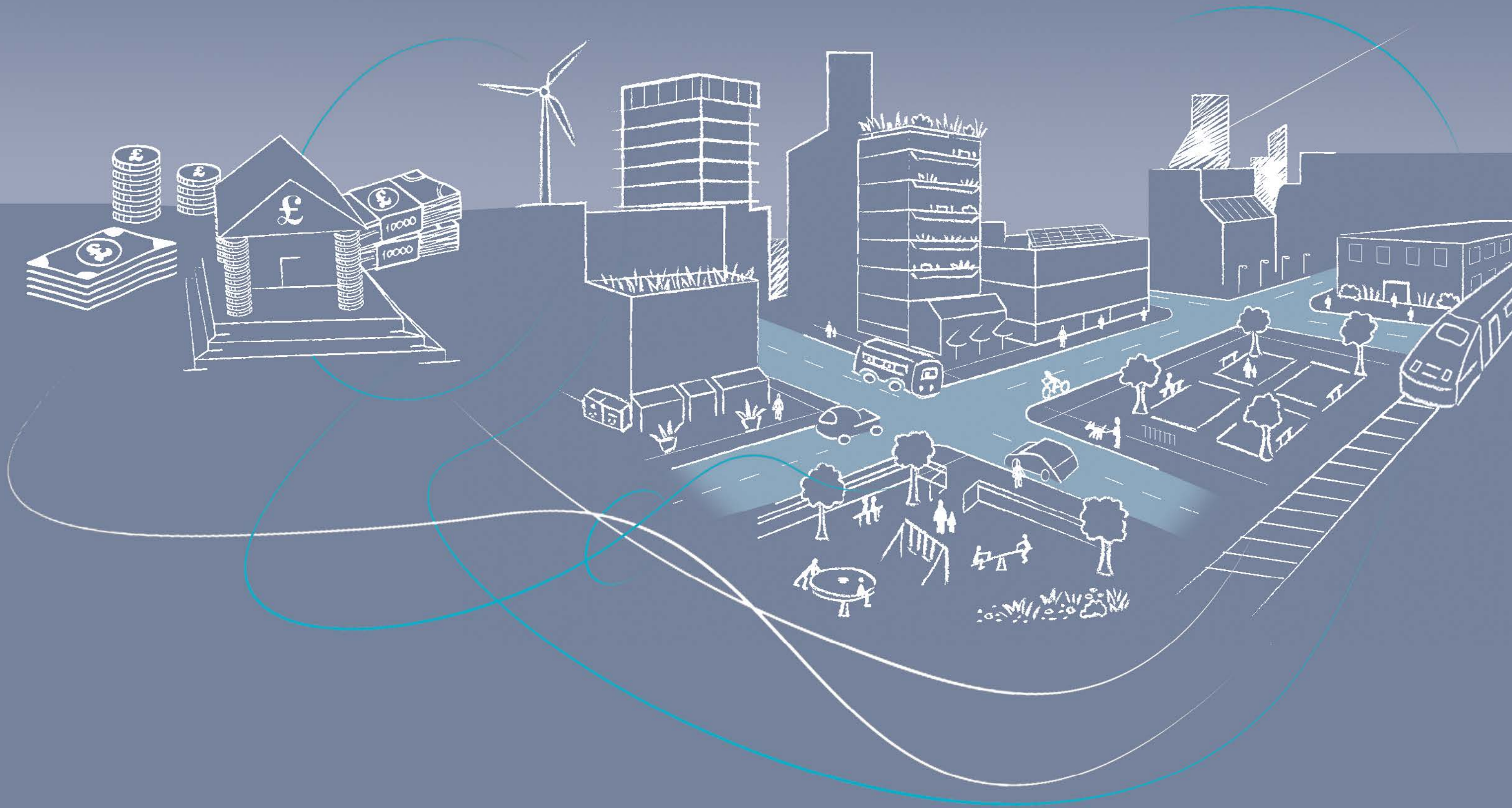
Banking on Trust:

Engaging to Rebuild a Healthy Banking Sector



Report on the BankingFutures Consultation

Leaders' Quest is a social enterprise that works with global leaders from all sectors to create a more inclusive and sustainable world. We are passionate about the role of business as a force for social good – alongside delivery of financial performance. Through our work, we challenge and support individuals to explore purpose and implement meaningful change in their organisations.

Meteos is a not-for-profit company that undertakes research-based, multi-stakeholder dialogues. Our dialogues, focused on finance, health and the environment, provide a forum for senior figures in the corporate sector, civil society, public sector and investment worlds to share different perspectives on the major trends that will shape market, regulatory and societal outcomes in coming years.

Introduction

from the BankingFutures Working Group

We – the BankingFutures Working Group – are a group of senior individuals from some of the largest banks present in the UK, experienced fund managers, and governance and sustainable finance experts. We believe that banks exist to serve the economy, and acknowledge the need to reintroduce and firmly reinforce this sense of purpose. We recognise that the financial crisis of 2007/08 – in which the banking sector played a pivotal role – was at the expense of social value.

We are variously involved in attempts to strengthen the resilience of financial structures and in efforts to change bank culture and improve conduct. We know we cannot solve these problems alone. In recognition of this, and of the fact that societal expectations of banks have changed irrevocably, in June 2015 we launched a consultation document in the hope that our stakeholders would engage with us in our attempts to understand the nature of those expectations today, and how we and other leaders should respond.

We have been delighted – and humbled – by the response. We would like to thank everyone who engaged in the BankingFutures dialogue, whether through roundtable participation, interview or written submission. The quality of the inputs has been extremely high and has given us much food for thought.

More than that, we are very appreciative of the collaborative and respectful tone that was the hallmark of each discussion. We know this was not a foregone conclusion. There is still a great deal of anger and mistrust in banks and bankers arising from their role in the financial crisis, and so we are particularly grateful that our conversations acknowledged that rebuilding a healthy banking sector is a shared problem, requiring engagement from stakeholders across the system.

This report lays out the findings of the dialogue. It attempts to reflect what we heard from the extensive consultation process, along with issues that remain unresolved and require ongoing work, and concrete proposals for action that we can begin to implement now. Underlying all our conversations was the fundamental need to rebuild trust amongst all stakeholders in order to build a healthier future collaboratively. We know that trust must be re-earned over time, and understand the need for incentives across the sector to be aligned so that all stakeholders are set up to deliver the right outcomes for each other and for the system.

The dialogue confirmed our view that the challenges we face are systemic. As a result, we have focused our recommendations on leadership steps that banks should take, and – consistent with our systemic approach – identified how other stakeholders could work with us to support their successful implementation. Nevertheless, we heard loud and clear that our stakeholders want to see principled bank leadership on the issues we discussed. We also heard that stakeholders want a few, carefully selected strategic actions upon which to work together, and that in order for proposals to be credible, they need to be time-bound and have milestones against which progress can be measured. We have therefore ended up with three recommendations that fit these three criteria.

BankingFutures has been unique in its ability to engage so many people with such diverse perspectives so constructively. Our original plan was to produce a statement of commitment from a group of individuals who understand the commercial imperatives and pressures banks face, and who believe that the best way to deliver these is by rediscovering a sense of purpose, putting the customer first and overcoming the corrosive impacts of short-term profit maximisation.

Over time, however, the project evolved into a systematic consultation with an array of bank critics and stakeholders, who challenged our assumptions and beliefs. By incorporating different voices, perspectives and experiences into the conversation, we have ended up with a rich series of recommendations that we hope will resonate powerfully with decision-makers in a position to effect change.

At the start of the project we committed ourselves to bringing our own individual leadership to bear on those parts of the system we can influence now and in the future. We reaffirm this commitment to take the findings of the dialogue to date back into our organisations and the way we work.

We realise that the dialogue began a conversation that clearly still has a long way to go, but it was an important start that we will act upon. We are committed to deepening our engagement and understanding with societal stakeholders. We know that there is no room for triumphalism. We see this as the time for continued humility and hard work. Nevertheless, the dialogue so far has left us feeling optimistic about the future. We plan to continue in these efforts, and hope our stakeholders will continue to engage with us.

The BankingFutures Working Group
January 2016

The BankingFutures Working Group

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Andy Griffiths	Executive Director Senior Advisor	Investor Forum Corsair Capital
Matt Hammerstein	Head of Client and Customer Experience, Personal and Corporate Banking	Barclays
Stephen Jones	Chief Financial Officer (until Oct 2015)	Santander UK
Natasha Landell-Mills	Head of Stewardship	Sarasin & Partners
Stuart Lewis	Chief Risk Officer and Member of the Management Board and Group Executive Committee	Deutsche Bank
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The BankingFutures Team

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Executive Summary

The BankingFutures Process

The BankingFutures dialogue was launched in July 2014 to explore how to rebuild a healthy banking sector in the UK. Over the course of the 18-month project, Leaders' Quest and Meteos convened members of the BankingFutures Working Group, which includes senior bankers, investors and sector experts. The Group is made up of self-selecting, forward-thinking individuals who are committed to contributing to positive reform and willing to engage with critics and stakeholders of the sector. They participate in a personal capacity.

The Group developed a discussion document on the nature of a healthy banking sector in the UK, which was launched in June 2015. Over the following six months it was the subject of a multi-stakeholder consultation with over 200 people (see Appendix B for the full list), including:

- Senior representatives from over 30 civil society and consumer organisations
- Individuals and organisations in community projects in Brixton and Tower Hamlets
- Senior regulators, including from the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA)
- Senior government officials from the Treasury
- Fund managers and Chief Investment Officers (CIOs) from some of the biggest investment firms with bases in the UK
- Experts in governance and ESG (environment, social and governance) from those and other investment firms
- The Chief Financial Officers (CFOs) and treasurers of (large and mid-cap) corporate clients of UK banks
- The company chairmen of the UK-based banks participating in BankingFutures
- Employees of the participating banks (in separate roundtables)
- CFOs and Chief Executive Officers (CEOs) of smaller and new entrant banks

The BankingFutures Findings

BankingFutures was an exploration of how to rebuild a healthy banking sector in the UK. Its single most important finding was the urgent need to rebuild trust between all bank stakeholders. Banks in particular have work to do to convince people that they can be trusted to be safe and responsible custodians of clients' money, provide reliable and fair payments services, and put customers back at the heart of the business model. Above all, they need to demonstrably exercise a duty of care to those they serve.

But it does not stop with banks. For investors and banks to trust regulators, they need greater predictability and transparency. If regulators change policy frameworks to reflect changing societal expectations, investors need such changes to be flagged, evaluated and debated. For regulators to trust banks, they need to believe that banks will operate within the spirit as well as the letter of the law. For banks to trust investors, they need to feel that investors are aware of – and care about – the need for banks to manage long-term challenges. For investors to trust banks, they need to feel confident that there will be no more costly surprises.

For civil society to trust banks presents the hardest challenge – it will require people to feel confident that regulators are acting independently, transparently and in their interests. They need convincing that banks will be more transparent and will understand and act on their continued outrage at reward structures.

Rebuilding trust requires an acknowledgement of the fact that the size and profile of the UK banking sector gives rise to ongoing tensions that will need careful and continuing management. Six tensions emerged strongly from the in-depth consultation process: differences about the core purpose of banks; the profile of the banking sector; the need for more diversity and competitiveness in the sector; the impact of a continued focus on short-term goals and outcomes; the implications of the UK public's limited financial literacy and engagement; and the need for clear government policy. Addressing the trust deficit will also mean identifying and disentangling what some people described as widely held but inaccurate 'myths', which reinforce prejudices and opinions, and make true consultation and engagement more difficult.

Most importantly, though, addressing trust requires acting on the old adage that actions speak louder than words. BankingFutures ended with a call to action from a new generation of bank leadership. At the start of the project, members of the BankingFutures Working Group – both bank and investor leaders – personally committed to take the project's findings into their respective organisations and into their daily leadership. This commitment was reaffirmed at the final meeting of the Working Group.

In addition, the Group committed to further engagement. The dialogue was described by some stakeholders (and particularly civil society participants) as the first meaningful engagement since the financial crisis. It was a vitally important start, but a start nonetheless. As a result, the report concludes with recommendations for action on three systemic challenges on which bank leadership is necessary and could make a huge difference. For action on these challenges to reflect societal expectations requires further consultation, which will allow bank leaders to feel confident in any proposed solutions. The three challenges, and recommendations to action arising from them, are as follows:

Recommendation One: Serving the Real Economy

Bank leaders commit to serve the real economy by working closely with policy-makers, businesses, investors and civil society to ensure that all stakeholders are more aware of and responsive to investment needs and opportunities in the UK.

A healthy banking sector in the UK is one that serves the real economy over the long term. To achieve this requires much greater clarity over what this means. What are the universal service obligations that the sector has to provide? How should they be paid for? How does serving the real economy contribute to financial stability? How should the sector determine what to prioritise when providing the long-term capital needed for a healthy economy? Which sectors require attention, and what policy frameworks would be needed to support investment? What would be needed to persuade investors to support a redirection of capital flows from intra-financial system trading and exchange and into the real economy?

The roundtable agenda will be to determine the role of the banking sector as a whole in support of other financially dependent policy goals (housing, infrastructure, energy); its role in promoting financial inclusion – and how provision for underserved communities will be made; and its leadership role in support of important global social and environmental objectives.

It should be an 18-month consultation in different regions of the UK, underpinned by a bank commitment to determine the framework for universal services provision and investment opportunities in the real economy. The consultation would identify a shared goal to be achieved by 2020, and develop appropriate key performance indicators and milestones to indicate progress towards that goal between 2017 and 2020.

Recommendation Two: Banking for the Long Term

Bank leaders commit to work with the Investor Forum to create banking and investment cultures that enable the sector to deliver long-term value.

The bank sector, like other parts of the equity market, suffers from a challenge of too much short-termism. Arguably this has three related sources. First, companies report their financial performance every quarter, which for an industry like banking is especially problematic given the typically long-term nature of most of their activities, and the fact that accounting rules do not necessarily reflect foreseeable losses and risks on the balance sheet. Second, asset owners award mandates to asset managers every 12 months at best. As a result, investors in the equity market – both long-term investors and hedge funds – in almost all cases report their investment performance on that same quarterly basis, thus aligning their own reporting to that of their investments. Thirdly, the nature of much of the research from investment bank sell-side analysts – often driven by the desire to generate higher trading volumes – encourages the quarterly reporting cycle of banks and their investors.

There should be a process to explore and find solutions to the specific challenges of banking for the long term. Facilitated by the BankingFutures team, and run by the Investor Forum, it should benefit from civil society, academic and regulatory input over time, to ensure that societal expectations are reflected in its findings. Its agenda could include, inter alia: information provision, focused on quarterly earnings and account transparency; the development of new non-quantifiable measures; rewards and compensation; and culture and communications mechanisms for banks and investors to enhance long-term value.

The process will be convened over 12 months, building in time for banks and investors to meet, as well as making provision for systematic civil society and regulatory input throughout the period. It would conclude with a public statement on its findings, complete with milestones to indicate progress towards commonly agreed goals by 2020. The statement would include suggestions about the appropriate policy frameworks to support the goals.

Recommendation Three: Respecting Customers

Bank leaders commit to a public process involving consumers, civil society and regulators to improve their duty of care and respect for customers.

The UK has extremely low levels of financial engagement. Many UK citizens have a deeply uneasy relationship with money and very limited understanding of finance and financial institutions. At the same time, even among more knowledgeable consumers there is a need for more advice to help people navigate their relationship with the financial world. Banks are professional intermediaries, with a duty of care that arises from the fact that they are in a position to respect or abuse the relationship of trust that their customers place in them. This trust has been badly damaged by the transactional relationship that developed between banks and their customers.

The loss of trust in banks to act in the customer's interest, and the resulting regulatory constraint on their ability to provide advice, has left an enormous gap for people who need help. The fact that the move to encourage greater responsibility among consumers for their decisions takes place against a background of weak financial engagement, makes it extremely important that as a society we have a clear view of what is a reasonable expectation of customer responsibility, the degree to which customers should be offered regulatory protection, and how this relates to the duty of care that banks as their service providers have towards them.

This public process would involve consumers, civil society and regulators, particularly the Financial Conduct Authority (FCA). Its agenda could include finding the appropriate balance between customer autonomy and duty of care, the involvement of customer and civil society representatives in bank governance structures, how to fund basic financial infrastructure, e.g. payment services, and how to provide products, services and advice for underserved markets.

The process would take place over an 18-month period, concluding with a statement of findings, accompanied by practical commitments to supporting the gaps identified. These could, for example, include measures to support low-income customers to manage their finances effectively, the use of technology to manage policy changes (e.g. the introduction of Universal Credit) and a commitment to partnership (e.g. with a consumer advice organisation, to mobilise volunteer bank staff to run programmes on financial education or debt financing), that will be introduced between 2017 and 2020.

Introduction to BankingFutures

The UK banking sector is undergoing a process of profound reform, driven by a desire to ensure that the British taxpayer is never again called on to provide emergency scaffolding for a collapsing financial system.

The social consensus in support of bank reform offers an opportunity to de-risk the banks and to address serious and egregious misconduct. And it goes further. The appetite for reform also provides a once-in-a-lifetime opportunity to provoke a systemic rethink about what we want and need from our banking sector.

To contribute to this, two not-for-profit enterprises, Leaders' Quest and Meteos, convened BankingFutures – a holistic, systemic and balanced dialogue on how to rebuild a healthy banking sector in the UK. We chose to commit our skills and experience of leadership, dialogue and multi-stakeholder facilitation to this project because of the vital importance of the banking sector to the UK economy. The re-establishment and reinforcement of the sector's purpose to serve the real economy over time could not be more important. Yet its history, size and profile make achieving this aim especially complex. The sector as a whole – if not individual banks within it – is too important to the British economy to fail, meaning it will always be underwritten by explicit or implicit public subsidy. It follows, then, that the sector underpins the public interest.

The dialogue sought to obtain the widest possible range of views on how to meet this public-interest purpose at the same time as withstanding the pressures that come from being publicly quoted commercial companies. To do this we undertook systematic consultation with as many bank stakeholders as we could, including people working to improve social inclusion, campaigners, bank employees, bank customers (retail and commercial), think tanks, investors, senior regulators and policy-makers. The result was an incredible learning experience for all involved.

At the end of this process, three things in particular stood out to us. First is the importance of trust. Trust between all bank stakeholders is today far from where it needs to be, and bank leaders face a particular challenge. The financial crisis and its aftermath left many people with a profound mistrust of bank leaders' commitment to service. It is vital that this changes. People need to feel confident that banks will respect the privileged access they have to government and policy-makers, will work with regulators, not against them, put the customer's – and not the bank's – interest first, and that they will reward themselves appropriately.

The second thing that stood out for us was the clear call for strong and principled bank leadership. At the start of the dialogue, public anger at banks and bankers was such that few leaders were willing to stick their heads above the parapet. The individuals who make up the BankingFutures Working Group were bold enough to do so – and to fantastic effect. Though there were some

challenging exchanges in the dialogue, the overwhelming response was one of constructive engagement with the Group's desire to put things right. It was also very clear that people want to see this bank leadership continue and be taken up by others in the sector.

The third stand-out issue was the consensus that if bank, investor and societal incentives were better aligned to meet each other's needs and expectations, the system would be more balanced and thus would require much less regulatory intervention. Of course, the role of the banks in serving the public interest brings with it the corollary that the sector will be regulated, but the extent and reach of that regulation is discretionary. The stringent regulation of bank activities and conduct between 2007 and 2015 was evidence of a catastrophic breakdown in trust in banks' ability to regulate themselves in ways that serve the public interest. When principled bank leadership is both firmly established at the helm and trusted to align incentives to deliver societal value, societal demands for regulatory oversight of the public interest will diminish.

2015 is likely to have been a pivotal year in changing the terms of the debate about the role and purpose of UK banks. The Bank of England's Open Forum, the wide-ranging and high-level engagement in the BankingFutures dialogue, the work of the Banking Standards Board and other current sector initiatives, all demonstrate a strong appetite to address the trust deficit between banks, investors, regulators, customers and civil society. The way in which bank leaders articulate their new role in response to changed societal expectations will go a long way to determine whether trust is rebuilt.

The dialogue came up with a clear articulation of some of these expectations, of where doubt and tension remain, and makes three recommendations of what bank leaders might do to address these issues. Not only are these recommendations achievable – and in the foreseeable future – they will also do much to realign incentives and expectations. Over time, their successful implementation would not only increase government confidence that banks can be trusted to run themselves without undue regulatory interference; it will also make it possible for banks to understand and meet the needs of customers and society as a whole. We are confident this can and should be done. It has been a privilege to facilitate the conversation so far, and we look forward to taking it to its conclusions.

Sophia Tickell and Anne Wade
Co-Directors, BankingFutures
January 2016

The BankingFutures Process

The BankingFutures dialogue was launched in July 2014 to explore how to rebuild a healthy banking sector in the UK. It began seven years after the start of the financial crisis of 2007/08 and during a process of profound reform of the banking sector. Designed to de-risk the banks and to address serious and egregious misconduct, these bank reforms also offered a 'once-in-a-lifetime' opportunity to provoke a systemic rethink amongst bank stakeholders about what they need and want from the banking sector. BankingFutures is one response to that opportunity, differentiated by its extensive and systematic outreach to stakeholders across the banking system.

Over the course of the 18-month project, Leaders' Quest and Meteos convened members of the BankingFutures Working Group of senior bankers, investors and sector experts. The Group (see page iii) is made up of self-selecting, forward-thinking individuals who are committed to contributing to positive reform and willing to engage with critics and stakeholders of the sector. They participate in a personal capacity.

Underlying the dialogue was the understanding that the financial crisis was caused by systemic risk: the complex mesh of behaviours and choices of individuals and institutions that shape and interact with the financial bodies that make up the system. Certainly the banks played a huge role in what happened – but so too did investors, regulators, policy-makers and – usually unwittingly – customers. Consequently, the dialogue sought the input of all these stakeholders in the belief that their engagement is essential to rebuilding a healthy banking sector.
To encourage this engagement, the Group developed a discussion document on the nature of a healthy banking sector in the UK. The document was launched in June 2015 and over the following six months underwent a multi-stakeholder consultation with over 200 people (see full participant list in Appendix B).

Engagement in BankingFutures

The high level of engagement in the BankingFutures dialogue is partly explained by the importance of the banking sector to both the UK and global economies, and also because of its inclusive, structured approach, which sought to ensure all stakeholders had a proper hearing.

It was also down to good timing. First, the Bank of England's commitment to greater openness and transparency, exemplified most clearly by its 2015 November Open Forum, was generating greater public (albeit specialist) engagement with finance more broadly, creating a more open environment to discuss these issues.

Second, most banks have seen new leadership seeking to preside over cultural change and changes to the business model to reflect more explicit – and higher – societal expectations of the sector. These changes may not yet have gone as far as many would like – more is needed on issues like compensation, for example – but changes are being introduced.

Third, as the project began, consequences of the – much-needed – bank reforms were beginning to emerge. Specifically, investor and banker concerns about whether the moves which could result in a more domestic-focused regulated banking sector would be beneficial to the economy, were beginning to resonate with regulators.

Fourth, enough time had passed since the crisis to allow leading civil society banking experts and forward-looking, reform-orientated banking executives to engage face to face in ways that had earlier proved fruitless or seemed pointless. At the same time, civil society and other important stakeholders, including bank employees and customer representatives, who until now had felt under-represented in the process of banking reform, welcomed the opportunity to contribute.

Finally, and importantly, during the course of the project there was a discernible thaw in relations between banks and the government. Shortly after

the election of May 2015, in his June Mansion House speech, the Governor of the Bank of England signalled this change by acknowledging – without detracting from the responsibility of the banks – that public policy had also played a role in the crisis.

The Report

This report outlines the findings of the consultation, which benefited from this multi-stakeholder engagement. It is written in three parts, each of which reflects the diversity and richness of the perspectives we heard during the roundtables.

Section One looks at systemic risks in banking before and after the 2007/08 financial crisis, what the reforms introduced since then have sought to achieve, and the resulting profile of the banking sector.

Section Two outlines the BankingFutures findings. It is split into two parts. The first highlights the urgent need to overcome the trust deficit between bank stakeholders in order to embed the changes needed to make the sector truly healthy. The second identifies six ongoing tensions that require management. They are: the purpose of banks; the profile of the banking sector; the role of diversity and competition in the sector; the continued focus on short-term goals and outcomes; limited financial literacy and engagement of society; and the need for clear government policy.

Importantly, Section Two also seeks to highlight and disentangle what some people described as widely held but inaccurate 'myths', which reinforce prejudices and opinions and make true consultation and engagement more difficult.

Finally, in acknowledgement that actions speak louder than words and that bank leadership is needed and wanted, Section Three makes recommendations for action on three issues that require a systemic response, but on which bank leadership is necessary and could make a huge difference. Consistent with the systemic approach, each also identifies the role other stakeholders could play in resolving the issue.

Section One
The UK Banking Sector Pre- and Post-Crisis

Background to the Crisis

In the years prior to the financial crisis a huge, opaque and poorly understood build-up of risk and who held that risk, developed across the global financial system. People charged with risk oversight – government policy-makers, auditors, investors, bank executives, regulators and the financial media – all overestimated the ability of the market to assess and manage financial risk, and to right itself accordingly.

The banking sector has a huge role in the UK's financial system. During the 1980s, '90s and noughties, changes in bank culture and risk management were contributing to the growing systemic risk. They included the move to universal banking, which brought with it more liquidity and a far greater appetite for originating, distributing and holding risk. And they coincided with the advent of unprecedented modelling and structured finance capabilities, which contributed to changes in perception, distribution and management of risk across the system, ending up with instruments being held by people who had little understanding of the underlying risk.

On the wholesale side, traditional banking activities were brought into the trading room, while in retail, banking products were treated as commodities to be insistently marketed to the public, increasingly without due care as to purpose and suitability. Furthermore, a low interest rate environment and adjustments to compensation structures and levels, combined with these changes to transform banks' strategies. The traditional 'buy and hold' approach was replaced by an 'originate and distribute model'[1] which played a significant part in the deterioration of underwriting standards and asset quality due to misalignment of incentives.

These structural and technical changes exacerbated a cultural sea change already taking place in the sector towards an intense focus on profits – and personal gain – at the expense of more traditional risk management tools and, often, the customer. This culture change was reflected in poor – and even criminal – behaviour, in the unprecedented pay levels of individual bankers, and in what many saw as banks 'optimisation' of the regulatory system.

Bank boards, executives, regulators, academics, auditors and investors became increasingly convinced that risk could be sliced up and managed in such a way as to radically diminish its impact, while insufficient attention was paid to those voices urging prudence. Changes to reporting standards played an important part. New standards replaced 'prudence' as the pre-eminent accounting principle with the principle of 'neutrality', signalling a move away from a focus on capital protection and stewardship as a core principle of accounting.

Investors were also unaware of the scale of the risk. A few – for example, leveraged credit arbitrage funds – may have sought to disguise it. Most, however, simply failed to understand its magnitude, and before the crisis – while they benefited from staggering returns – had little incentive to do so.

Monetary policy also played a significant role; arguably it was too lax in the run-up to the crisis, and too tight as it unfolded. Public sector debt was ballooning, but while

[1] This refers to a shift in practice over the last 20 years towards banks creating or originating loans, and then selling/distributing them to third parties. This contrasts with a more traditional model in which a bank creates a loan and holds it on its own balance sheet to maturity.

easy access to credit was good for governments wanting to counter income inequality and encourage home ownership, they did not object.

There was also a notable reduction in public prudence when it came to accepting the array of financial offerings. Where only a decade before, conditions for obtaining loans and mortgages had to be underwritten by evidence of the ability to repay, many people threw caution to the winds and happily reaped the rewards of cheap credit.

The result was the catastrophic financial crisis of 2007/08. Although the exact cost is impossible to quantify, in 2010 the Bank of England estimated that solely in terms of output loss to the world, it represented up to $200trn.[i] For the UK alone, it is estimated to have led up to £7trn in lost output.[ii] It wasn't until 2014 – seven years after the crisis first hit – that the British economy grew to its pre-crisis size.[iii]

The Call for Reform

The crisis and its fallout led to clear consensus amongst regulators about what bank reforms needed to achieve. First was the elimination of the macro-economic risk that the sector as a whole represented to the economy. This did not mean that individual banks should not be allowed to fail. Rather, it was a call for the removal of systemic risk posed by the sector as a whole which results in taxpayers shoring up a collapsing banking system in moments of crisis. The second call was for the sector to create more value for society as a whole – individual customers, taxpayers, the Inland Revenue – and not just for shareholders and bank employees.

The third call was for cultural change within the banks. The size and scope of the sector brings enormous advantages to the UK economy, giving bank leaders power and influence. With such power comes the responsibility to ensure that the internal culture of individual banks – and the sector as a whole – is appropriate for what banks are there to do: to serve the real economy over time.

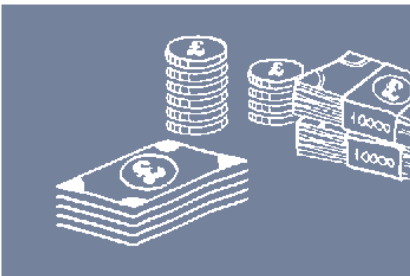
There have been significant attempts – external regulations and internal management changes – to meet these demands. The first wave of regulatory reform focused on reducing total risk in the banking sector. This led to the introduction of new liquidity, capital and leverage requirements, increased depositor insurance, measures to ensure banks are better placed to absorb losses, and measures to restructure the banking sector. This was followed by a more specific focus on longer-term structures to increase competition, support resilience and address conduct within the banks. This included introducing, from 2019, some ring-fencing of 'core banking activities' (retail and commercial) from investment banking activities, holding senior executives to greater account, increasing the independence of the audit process, improving capital rules to reduce procyclicality, and focusing on incentives. Conduct moves have included bank fines for a range of crimes and transgressions, some of which took place after the banks had been bailed out.

Internally, banks have introduced new management procedures to address both the structural and cultural challenges of risk management. There have also been changes to compensation at all the banks in response to new regulatory requirements – including a reduction in the permitted level of bonuses, greater levels of deferred compensation, broader metrics on which outcomes are measured, and stricter clawbacks.

The importance of changing bank culture was highlighted throughout the BankingFutures dialogue. From the start, the BankingFutures Working Group argued for banks to exercise greater humility and to take a more respectful and conciliatory attitude to their various stakeholders. The Group called for leadership to make commitments to do this, to take a comprehensive and holistic approach to risk management, ensuring full and fair disclosure of risk, and to comply with the spirit and letter of regulations in ways that make it clear that sound and prudent banking should prevail over maximising short-term profit-making opportunities. They also called for a more open, self-critical

culture that rewards simplicity and accountability, and allows people to make mistakes.

Compensation – what and how bankers are paid – has been highlighted as a significant barometer of cultural change since the crisis. Many remain concerned that the needle has not swung far enough. Regulators, the media, public opinion and some investors argue that quantum (the sums paid) of compensation remains far too high considering the value-add that the UK has received from the sector relative to the risk the country has been exposed to – and indeed has paid for. They also argue that incentives remain too focused on short-term profits rather than risk or the long-term creation of value, and do not reward – nor yet are designed to drive – customer-centric behaviour. For a wary public to believe that banks are taking culture change on board, compensation remains the single most important bellwether issue.



The Banking Sector Today

These reforms have led to profound changes in the regulation of the UK banking sector. There is much, though, which – eight years on – looks remarkably familiar.

The sector continues to play a pivotal role in the UK economy. The UK financial system as a whole overshadows the underlying economy, with assets six times annual GDP.[iv] The UK remains the second most important financial centre in the world.[v] The financial and insurance service sectors contributed £127bn in gross value added to the UK economy in 2014, representing eight percent of the total.[vi]

The UK's financial sector is dominated by banking, with UK-domiciled and international banks holding nearly £5trn in assets[vii] (compared to $11trn in the largest US banks[viii]). It also has high concentrations of shadow banking assets, which are equivalent to a whopping 350 percent of GDP,[ix] and supports global concentrations of other financial market activity, most notably fixed income, currency and commodities (FICC) and various classes of derivatives. The size of the financial sector (including insurance) is very large relative to the rest of the economy and compared to other OECD countries. The UK accounts for 42 percent of EU investment in 'Fintech' – the development of software to provide new financial services.[x] Fintech is estimated to contribute £20bn per annum to UK GDP – a figure the government is keen to see rise.[xi]

Five banks and one building society (Barclays, HSBC, Lloyds, RBS, Santander and Nationwide) dominate the high street. In addition to the giants, a number of older, smaller banks like C. Hoare & Co. and Secure Trust Bank successfully weathered the storm, while others, e.g. the Cooperative Bank, remain under special measures. Some retailers, such as Tesco, have developed banking arms, though some of these newly designated 'challenger banks' are owned by the 'big four' (Barclays, HSBC, Lloyds and RBS). And there have been a number of new technology-driven market entrants, particularly in the payment arena, such as ApplePay and Transferwise. Despite the plethora of players, however, the retail banking sector remains highly consolidated, with the big four and Nationwide controlling 77 percent of the current account market and 85 percent of small business banking.[xii]

The UK banking sector also remains globally significant. Global giants such as Deutsche Bank, Citigroup, Goldman Sachs and UBS are still hosted by the City (and Canary Wharf), while four major UK-owned banks – Barclays, HSBC, RBS and Standard Chartered – are designated as Globally Systemic Banks (GSB) by the Financial Stability Board (FSB).[xiii]

The final defining characteristic of the UK banking sector today is the growth and reach of the fast-growing shadow banking sector, whose high salaries and focus on innovation are attracting talent from more traditional banks. Driven by tighter regulation of the formal sector and ample liquidity, there is a

discernible shift of focus into the shadow banking sector.

The term 'shadow banking' describes a range of financial intermediaries or activities involved in credit intermediation which lie outside the regular banking system. This means they are not subject to the same regulation, oversight and insurance as regular banks. Shadow activities are known to have played a role during the financial crisis – some shadow intermediaries were highly leveraged or had large holdings of illiquid assets, making them vulnerable to runs when investors withdrew large quantities of funds at short notice. Some shadow activities complement and support traditional banking, but others such as 'Peer to Peer' (P2P) platforms offer alternatives, such as new specialist smaller loan offerings.

Although its full implications for systemic risk are not yet well understood, alarm bells are beginning to sound on shadow banking.[xiv] Its rapid growth and spread is leading sector experts to warn that, far from being reduced, risk is moving into a part of the financial system that is less visible and is poorly understood.

Regulators are responding to these warnings by attempting to manage shadow banking globally. The FSB is coordinating oversight and monitoring of how traditional banking activities are moving into shadow, and seeking to regulate them more effectively by introducing new standards to limit large exposures of traditional banks to shadow banks; strengthening oversight and regulation (system-wide and on a global level) so that authorities can be alerted to the excessive growth of leverage and liquidity risks; and introducing reforms to make shadow banking institutions and markets more resilient.[xv] As in the 2007/08 crisis, the global nature of financial markets makes the UK particularly vulnerable, a fact acknowledged by Bank of England Governor Mark Carney, who has warned that shadow banking excesses in emerging markets, and China in particular, now pose the biggest threat to the international economy.

Government policy toward the banking sector continues to acknowledge the importance of the sector, as – despite its regulatory responses – it has done throughout the crisis and its aftermath. This has recently been demonstrated by a number of Treasury policy initiatives (its support for Fintech, its outreach to engage with Chinese and Indian financial markets and policy, and the commitment to support the extension of financial services to regions beyond London, including its aspiration for a 'Northern Powerhouse').

Section Two
The BankingFutures Findings

A Healthier Banking Sector?

BankingFutures sought to answer the question of how to rebuild a healthy banking sector in the UK. Its starting point was to ask whether the reforms introduced since 2007/08 had achieved this goal and, if not, what more needs to be done. No one who participated in the BankingFutures dialogue considers risk to have been completely eliminated from the financial system, or from the banking sector within it. It is recognised that any banking sector is inherently risky, arising – at a very minimum – from the fact that banks have to make decisions about loans and investments based on an assessment of the credit-worthiness of customers and clients.

When evaluating the reforms, it is important to note that they were not designed to change the sector from being made up of competitive, privately-operated, for-profit businesses. Rather they were attempting to rein in the excesses of a dangerous culture, to reintroduce a strong sense of purpose, to radically reduce risk, and to ensure that value generated by banks is more widely shared. Although a few participants in the dialogue wished for more revolutionary change, the debates were largely focused on how to make the current system healthier – more resilient, fairer and less risky.

The findings of the dialogue are outlined below. They are divided into two parts. First, they highlight the vital task of addressing the massive trust deficit that continues to exist between bank stakeholders. Improving relationships between these people is a prerequisite to achieving lasting improvements to the other challenges facing the sector. Second, the findings identify six ongoing tensions that arise from the nature of the UK banking sector. These emerged powerfully from the roundtables as requiring continuing and vigilant management if divergent stakeholder needs are to be met.

Part One: The Importance of Trust

The importance of rebuilding trust between bank stakeholders was the central theme throughout the dialogue. Everyone acknowledged that trust – possibly the most used word in the roundtables and extensive interview process – was badly damaged by the financial crisis and subsequent scandals, and that it urgently needs rebuilding.

Trust – the belief that it is safe to make something of value subject to another person's actions – lowers transaction costs in any social, economic or political relationship. It lightens the burden of providing evidence, and makes people happy – or at least satisfied – with the ongoing relationship.[xvi, xvii] Because trust is constantly revisited on the basis of new information, rebuilding trust is more difficult than establishing it from scratch.[xviii] Furthermore, if a person or organisation is already mistrusted, data that confirms suspicions tends to be over-emphasised. Of all the factors that might predict levels of trust, perceived past trustworthiness is the greatest. All this goes some way to explaining why the scandals that have plagued the banking sector since the crisis have been particularly damaging.

Banks in particular need to work hard to prove they can be trusted to be safe and responsible custodians of clients' money, provide reliable and fair payments services, and put customers back at the heart of the business model. Above all, they need to exercise a duty of care to those they serve. An important first step, for some participants, is for banks to acknowledge the scale of that challenge.

Questions of mistrust were not, however, limited to banks. For investors and banks to trust regulators, they need greater predictability and transparency over changes to policy. It is a strength of democratic political systems that policy frameworks can be adapted to reflect changing societal expectations. In order not to inhibit long-term provision of capital, investors need any such changes to laws and regulations to be clearly flagged, evaluated and debated.

For regulators to trust banks, they need to feel that banks will operate within the spirit as well as the letter of the law. For banks to trust investors, they need to feel investors are aware of – and care about – the need for banks to manage long-term challenges. For investors to trust banks, they need to feel confident that there are no more costly transgressions waiting in the wings.

Rebuilding the trust of civil society in banks is an even more arduous task, which will require civil society to feel confident that regulators are acting independently and transparently, in their interests rather than the banks'. Civil society also needs convincing that banks will be more transparent, and will understand and act on their continued outrage at reward structures. But it is not just a one-way street. Rebuilding trust will also require civil society to engage with the systemic nature of the problems and not just to default to reacting to the misdemeanors of individual bankers.

> *"Banking replaced the client at the heart of its business model with bankers. We forgot who paid our bills and who we were meant to service as part of our core function."* **Banker**

Rebuilding trust was seen as an essential first step in the construction and maintenance of a healthy banking sector in the UK. To achieve this requires honesty and openness. Unsurprisingly, given the breadth of views of those consulted, beyond the need for trust there were multiple views on the nature of a healthy banking sector and how to achieve it.

The dialogue revealed steps that can be taken to begin to rebuild trust. It uncovered a number of concrete, structural tensions inherent in UK banking that will require ongoing and active debate for the foreseeable future. They are described as tensions because they encompass conflicting interests and views that cannot be resolved, only managed. For these 'tensions' to be managed and divergent stakeholder needs understood, there is an urgent necessity to systematically and continually improve communication channels between banking sector stakeholders. These tensions, and the dilemmas they pose, are outlined below.

Part Two: Ongoing Tensions for the UK Banking Sector

Tension One: The Purpose of Banks

Banks exist to serve the real economy over the long term. At its most basic, this means supporting economic activity and capital allocation in the economy in ways that underpin financial stability. They do this by providing services to retail and wholesale customers: individuals, households and small and medium enterprises. These services include financing mortgages and helping people to make payments, plan pensions and travel abroad for work and holiday. Banks also offer a range of services to corporate customers, both small and medium enterprises and global companies. All participants in the dialogue agreed with this baseline and endorsed the call to place that purpose of service to the economy, and to the customer, back at the heart of the financial services sector. There was also widespread acknowledgement that given their role in the economy, banks, in common with a limited number of other commercial entities, such as those involved in healthcare, have a duty of service that makes them

> *"...we're here with a noble purpose. We can't be temples of greed and self-interest any more. We need to be trust-based, serving purpose and operating on a vision of serving customers, without too much risk and with good conduct."* **Banker**

different from other sectors. The tension lies in what the role of banks – as private and commercial enterprises – should be in the provision of public services, and who meets the needs they cannot fulfil.

A clear policy steer would help. Banks play a fundamental role in enabling citizens to participate in the economy. Given the commercial constraints on for-profit (and largely publicly listed) companies, some participants called for government to seek and articulate societal consensus on the financial services that society – as a whole – needs. From this it would then be possible to define which of those services it is reasonable to expect banks to provide, and what provision should be made – and by whom – to ensure there is a social safety net for vulnerable and underserved communities.

At the other end of the spectrum, focusing on a purely commercial view of the role of banks, some dialogue participants argued the need to extend the purpose of banks from domestic to international finance. They argued that it should be considered a core purpose of some UK based banks to continue to support the UK in playing an important role in the global economy. They do this by providing high-level services that facilitate transactions of UK-based (domestic and global) corporations and various City-based global financial market activities, e.g. fixed income, currency and commodities (FICC) and derivatives.

"A lot of what banks do is to provide public utility; the part of banking which does not generate income. From an investor perspective that means they need to carry the cost of servicing and maintaining that infrastructure. There is no levy on the taxpayer to support core banking infrastructure, and that's a problem." **Investor**

Another group of participants argued that banks should also play a more future-orientated role. The UK's financial sector is already at the forefront of debates about how financial markets should be re-orientated to respond to sustainability challenges. They include ideas such as: enabling capital flows to meet the needs of emerging economies; pioneering sustainable finance initiatives (such as green bonds, carbon markets, climate disclosure and risk); financing much-needed national infrastructure; funding housing and education; introducing integrated reporting; and improving stress-testing to make the sector more future-proof.[xix]

"I'm worried that in the UK, banks are getting further and further away from fulfilling their basic social role. Look at the closure of branches. There's a middle-class belief that they're no longer needed, but where they don't exist – that's where you see the loan sharks and payday lenders. Banks play a key role in keeping our high streets alive." **Civil society participant**

Coming to agreement on the purpose – or range of purposes – that banks need to fulfil would help all stakeholders understand and manage where to place their expectations. Conflict is often created by seeking solutions to problems in quarters where they cannot be found, and by a lack of clarity and agreement about who is – or should be – responsible for the duty of care associated with what products are sold, as well as ensuring that financial services are extended to all who need them.

Tension Two: Too Important to Fail

The second great tension identified by the dialogue was the acknowledgement that the sector as a whole is too important to the UK economy to fail. This brings with it an implicit public subsidy; governments are prepared to accept that individual banks may be allowed to fail but the sector as a whole may not. This gives rise to unease about the power and influence held by individual banks and bankers, and questions about how to effectively hold them to public account.

The advantages and disadvantages arising from size of the sector and its

international reach need to be fully understood and vigilantly managed. The benefits of the large and international presence of the UK financial sector currently include the following:

- The UK banking sector's profile gives the UK an influential seat at global regulatory tables: the FSB, the Basel Committee on Banking Supervision and the Bank for International Settlements. This role in setting European and global rules could be used to set new norms and standards not only directly to promote UK and global financial stability, but also indirectly by taking leadership on the role finance can play in support of important global social and environmental objectives. It also should enable the UK to take a leadership role in trying to untangle and manage the overlapping and often conflicting realities of having UK, European and international regulation all applying to the UK banks at one time.
- The sector's profile allows the country to benefit from the fees of the banking and trading transactions of the global capital flows that pass through the City. Finance and insurance contributed £127bn in gross value-added to the UK in 2014.[xx]
- The banking industry contributed more than £31bn in tax in 2014. £16bn (51 percent) of this tax contribution came from foreign banks, while £15.3bn (49 percent) was derived from UK-headquartered banks.[xxi]
- Banking accounts for 1.7 percent of the UK's total employment. Approximately 25 percent of the 510,630 banking jobs in Great Britain are in the wholesale banking sector.[xxii]
- It also sustains a professional services industry of lawyers and accountancy firms, which contributes to the country's stated commitment to be a knowledge and service economy.
- The UK corporate landscape is, itself, very international, with large numbers of FTSE, medium and small companies operating outside the UK. The large and international structure of the UK banking sector provides easily accessible financial services to UK firms of all sizes (including the SMEs who provide much of the employment in the UK) seeking support for their global sales or supply chain activities. These smaller companies in particular do not have the range of banking options open to large multinational companies domiciled in the UK, and so they are highly reliant on the international UK banks.
- Finally, if tapped appropriately, the size and reach of the financial services sector could provide unique financing opportunities in support of other key government goals, such as infrastructure, housing and investment in UK energy generation.

Despite these advantages, other participants argued that the banking sector's current profile is net negative for the UK. They point to ongoing risks to the economy posed by the sector's size and international profile. These include the fear that whatever regulatory safeguards may be in place, the sector as a whole is too big to fail and the UK taxpayer will ultimately be left picking up the tab in the next crisis. The UK-based market-based financial system is forecast to grow in size from six times GDP today to fifteen times GDP by 2050.[xiii] Under this scenario, even if regulation has made banks safer, it is not possible to protect either individual savings or the economy more broadly from market failure stemming from elsewhere.

> *“In the UK market, you really have two totally different banking systems. You have the City (global market) and what the UK needs. No one thinks of them separately. So there's tremendous pressure to perform globally, and not so much to provide services for local people. It means banks aren't competitive globally, nor do they provide services people need.”* **Civil society participant**

"Really, the existential question is: what kind of system do we want? There are two very alternative views on this. There is a vision of a banking system that's retail and commercial and essentially domestic. I suspect many stakeholders would say that's a good system. I personally believe it would have devastating consequences the public don't get. Sure, we have the monarchy and we have some good industries, but we have a limited manufacturing industry. I think it would be a massive blow to what makes this country, and this city, unique."

Banker

Their size and role also gives banks too much political power in negotiations with government. Some participants also argued that the disproportionate size may even be bad for productivity, as it leads to a concentration of resources and power in London's global hub, with negative implications for the rest of the UK economy.

The size and international profile of the sector also affects its ownership model. The large market cap of the sector means that, for the foreseeable future, UK banks will be owned jointly by UK investors and international asset managers. Some argue that the international ownership model complicates the sector's ability to serve the real economy in the UK, as the knowledge of local and regional economic possibilities are not adequately understood. Whether this is true or not, the fact that banks have a duty of care to customers and the economy as a whole is complicated for the investment community, for whom banks' purpose must be an attractive part of the investment case, rather than being based on other criteria.

Although the profile of investment banking has already been dramatically reduced since the financial crisis, the macro-economic risks of international investment banking continue to be of greatest concern. These risks include:[xxiv]

- Complexity, which makes it difficult to understand the assets on the balance sheet.
- Interconnectedness, which means that insolvency problems can become contagious very quickly.
- Size, which means that distress of a major investment bank can result in dramatic and rapid withdrawal of market-making and financial infrastructure services across the financial system.

All banks are inherently risky, but when the decisions made by the sector in aggregate have global reach this brings with it risks of a different magnitude. However, as outlined above, they also bring opportunities. Likewise, the implicit public subsidy that underpins a sector that is too important to fail brings with it the need for high accountability, both of the regulator and participants in the sector itself. This situation results in the need to constantly evaluate and manage the ensuing risks and to grasp the opportunities. Participants in the dialogue acknowledged that the sector is considerably more stable that it was before the financial crisis, but recognised the need for ongoing dialogue in order to manage these macro-economic risks that are inherent to the UK banking sector's profile.

Tension Three: Diversity and Competition

The UK banking sector is not only large; it is also highly concentrated. There was consensus amongst dialogue participants that increased competition is good. Most argued that the sector's commitment to put the customer at the heart of the business model cannot be fully realised without a more competitive market. Tensions and disagreements arise over the role that a diversity of business models and offerings plays in creating real competition and tackling systemic risk.

The key argument in favour of greater competition is that it provides the customer with the best means of getting a fair deal from their banks. At an individual level, with better ways to compare bank offerings, as well as having more to choose from, consumers are able to exercise their preferences and express satisfaction or dissatisfaction with what is on offer by taking their custom elsewhere. Individual retail customers and small businesses in the dialogue

expressed the desire for more banking options, including more high street banks with greater knowledge of the local economy.

Systemically, greater competition should disperse risk across the system. At the same time, a greater diversity of business models can be argued to improve resilience, as they are subject to different pressures and will therefore be differently affected by systemic shocks. It should, however, be recognised that today's globally interconnected financial system makes it extremely difficult for any bank to be immune from systemic risk.

Either way, increasing competition and diversity in the sector is a complex challenge. Competition has made, as yet, limited inroads in the banking sector. So-called challenger banks doubled their retail sector lending between 2010 and 2013, but today only account for seven percent of the total.[xxv] Arguments to explain this include:

- Regulatory changes which have introduced higher capital requirements, new technological and infrastructure thresholds, and tougher conditions on providing advice to customers. These all create material barriers for new market entrants.
- The scale of bigger banks enables them to disaggregate the cost of products and services and subsequently to cross-subsidise in ways that make it difficult for smaller banks to compete on price. Limited transparency about the costs to banks of providing particular products and services exacerbates this situation.
- Customers have been reluctant to switch their accounts. This is not necessarily due to satisfaction with the products and services they are being offered. According to dialogue participants, it is as likely to be due to a lack of differentiation and diversity in the alternatives.
- There may, however, be another, important reason for the lack of competition in the market, stemming from the dual domestic and international role banks serve. Regulators have the unenviable task of balancing the need for consumer protection in the UK with permitting banks to compete in the global market. From a regulatory point of view, consolidation can be argued to reduce risk as fewer large banks are easier to control. In light of bank transgressions and illegal activities since the crisis, some participants argued, this consideration should take precedent over others, even if such an approach does hamper competition.

“I'm saying that if you ask a customer what they want, they might not say or even know what's in their best interest. If you have more competition in the sector, inevitably banks will have to serve better customers.” **Banker**

Despite competition having made limited inroads, a number of participants highlighted high levels of uptake of new technology-driven payment models and the excitement being generated around crowdfunding and peer-to-peer lending models. It was acknowledged, however, that the lack of regulation in the shadow banking sector poses new and different risks – both to consumers and the system as a whole.

The degree to which competition and diversity could lead to improved customer service and protection and a more resilient banking sector in the UK is unclear. The Competition and Markets Authority continues to undertake important work on this issue. Recent regulatory changes – capital requirements, technology and infrastructure thresholds, and restrictions on providing advice have led some civil society participants to conclude that the regulator has decided that having greater control over fewer banks is the better option. This, they argue, has important implications for how much competition and diversity there is in the sector. Further discussion of this issue would allow better understanding

“There's such a high turnover of staff managing our relationship, which is really frustrating. And it would be better if we had more banks to choose from.” **Customer**

of the merits of both views and how they contribute to the outcome – sought by all parties – of customer wellbeing and system resilience.

Tension Four: Long-term Needs versus Short-term Imperatives

The banking sector has important, long-term needs that require bank management and investors to create a culture that rewards adopting a longer-term perspective, and long-term investment approaches that support the sector in meeting the needs of the real economy over time.

Participants in the dialogue acknowledged a serious tension inherent in successfully balancing these long-term needs with short-term imperatives that prevail today. They called on banks' leadership to embrace and advocate for a long-term perspective on value generation.

Many people argued that bank culture still focuses far too much on delivering short-term profitability. They pointed to a continued investor reliance on short-term sell-side analysis, the focus on quarterly reporting and short-term trading, and accounting rules which fail to reflect longer-term risks and potential losses on the balance sheet. This, they argued, leads decision-making, risk profiles, targets and – above all – compensation schemes

> *"If there is short-termism – it's the responsibility of boards, not investors, to make sure the bank is building a long-term franchise."* **Banker**

to remain heavily weighted to short-term gain. While internal reward and incentive structures continue to be misaligned with long-term goals in this way, it is very difficult to envisage how culture change will be fully embedded or how long-term capital requirements will be met.

In addition, to attract long-term investors will require bank leaders to address two other important issues: the need to reduce complexity and to enhance transparency around performance, capital and risks in the accounts presented by banks. Some long-term investors will not invest in banks due to the lack of visibility about the ongoing risks they may carry – both in bank financials and in the unpredictability of fines. Financial reports run to hundreds of pages, so it is visibility rather than the lack of data that needs addressing. Participants in the dialogue agreed on the need to improve accounting standards, and pointed to related initiatives such as the Enhanced Disclosure Task Force of prudential authorities, the FSB and the Basel Committee, as well as the main accounting standards setters, the Financial Accounting Standards Board in the US and the International Accounting Standards Board.

> *"Fred Goodwin said you can't shrink your way to success – and bought NatWest. Actually you can! You can persuade investors this is a good strategy – just tell them. They [the banks] need to be more robust with investors."* **Investor**

There were, nevertheless, strongly divergent views about the precise shape of the changes needed to accounting rules. Some argued that long-term stewardship and financial stability would be best achieved by more prudent accounting rules, which they argue are necessary to ensure that banks' performance and capital are not overstated. In turn such rules would help ensure that executive bonuses are based on long-term performance rather than short-term gains. Irrespective of new accounting rules or regulatory initiatives, however, it was agreed that banks could take leadership to ensure greater transparency and clearer definitions of capital and returns. This would increase trust placed in banks by longer-term investors.

Investors themselves were seen as also having an important role to play in this. Investors in banks are heterogeneous. They include hedge funds and private equity, and, increasingly, large short-term programme traders who may hold stocks for days or less, as well as longer-term asset owners and asset managers, and bond-holders. Despite this diversity, banks and civil society believe many of their investors are over-influenced by the sell-side and its focus on short-term imperatives (e.g. quarterly reporting and short-term trading). In addition, there are many investors who view bank stocks as a trading

opportunity rather than a long-term investment option. Many dialogue participants were concerned that investors are overly influential. If investors are interested in long-term value drivers, they argue, they could signal this much more clearly, including on questions of compensation, where investors should be seeking strategies which reward long-term – not short-term – incentives.

Investors and banks called for regulators to be included in this conversation. Intense regulatory pressure and ongoing poor publicity has left banks strategically frozen, focused on the past – not even the present, let alone the long-term future. Given the investment needed in the sector, participants called for regulators to create more predictability and to reduce the number of unexpected fines/costs. This is, of course, extremely difficult to do, without knowing whether there are more scandals to emerge. If there is a way to improve predictability, investors will be able to accept a reduced risk for their lower returns. At the moment, despite claims that the system is safer, the cost of capital has not come down. That circle has yet to be squared – by banks, investors and regulators better understanding the likelihood of further problems coming to light and provisioning for them.

One example of a pressing need – and one which came up continually during the dialogue – was the need to invest more in the customer, and to simplify and modernise service standards to better meet customers' needs. Participants across multiple sectors argued that under the new regulatory regime the business model for large banks has changed irrevocably. Many people – including bank employees – called for banks to be honest about the fact that structural changes will lead to lower returns for the foreseeable future. Banks and investors claim they already understand this, and point to the fact that all banks have dramatically lowered their return on equity (ROE) targets from 20-25 percent pre-crisis to 10 percent today. Despite this, retail and commercial banking in the UK is highly profitable, which may be good for shareholders but leaves some stakeholders believing that the needs of customers remain subordinate to the demand for short-term returns.

"Two key things for banks are technology and succession of human talent, but I could count the number of times we get to discuss this on my hands. Whereas we discuss the minutiae of remuneration and regulation all the time." **Banker**

A second example was the much-cited need for significant investment in technological infrastructure and innovation technology. Many banks rely on complex legacy platforms that are not only inefficient, but may be insecure. Despite fully understanding the need, many investors are responding lukewarmly to requests from banks to invest heavily in such capital expenditure projects. Banking groups as a whole are challenging for investors. Post-crisis requirements for higher capital buffers, credit losses, conduct fines and low returns on investment banking activities mean that over the past five years investors have already had to accept very heavy short-term costs. This is making them reluctant to accept any further reductions to dividends that significant investment to address long-term structural problems might imply.

The key to creating positive outcomes for society, banks, employees and investors will be to align incentives and reward structures with long-term goals. Investors and banks will need to work together to do this. To find longer-term owners who are prepared to support a complicated and time-consuming transition to new, safer models, banks must exercise assertive leadership on the need for investors to be happy to accept short-term investment for long-term gain. More 'patient' investment will also require those investors with a longer-term perspective to find ways to signal their interests differently to banks. A number of people pointed out that bond-holders could usefully be drawn into the conversation, given that their focus is avoiding downside risk. It should be noted that, as many long-term investors are reluctant

"I get very alarmed when I hear banks see themselves as a retail business. They are more analogous to other trust-based professions where there is a huge information asymmetry between parties – like lawyers or doctors – and that means starting with ethics and professional integrity." **Banker**

to engage in public dialogue, new channels will have to be forged to achieve this.

Tension Five: Low Levels of Financial Literacy and Engagement

The fifth challenge to the achievement of a healthy banking sector is the low level of financial literacy and engagement in UK society. The absence of a societal voice is important to the financial system because it means that regulators and policy-makers have only limited input on whether they are working in the interests of society; financial institutions do not get adequate feedback on the value of their societal contributions and hence their licence to operate; and customers are unable to exercise informed choice and thereby hold their banks to account. This lack of overall accountability creates risk within the system by muting the signals that key stakeholders can send about what they want and need from banks.

Roundtable participants highlighted the fact that the root of the problem lies in most people's deeply uneasy relationship with money. Many people worry about their ability to manage their family finances; a concern exacerbated by the financial crisis and its economic aftermath. Extending this already fraught relationship with money to the wider world of seemingly hostile financial institutions then becomes very problematic, and this is particularly true at times of economic insecurity.

This disengagement with finance has a number of consequences. The majority of people do not even understand that finance is inherently risky, while those who do, do not feel equipped to deal with this risk, fearing they have more to lose than gain by engagement.

Customer inertia (as it can be perceived by banks) or fear can lead to exploitation, as banks can lower interest rates or increase prices with no resulting customer action. It means that bank credit card profits can largely be derived from the poorer members of society, without anyone being aware that richer people are being cross-subsidised. It means that banks are free to use the large amounts of data they hold on individuals, without thinking about how it might benefit the customer.

Many people talked about the need for more and better-trusted advice to help people navigate their relationship with the financial world. The loss of trust in banks to act in the customer's interest has left an enormous gap for people who need help. And an already fraught relationship between banks and customers has, some argued, been exacerbated by recent regulation attempting to address mis-selling. Requirements that banks only provide customers 'standard' approved responses only enhances the sense that individual needs are not understood and are therefore not being met.

Although many people see the solution lying in greater financial literacy, there was consensus that there is a long way to go to achieve it. Part of the problem comes from a lack of clarity about who is responsible for making it happen. Some argue that it should be initiated and run by government, others that the banks themselves have a responsibility for increasing the knowledge of their customer base. Still others argue a hybrid approach, where the framework is set by government and then run by banks.

A number of participants argued that even if financial literacy were to be significantly improved, of itself it will never be enough to protect customers. Nor is offering more choice likely to help, as widening the

"Do people understand what a bank is? What we do, the products we offer, and the income most of us earn? We need to help people understand. Our customer base is the UK – and we need to prove we're doing the right thing for them." **Banker**

number of options that are not understood leaves people feeling overwhelmed rather than empowered. As a result, they argued, it is the role of the regulator to protect vulnerable people and to regulate in favour of the duty of care banks need to exercise. A surprising number of participants called for a reversion to a paternalistic attitude to customers in response to the information asymmetry between banks and most of their customers.

Banks, regulators, civil society and consumer groups all recognise the need for greater financial engagement by the general public. They also acknowledge that there is unmet demand for better financial advice. Further discussion about the appropriate balance between protecting customers and the legitimate responsibility customers hold for their actions is urgently needed, would enhance understanding of the loopholes that might be exploited and how they can be avoided, and would help define where financial advice should come from and who should provide it.

Tension Six: The Lack of Clear Public Policy

Many participants in the dialogue argued that a clearly articulated, long-term economic strategy for the UK would provide the most useful framework for defining the range of services a healthy banking sector should offer. The absence of a transparent and holistic strategy for financial services, aligned to other financially dependent policy goals – such as housing, infrastructure and environment policies – creates confusion and conflict between policies, investor uncertainty, and represents a lost opportunity.

> *“Of the complaints the Financial Ombudsman receives, two-thirds are – annoyingly – about PPI. There are hardly any about the credit cards that are ripping people off. Sadly, people don’t realise there’s another way.”* **Investor**

Some argued that such a strategy would make it clear to investors and banks where incentives to encourage private investment and corporate lending lie, and how they could be generated. Others maintained that such a strategy would allow government to define what essential bank services are needed and then commit to making sure they are provided. Finally, some pointed out that a positive narrative, articulated by government, would help reinforce the role and purpose of banks in society.

The absence of such a strategy is leading to regulatory ambivalence or even inconsistencies, according to some participants. A number of examples were raised:

- The adverse impact that de-risking the banking sector is having on the willingness of banks to lend to SMEs.
- A disconnect between regulatory efforts to protect the consumer by pushing prices down, and those designed to increase the capital base of banks.
- An anomaly arising from the political difficulty of asking the public to pay for bank services, which means that ‘free’ banking is in fact paid for by cross-subsidies of richer customers by charges on poorer customers, implicitly condoned by the regulator.
- Opaque policy, e.g. fines used to fund government, which could be used to support banking-related imperatives, e.g. the infrastructure of the banking sector, or to provide private lending to support people in the face of stagnant wages.
- The inconsistency between policies designed to decrease complexity of the financial services system and the very complex regulatory regime.

> *“In the UK we have a major societal crisis – low growth, declining living standards, a finance sector in which 80 percent of loans are going to housing. More low-income people can’t buy housing. Is there a co-production process whereby government, society and banks design a process where real money does lead to real enterprise?”*
> **Civil society participant**

- Lack of clarity about who has responsibility for improving financial literacy and public engagement with finance, and how this should be addressed.
- A lack of integration between overarching policy on housing and mortgage-related activities, despite their role in previous financial crises.
- A lack of integration between energy policy and financial incentives that would permit long-term planning in support of the UK's expressed desire to upgrade energy infrastructure and to change the energy mix in the UK towards a lower-carbon economy.

"We have two regulators: the capital regulator, whose objective is to increase capital as much as possible, and the pricing regulator (who should actually be customer-focused), who just wants to push prices down. There's a fundamental disconnect!" **Investor**

A more joined-up conversation between investors, banks, civil society participants, and government policy-makers and regulators about the economic direction and the role of the banking sector in achieving policy goals, would provide invaluable insights about the banking sector that society wants and needs – insights that could play an important role in policy formulation.

Section Three
Recommendations for Action

“We need good leadership – right through the organisations. Are banks rebuilding strong leaders at base, middle, senior, top management levels? People who set examples, and have skills and ability? It’s all about role models.” **Investor**

The Call to Leadership

BankingFutures revealed intractable tensions in the UK banking sector, the implications of which will require ongoing and active management. It also revealed what some people described as widely held but inaccurate ‘myths’, which consolidate prejudices and make open engagement much more difficult. Improved communication channels between banking stakeholders would not only address the trust deficit highlighted as so important by participants in the dialogue. They would also contribute to improved understanding, and permit trust to be built into the foundations of how the UK banking system functions in future. By inviting stakeholders to answer what they need from one another in terms of commitment, capabilities and consistency – the three pillars of trust – the likelihood that they will work fruitfully together to achieve common goals is increased.

The dialogue demonstrated how this might be done. Bank stakeholders expressed a strong interest in iconic leadership from within the sector. At the start of the project, members of the BankingFutures Working Group – both bank and investor leaders – personally committed to take the project’s findings into their respective organisations and into their daily leadership. This commitment was reaffirmed at the final meeting of the Working Group.

“We need more humility and honesty from leaders. Stop passing on blame. Accept responsibility and communicate that clearly and consistently.”

Civil society participant

In addition, the Group committed to further engagement. The dialogue was described by some stakeholders (and particularly civil society participants) as the first meaningful engagement since the financial crisis. It was a vitally important start, but a start nonetheless. As a result, the report concludes with recommendations for action on three systemic challenges on which bank leadership is necessary and could make a huge difference. For action on these challenges to reflect societal expectations requires further consultation, which will allow bank leaders to feel confident in any proposed solutions.

Three tensions in particular lend themselves to such leadership, supported by other stakeholders but led by banks. If this leadership were well executed it would go a long way to rebuilding trust that does not exist today. What follows are calls to action on three critical issues that require more informed discussion before they are translated into policy or bank reform:

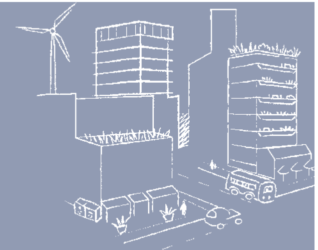
1. For banks to take a lead in articulating how the sector will better serve the real economy.
2. For bank leaders to work with investment leaders to champion a long-term investment culture.
3. For leaders to support a revolutionary change to banks’ relationship with customers, based on respect and fairness.

To be convincing, this work should identify a deadline by which it can be expected that these aims should be achieved (e.g. 2020) and concrete milestones to indicate material progress.

“There needs to be more humility about the fact that we’re here to serve. Our industry is poorly represented from a leadership perspective – even now, the best people don’t want to be spokespeople.” **Banker**

Recommendation One:
Serving the Real Economy

Bank leaders commit to serve the real economy by working closely with policy-makers, businesses, investors and civil society to ensure that all stakeholders are more aware of and responsive to investment needs and opportunities in the UK.



BankingFutures participants were all in agreement that a healthy banking sector in the UK would be one that serves the real economy over the long term. The dialogue revealed a concern that the financial sector has become too self-referential, better at financing itself than the real economy. And it demonstrated interest in understanding how the sector will respond, not just today but to future challenges that the UK economy is going to face.

For this to be achieved requires much greater clarity over what serving the real economy actually means. What are the universal service obligations that the sector has to provide? How should they be paid for? How does serving the real economy contribute to financial stability? How should the sector determine what to prioritise when providing the long-term capital needed for a healthy economy? Which sectors require attention, and what policy frameworks would be needed to support investment? What would be needed to persuade investors to support a redirection of capital flows from intra-financial system trading and exchange and into the real economy?

> *“You need to understand your role in the economy, how you serve people, who the customer is and what your impact is when you transact with them. Everything we do has to be related to the economy and people.”* **Banker**

To respond to this challenge, BankingFutures recommends that bank leaders commit to work with others to determine how best the banking sector can serve the real economy.

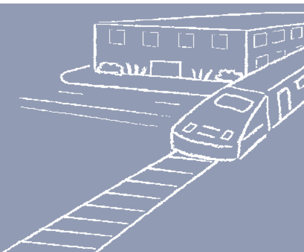
> *“Banks have the licence to print money – as part of that, do you then say that in many different ways this credit needs to be steered to areas of public interest? Even though there are huge problems that come with that, there’s a quid for the pro. You can create fairy dust – credit – but only in exchange for value to the real economy.”* **Civil society participant**

The agenda will be to determine the role of the banking sector as a whole in support of other financially dependent policy goals (housing, infrastructure, energy); its role in promoting financial inclusion – and how provision for underserved communities will be made; and its leadership role in support of important global, social and environmental objectives.

It should be an 18-month consultation in different regions of the UK, underpinned by a bank commitment to determine the framework for universal services provision and investment opportunities in the real economy. The consultation would identify a shared goal to be achieved by 2020, and develop appropriate key performance indicators and milestones to indicate progress towards that goal between 2017 and 2020.

Recommendation Two:
Banking for the Long Term

Bank leaders commit to work with the Investor Forum to create banking and investment cultures that enable the sector to deliver long-term value.



The banking sector – along with some of its investors – has played a pivotal role in creating a culture which gives primacy to short-term rewards over longer-term benefits. While the market for banking products and services was expanding – with more and more customers willing to pay for multiple products – and regulatory hurdles were low, this may have made sense. But the sector and its investors are now feeling the adverse consequences of under-investment in banking on the sector's ability to deliver long-term value.

The bank sector, like other parts of the equity market, suffers from a challenge of too much short-termism. Arguably this has three related sources. First, companies report their financial performance every quarter, which for an industry like banking is especially problematic given the typically long-term nature of most of its activities, and the fact that accounting rules do not necessarily reflect foreseeable losses and risks on the balance sheet. Second, asset owners award mandates to asset managers every 12 months at best. As a result, investors in the equity market – both long-term investors and hedge funds – in almost all cases report their investment performance on a quarterly basis, thus aligning their own reporting to that of their investments. Thirdly, the nature of much of the research from investment bank sell-side analysts – often driven by the desire to generate higher trading volumes – encourages the quarterly reporting cycle of banks and their investors.

“My perspective as a long-term investor is that the banks failed in so many ways it's hard to know where to begin. A lot has been done with regards to prudential regulation. But where perhaps there's been less thought and work is around: what was the role of shareholders in the run-up to the crisis, and what's their role now to stop future crises?”

Investor

These challenges require culture change. They cannot – as recent reform attempts have proved – be successfully imposed from the outside. Bank leaders and forward-thinking investors are uniquely placed to tackle these challenges – indeed they are arguably the only people who are convincingly able to do so. Rebuilding a healthy banking sector will require outstanding leadership on this theme.

There is a need for better communication between investors, banks and regulators on these issues. As many long-term investors are reluctant to engage in public dialogue,

“Investment can't be other than long-term. The message from the top of funds is always different from sell-side and in the media. Often you read “Top 10 shareholders think X”, but I don't hear that from the investors I speak with. The long-term voice should speak out more.” **Banker**

new channels will have to be forged to achieve this.

BankingFutures recommends that banks request the Investor Forum to engage banks and investors in practical steps to explore and find solutions to the specific cultural challenges of banking for the long term. Facilitated jointly by the BankingFutures team and the Investor Forum, such a forum should benefit from civil society, academic and regulatory input over time, to ensure that societal expectations are reflected in its findings.

There is a great deal of related activity being undertaken, ranging from quarterly reporting to accounting standards and measures to improve transparency.

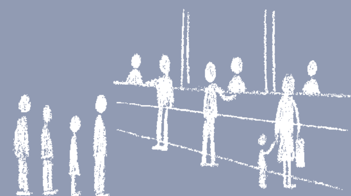
The BankingFutures workstream will seek to ensure it is informed by and supportive of this work, but not duplicative. Its agenda could include:

- Promotion of long-term culture, linked to rewards, involving the development of a framework to identify tangible actions to achieve this culture change.
- Communication – identification of ways in which the long-term investment community and banks can create a mutually reinforcing virtuous circle, whereby investors and banks signal to each other the most effective ways to create long-term value.
- Identification by the long-term investment community of pre-competitive channels to publicly further a long-term agenda.
- Information provision, focusing on quarterly earnings and new non-quantifiable measures.
- Rewards – surveying what has changed, what is being proposed and what is best practice, and testing this against civil society.

At the end of this process, the participants should issue a public statement on its findings. The statement would include common goals and milestones to indicate progress towards them by 2020. The statement would include suggestions about the appropriate policy frameworks to support the goals.

Recommendation Three: **Respecting Customers**

Bank leaders commit to a public process involving consumers, civil society and regulators to improve their duty of care and respect for customers.



BankingFutures considered the implications of the fact that banks in the UK are operating in a society with extremely low levels of financial engagement. Many UK citizens have a deeply uneasy relationship with money and a very limited understanding of finance and financial institutions. At the same time, even among more knowledgeable consumers there is a need for more advice to help people navigate their relationship with the financial world.

Banks are professional intermediaries, with a duty of care that arises from the fact that they are in a position to respect or abuse the trust that their customers place in them. This trust has been badly damaged by the transactional relationship that developed between banks and their customers. The loss of trust in banks to act in the customer's interest, and the subsequent regulatory constraints on banks' ability to provide advice, has left an enormous gap for people who need help.

> *"One thing we need to ask as a society is: what can we reasonably expect people to understand about finance?"*
>
> **Regulator**

Although a focus on the customer is increasingly seen by banks as a source of competitive advantage – as it should be – there is a pre-competitive dimension to this issue as well. The move to encourage greater responsibility among consumers for their decisions takes place against a background of weak financial engagement, making it extremely important that as a society we have a clear view of what is a reasonable expectation of customer responsibility, the degree to which customers should be offered regulatory protection, and how this relates to the duty of care that banks as their service providers hold to them. There is also a need for banks to respond creatively to recent FCA initiatives to understand and articulate the advice gap and how it should be filled.

To address these challenges will require bank leadership to continue to emphasise reforms that embrace a new relationship with customers; one that is built on respect and fairness.

> *"It's right for society to tell banks how we serve them. We also have a responsibility to let them know the extent of what we can do."* **Banker**

BankingFutures recommends that bank leaders commit to a public process involving consumers, civil society and regulators, particularly the FCA. Its agenda could include:

- Finding the appropriate balance between customer autonomy and duty of care.

- The involvement of customer and civil society representatives in bank governance structures.
- Discussion on the degree to which banks should – and do – provide basic financial infrastructure, e.g. payment services, and agreement on how it should be funded.
- Identification of product, service and advice gaps for underserved markets (including ageing population, under 25s), in collaboration with the public and customers.

“Even if you have informed consumers, that’s not enough. What is the mix between the role of consumer, internal bank culture and regulator in holding banks to account and driving good behaviour?” **Customer**

The process would take place over an 18-month period, concluding with a statement of findings, accompanied by practical commitments to supporting the gaps identified. These could, for example, include measures to support low-income customers to effectively manage their finances, the use of technology to manage policy changes (e.g. the introduction of Universal Credit) and a commitment to partnership (e.g. with a consumer advice organisation, to mobilise volunteer bank staff to run programmes on financial education or debt financing), that will be introduced between 2017 and 2020.

Appendix A
A Healthy Banking Sector in the UK

Stakeholder Relationships: How We Can Work Well Together

The banking crisis was caused by the failure of stakeholders within the banking system to identify and manage the risks of an inherently risky sector. To avoid the same thing happening in future, these stakeholders need to work together to understand one another's needs and perspectives.

The original consultation document defined the stakeholder behaviours and relationships that characterise a healthy banking sector. The original ideas were enhanced by feedback from the roundtables, leading to the expansion and refinement of the list below. The two most important changes are:

- The introduction of bank employees as a key stakeholder in the sector.
- The strong reinforcement of the core premise that banks have a duty of care to clients, and a reiteration, particularly from civil society and customer-facing organisations, that given the knowledge gap between much of the consumer base and banks, the responsibility for the relationship must continue to rest disproportionately with the banks and regulators.

Customers and Citizens

Retail customers – individuals and SMEs

There is no hard and fast rule about where a retail customer ends and a wholesale one begins, but the term 'retail customer' here refers to individual clients of the banks, and also small and some medium-sized companies.

When the relationship between retail customers and banks is working well:

Banks:

- Are trusted to always uphold a duty of care to all clients, particularly with individual consumers and most importantly with those more vulnerable customers, where there is an acknowledged mismatch in their level of expertise and that of the banks.
- Provide ease of use and appropriate points of customer contact – online and in branches – to reflect diverse customer preferences, particularly for elderly or low-income clients.
- Create a sales culture predicated on service over all other considerations as the most effective path to long-term commercial success, and build it into incentives.
- Create appropriate, value-generating products for clients, which are sold judiciously in clients' interests, with transparent pricing and simple communications.
- Are permitted to give advice and appropriate product guidance to their clients, in an appropriate regulatory environment.
- Work with others to ensure that access to financial products is extended to currently underserved individuals and communities.
- Extend credit to SMEs whose businesses have been appropriately understood and risked.
- Fulfil an important role in underpinning economic prosperity in society.

- Enable members of society to fulfil their aspirations.
- Protect the deposits of individuals and small businesses from riskier investment banking activities.
- Are safe custodians of the significant personal data they hold on behalf of their customers, which includes having adequate protection against cybercrime.
- Ensure that small businesses have access to the capital they need to support prosperity without having to pay higher fees than larger companies.
- Develop a better relationship with small companies (facilitated by lower turnover in account managers and faster decision-making).

Citizens and customers:

- Ordinary citizens and people who run businesses endeavour to have a deeper understanding of the financial system while trusting the banks to uphold their duty of care.
- Customers are sufficiently well advised and educated to make appropriate decisions about the right financial products for them and assume responsibility for their choices.
- Customers are active in their relationships with banks, and switch between banks when they perceive better value and more desirable behaviour at a competitor.
- Consumer groups engage with banks about what products customers want and need, which will require better access to bank decision-makers.
- Consumer groups engage in discussions with the regulator about the right balance between consumer protection and allowing banks to provide advice.
- Citizens and government engage in constructive debate about finance, the role of banks, financial risk, and value created and distributed by the sector.
- Customers make efforts to understand the risks they are exposed to, and how that relates to the return they are expecting.

Wholesale Customers – Large Corporates and Financial Institutions

Investment banks offer wholesale clients a range of high-level financial services, which facilitate capital transfer across markets to help fund business activities, and finance infrastructure and other capital-intensive development.

When the relationship between wholesale customers and banks is working well:

- Banks offer the full range of services needed for a healthy economy, e.g. raising debt and equity, bond issuance, share sales, Initial Public Offering (IPO) services, derivatives, risk management solutions and international payment services.
- Banks accept that they have responsibility for their clients' best interests, and task themselves with always behaving as such.
- Banks manage market conduct to be free of conflicts of interest between different branches of the investment bank, and particularly to ensure proprietary trading is free of conflict with customers' interests.
- Proprietary trading, in its various guises, is managed in such a way to ensure that it does not threaten the deposits of individuals and small businesses.

Government

Government is one of the banks' most important stakeholders due to its role in framing the banks' social contract via regulation and policy, and because government is a major client and user of the financial system. The relationship between regulators and banks is strained. The banking sector has played a major contributory role to this situation through taking an adversarial approach to regulation and regulators, and in some cases engaging in illegal activities.

When the relationship between banks and government is working well:

- Banks and regulators engage in regular, respectful dialogue, characterised by more public expressions of respect.
- The relationship is depoliticised, open and transparent. It is characterised by a desire to collaborate.
- The tensions between government objectives to promote the financial sector and consumer safeguards are well balanced.
- The statutory objectives of regulators are extended to consider the best interests of the full range of stakeholders, including those of the customer.
- There is global harmonisation or cooperation between countries and regulators.
- There is a degree of regulatory standardisation to ease transaction costs while permitting national differences.
- Banks and regulators are both accountable to specific and clear objectives.
- Banks are sufficiently trusted for regulators to be confident that they do not need to micro-manage internal bank functions.

Banks:

- Acknowledge the enormous responsibility exercised by regulators in issuing bank licences.
- Comply with the spirit and legal requirements of regulations, and assume a policy of zero tolerance of optimising regulatory loopholes.
- Introduce improved internal accountability functions, such as whistle-blowing mechanisms.

Government:

- Successfully promotes financial literacy and understanding of the role of the financial system in society.
- Coordinates approaches to legislation and regulation of the financial system to ensure coherence across the whole.
- Creates coherence between policy for the financial sector and other key government policy initiatives.
- Signals services in the financial sector that are absolutely essential, and if these are not being adequately provided by private commercial entities, is willing to fill the gap.
- Moves to ensure that the regulatory regime is as independent from political debates as possible.

The regulator:

- Provides clarity about when and how regulatory decisions will be made to allow banks time to prepare appropriately.
- Takes the views of bank executives into consideration in the drafting of new regulation, such that unintended consequences are understood and minimised.
- While maintaining independence and avoiding inappropriate influence, the regulator and banks take concrete steps to enhance mutual understanding.
- Endeavours to create regulation that reinforces the desire from all stakeholders for transparency and simplicity in the sector, above complexity.

Investors

For commercial entities to deliver long-term, sustained profitability and dividends to shareholders as well as social benefits, investors need to acknowledge the need for prudent behaviour at banks. The existing relationship between banks and investors could be improved if UK banks were able to attract an investor base that matches its calls for more stability in returns and a focus on long-term value creation, and which demonstrates greater tolerance for the impact reform might have on performance in the short term.

When the relationship between banks and investors is working well:

- The sector appeals to investors seeking attractive and stable capital returns over the long term.
- Investors actively engage with bank management teams and boards on long-term strategy, transparency, accounting and remuneration.

Banks:

- Communicate realistic expectations of sustainable returns to investors.
- Provide simple, clear and transparent reports that give investors an accurate and detailed understanding of the underlying business and financial position.
- Provide clarity about the business models – and how they relate to one another – upon which banks' plans to generate returns will be based.

Investors:

- Communicate their views to management about what will create long-term value for the sector, to ensure that such views are aligned with management plans to deliver stakeholder, as well as shareholder, value.
- Demonstrate willingness to accept short-term costs for longer-term value creation, and patience with changes to business models that are currently not serving the customer well and hence are undermining longer-term value.
- Have a deep understanding of bank operating models, and specifically of how banks are making money from their clients and customer base. Investors communicate to banks when their actions and businesses are not understood, and require them to explain.
- Signal to government their interest in a predictable, long-term approach to regulation.
- Disclose to their clients and the general public how they are exercising their stewardship duties to deliver long-term, sustainable value creation – and engage with beneficiaries on strategies to deliver healthy banking.

Employees

Employees are one of the most important stakeholders in banks for two key reasons. First, culture change depends on their behaviours. Some of this will be driven by incentives, and some by individuals exercising integrity. This change cannot be solely imposed externally, but must be both driven and embraced by bank employees. Second, rebuilding trust with customers and society is predicated on customers having positive interactions with bank staff, giving them a key role in the rehabilitation of the sector.

When the relationship between banks and their employees is working well:

Banks:

- Ensure consistency between leadership actions and their calls for staff to focus on the customer and values.
- Align customer and shareholder needs by focusing on the longer term, and work to understand and reduce tensions between customer focus and short-term shareholder pressure.
- Empower their employees to take action and do the right thing on behalf of both the customer and the bank.
- Are transparent with employees as well as the public about what the bank gets wrong, and advocate for what the bank is getting right.
- Reinvest resources in both the customer and the infrastructure to support the long-term health of the bank.
- Offer attractive, merit-based compensation, as well as significant transparency around senior executive compensation.

Employees:

- Take pride in the actions and culture of their bank and act as ambassadors for the sector.
- Lead by example and model any changes that they wish to see.
- Champion the customer at all times.
- Enforce a culture of complying with the spirit of regulation.
- Challenge the status quo, and speak up when they see behaviour that does not reflect the customer focus and values that their bank is espousing.

Appendix B
Consultation Participants[2]

BankingFutures benefited from the active engagement of over 200 people at roundtables, in interviews and by written submission. Most people were happy to have their participation acknowledged by being included in the following participant list. Inclusion in this list, however, should not be taken as endorsement of all the project's conclusions or findings.

Paras Anand	Head of European Equities	Fidelity
Giles Andrews	Executive Chairman	Zopa
Chris Anker	Corporate Governance Analyst	Railpen
Habib Annous	Portfolio Manager and Analyst	Capital International
Andrew Bailey	Deputy Governor for Prudential Regulation and Chief Executive Officer of the Prudential Regulation Authority	Bank of England
Peter Bakker	President and Chief Executive Officer for Sustainable Development	World Business Council
David Barnes	Managing Partner for Public Policy	Deloitte
Leigh Bartlett	Chief Financial Officer	Future Williams & Glyn
James Bevan	Chief Investment Officer	CCLA
Justin Bisseker	Pan-European Banks Analyst	Schroders
Lord Norman Blackwell	Chairman	Lloyds Bank
Fran Boait	Executive Director	Positive Money
Roland Bosch	Associate Director	Hermes Investment Management
Dame Colette Bowe	Chair	Banking Standards Board
Andy Briscoe	Chairman	Money Advice Service
Steve Britain	Director of Strategy and Chief of Staff	The Co-operative Bank
Kirsty Britz	Global Head of Citizenship	Barclays
Vyvian Bronk	Manager, Banking and Payments Policy	Financial Conduct Authority
Anthony Browne	Chief Executive Officer	BBA
Tim Bush	Head of Governance and Financial Analysis	PIRC Limited
Arthur Caye	EMEA Banking Analyst	Capital International

[2] This does not include the employee roundtable participants

Malcolm Cooper	Global Tax and Treasury Director	National Grid
Elizabeth Corley	Chair	Fixed Income Markets Standards Board
Alison Cottrell	Chief Executive Officer	Banking Standards Board
Yolanda Courtines	Partner	Wellington Management International
Tom Cummings	Senior Adviser, Board Member	Global Alliance for Banking on Values, Tallberg Foundation
Stuart Cummins	Head of Portfolio Management & Wealth Planning	C. Hoare & Co.
Lord Mervyn Davies	Independent	
Mikael Down	Director of Policy and Analysis	Banking Standards Board
Elizabeth Fernando	Head of Equities	USS Investments
Graham Fisher	CEO	Toynbee Hall
Paul Fletcher	Chairman	Actis Group
Douglas Flint	Group Chairman	HSBC
Greg Ford	Senior Communications Advisor	Finance Watch
Simon Fraser	Chairman	Investor Forum
Robin Freestone	Outgoing Chief Financial Officer	Pearson
Charles French	Head of Investment	Newton Investment Management Ltd
Clark Gardner	Chief Executive Officer	Summit, Financial Wellbeing for Life
Damon Gibbons	Director	Centre for Responsible Credit
Phineas Glover	Senior Adviser	The Investor Forum
Tony Greenham	Director of Economy, Enterprise and Manufacturing	RSA
Vinay Gupta	Strategist	Consensys Systems, Ethereum Foundation
Peter Harrison	Chief Investment Officer	Schroders
Pamela Hartigan	Director	Skoll Centre for Social Entrepreneurship
Deborah Henderson	Managing Director	Centre for Inspired Leadership
Chris Hewett	Head of Advocate Programme	The Finance Innovation Lab
Julie Hill	Advisory Board	B-Team
Oliver Holbourn	Head of Market Investments	UK Financial Investments

Rob Hopkins	Founder	Global Transition Towns Movement
Catherine Howarth	Chief Executive Officer	ShareAction
Rob James	Banking Analyst	Old Mutual Global Investors
Margaret Jarrett	Director	High Trees Centre
Richard Kibble	Group Director of Strategy and Corporate Finance	RBS
David Korslund	Senior Advisor on Values	Global Alliance for Banking
Peter Lacy	Managing Director	Accenture
Benoit Lallemand	Head of Strategic Development and Operations	Finance Watch
Joe Lane	Policy Officer	Citizens Advice Bureau
Duncan Law	Founder	Transition Brixton
Robert Law	Independent	
Anna Laycock	Lead Strategist	The Finance Innovation Lab
Paul Lee	Head of Corporate Governance	Aberdeen Asset Management
James Leigh-Pemberton	Chairman	UKFI
Lindsay Levin	Founder	Leaders' Quest
Nektarios Liolios	Co-Founder and Chief Executive Officer	Startupbootcamp FinTech
Paul Lynam	Chief Executive Officer	Secure Trust Bank PLC
John Macfarlane	Chairman	Barclays
James Macpherson	Managing Director and Head of UK Equities	BlackRock
Anna Marrs	Chief Executive Officer, Commercial and Private Banking	Standard Chartered
Will Martindale	Head of Policy	Principles of Responsible Investment
Edward Mason	Head of Responsible Investment	Church Commissioners for England
Louise Matcham	Team Manager, Payment Schemes	Barclays
Mick McAteer	Founder and Director	Financial Inclusion Centre
Roger McCormick	Director	CPP Research Foundation
Francesca McDonagh	Head of Retail Banking and Wealth Management	HSBC
Jeremy McKeown	Equity Sales	Liberum
Karina McTeague	Director of Retail Banking	Financial Conduct Authority
Ian McVeigh	Fund Manager	Jupiter UK Growth Fund

Marco Meyer	PhD Student	University of Cambridge
Peter Michaelis	Head of Equities	Alliance Trust
Clara Miller	President	Heron Foundation
Olivia Mooney	Investor Engagements Manager	Principles of Responsible Investment
Jen Morgan	Co-Founder	The Finance Innovation Lab
Robert Nash	Independent	
My-Linh Ngo	Senior ESG Analyst	BlueBay Asset Management LLP
Hannah Nixon	Managing Director	Payment Systems Regulator
Russell O'Brien	EVP Treasurer and Corporate Finance	Shell
Susan Ochs	Senior Fellow and Founder	Better Banking Project at New America Foundation
Patrick O'D Bourke	Group Finance Director	John Laing Group, Plc
Sven Oestmann	Senior Banks Analyst	Fidelity Worldwide Investment
Catherine Ogden	ESG Analyst	LGIM
Neil Patel	Investment Banker	Liberum
Sanjay Patel	Senior Partner	Apollo Global Management
Stephen Pearson	Senior Adviser to the Chief Executive Officer	Virgin Money
David Pitt Watson	Executive Fellow	London Business School
Adam Pollock	Head of Corporate Broking	Zeus Capital
Anne Richards	Chief Investment Officer	Aberdeen Asset Management
Fred Rizzo	Vice President	T. Rowe Price
John Schaetzl	Lead Non-Executive Director	SustainAbility
Buzz Schmidt	Chair	Heron Foundation
Tim Sharp	Policy Officer	Trade Union Congress
Kaori Shigaya	Policy Adviser	Oxfam GB
Luke Simpson	Analyst	Barclays
Ed Smith	Head of Bank Policy	Financial Conduct Authority
Herman Spruit	Partner	Bain & Company
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