has a role to play in cultural reform because banks are special. The public purposes of banking are too important to allow culture to develop without supervisory attention. The official sector should continue to monitor, assess, and encourage the industry's efforts, especially its reform of incentives. Limiting the official sector's role to enforcement is too little, too late.

Finally, Mr. Dudley reiterated his view that large financial firms provide valuable services to the economy, but will face increasing calls for break-ups and dissolutions if there is not clear evidence of better behavior. That is why banks should treat the reform of culture as a matter of existential importance.