“What is banking for?”

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October 20, 2016

Purposes

The most basic question we can ask about any activity or any institution is **what is it for**? What are its purposes? By this I do not mean the objectives or targets its leaders or managers set for a particular activity or time period, but what it seeks to achieve.

So for example, a small bank might have as **one** of its corporate purposes providing retail banking services in the state of Vermont, or affordable mortgages in the state of Illinois. A systematically important bank may have multiple corporate purposes that include offering a wide range of financial services to many types of client or customer on an international scale. Long term success for an institution will lie in achieving its corporate purposes.

Some of the purposes of banks are corporate, but others are public purposes, such as supporting the smooth working of an economy, or enabling rapid business transactions. Because banks have public as well as corporate purposes, they typically enjoy distinctive public benefits, as well as facing distinctive public regulation, including distinctive approaches for dealing with (potentially systemic) bank failures. Most obviously, like other corporations, banks have limited liability; more exotically they benefit from publicly funded protection for depositors.

As further evidence that banks have a public purpose, you need only look to the volume of banking regulation compared to the regulation of other industries. I am informed that, measured by length of shelf space, only “Environmental Protection,” “Internal Revenue,” and “Agriculture” exceed the volume of regulation for “Banks and Banking.” That alone speaks volumes. Banking is regulated on a par with the food we eat, the air we breathe, and taxes. There is no doubt of the public importance of banking and of the existence of its public purposes.

I do not seek today to propose a single or definitive account either of the public or of the corporate purposes of banks. Rather, *my* purpose is to urge you to think carefully about the purposes of banking. How would you answer the question, “What is banking for?” Or, if you are a bank employee, director, or investor, “What is *your* bank for?”

If your answer to that question is “maximizing shareholder value,” I suggest you start over. “Maximizing shareholder value” may be a nice defensive phrase, but it tells us little about the purposes of banks. Other profit-seeking corporations, whose activities might be manufacturing or retailing, also have to take account of shareholder value; and some banks—those organised as mutual savings associations or credit unions, for example—do not. Moreover, the phrase tells us nothing about how value will be maximized, and over what period. “Maximizing shareholder value” is not an adequate account of a bank’s purposes.

Because the public and corporate purposes of banking are deeply linked, it makes sense to think of banking as requiring a **social licence**, which Mark Carney has defined as the broad consent of society.[1] Without a **social licence** it would be harder, perhaps impossible, to achieve both the corporate and public purposes of banks.

Standards and Trustworthiness

Once we note what banks are for, we can ask which standards matter for achieving those purposes. I think it is useful to speak of **standards** rather than **values**. The term 'value' has risen in popularity but lost a lot of its point and weight during the last century (you can blame the philosophers of 1930's Vienna and generations of economists for that). 'Values' are now often seen as subjective, as something that individuals choose or reject, as projections of self or of individual autonomy, rather than as objective. Values are indeed commonly equated with preferences. This is also evident in discussions of values in institutional life that speak of institutions as 'deciding on their values', as if these were matters of choice. But not everything is optional. The standard that matters most for banking, as for other complex interactions and institutions, is **trustworthiness.**

We often hear it said that what matters is **trust,** or that we need **more trust**. I think this puts the cart before the horse. We do not always need or want more trust. For example, it would have been a bad thing if the well-known Mr. Madoff, who made off with so many other people's money, had been (even) ***more trusted***, but all to the good if he had been ***more trustworthy***. We need to focus first on trustworthiness and secondly on the intelligible communication of evidence of trustworthiness to others, without which they cannot place or refuse trust intelligently.

I think there are at least three necessary elements of trustworthiness: honesty, competence and reliability. **Competence**, in banking as elsewhere, is a matter of bringing the relevant skills to each task—and where the tasks are multiple and complex, the skills will be many and demanding. **Honesty,** in banking as elsewhere, is a matter of saying only what is intended, and of doing what is undertaken. **Reliability**, in banking as elsewhere, is a matter of achieving competence and honesty not just on special occasions, but with boring regularity. These standards are not particularly exotic, and not particularly controversial.

A requirement to communicate intelligibly is also neither exotic nor controversial. It has, however, often been replaced during the last thirty years by claims that what matters is **transparency**, which sets a far lower standard. Transparency requirements can be met merely by placing information in the public domain, and thereby provide a remedy for misplaced secrecy. But transparency is not an adequate remedy for countless other purposes, since the information that is disclosed may in the event not be accessible to or intelligible to—let alone assessable by—those for whom it matters. There is also a practical downside to transparency: It may limit discussion, especially of unpopular ideas. Can a policy of transparency encourage people to be less honest? Perhaps. Secrecy is not the enemy. Untrustworthiness is. Intelligible communication demands more than transparency.

Trustworthiness is needed throughout personal, institutional and social life, and is both important and demanding in banking, where the activities undertaken are complex and have varied, sometimes very long, time horizons; where they involve many participants but little personal contact; and where much may be at stake and asymmetries of knowledge and skill are common. It is easier to take advantage of others by untrustworthy action in banking than it is in simpler institutions and interactions.

[1] Mark Carney, "Building real markets for the good of the people," Speech at the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House, London, June 10, 2015, *available at* http://www.bankofengland.co.uk/publications/Pages/speeches/2015/821.aspx.

And the standards required for intelligible communication are also onerous in banking (as in other complex institutions and activities), both because of the volume and complexity of the information involved and because there are radical asymmetries of knowledge, understanding and available time. It is unfortunately demonstrably quite easy to fool a lot of people a lot of the time, and extremely easy to get them to indicate what some people count as consent to propositions which they are in no position even to understand. That, after all, is what mis-selling scandals have revealed.

Regulation or Culture?

Banks are heavily regulated, and nobody would expect that to change. But regulation has not always secured trustworthy behaviour. Is more or better regulation the right remedy? Opinions differ, details are complex, and I am inexpert. However it is evident in many areas in life that making regulation more complex does not always improve standards of behaviour. The risks of regulation include driving a focus on compliance with regulatory requirements at the expense of trustworthy performance of primary tasks, and the creation of perverse incentives—thereby tempting some clever people to game the system.

More fundamentally, I worry that overuse of regulation leads to the equation "Legal = Right." Or, equivalently, to the thought that so long as an action is not illegal, it is acceptable. In our everyday lives, we do not tolerate this false equivalence. Why should it be tolerated in banking?

This, I think, is why it is now widely agreed that we need to look not only to regulation, but to institutional cultures. Where an institutional culture—evidenced in behaviour and attitude—is well entrenched and well understood, its standards may guide good practice with less effort, less checking and less emphasis on compliance. Of course, not every culture embeds high standards: Some institutional cultures are lazy or corrupt, even predatory. Still, institutions with good cultures —and, specifically, trustworthy cultures—are likely to support and embed standards that matter.

The Banking Standards Board in the UK focuses on institutional cultures in banking and seeks to provide confidential feedback on their cultures to member banks. So it is like someone else holding a mirror at an unfamiliar angle to give a view that in-house exercises may not provide. Since Alison Cottrell, the CEO of the Banking Standards Board, will be speaking later today, I shall say no more about the approach, and will finish with some short comments on institutional cultures.

By and large we discuss ethical norms as if they were for individuals, but cultural, political and social norms as if they were for institutions. We spread and entrench ethical norms by education, by example and by exhortation. But we are often less clear about the best ways to spread and entrench cultural norms. In particular, what is the best way in which to spread and entrench cultural norms that challenge the existing cultures and assumptions in an institution?

Changing cultures is never easy. Institutions sometimes speak of being on a **cultural journey**, using a range of terms to characterise the cultures to which they variously aspire. But I think that it is worth noting that in many such discussions the elementary importance of having a trustworthy culture is not always stressed. Some rather grander terms—**integrity** springs to mind—are more popular. I am cautious about integrity: While wholeness and integration of all aspects of life is wonderful if it brings together the right elements, the integrity of individuals or institutions that do not start out at the right place would be less wonderful. Integrity is admirable where there is *already* a good culture, so it is difficult to start there.

The first step is surely to achieve clarity about the sort of culture an institution ought to develop in order to support trustworthy standards in pursuing both its corporate and its public purposes. Moreover, if a **shared** culture is one of the things that enables an institution to work well, it must indeed be shared, from top to bottom, from bottom to top, and through all departments. And clearly this sharing must entrench the culture, rather than providing a set of slogans that are remote from daily practice. It hardly needs saying that sharing a culture needs time and effort, good communication, and leadership that exemplifies and lives as well as preaches the culture—and constant reinforcement. There is no way of parachuting in a common culture, and there are many ways in which a culture can fragment.

Large institutions will certainly have different operating rules and norms within them. Engineers work differently than philosophers, and thank goodness for that. But any institution, and every person who works or invests therein, needs clarity about first principles—about the purposes of the enterprise, about what the firm is for.

Thank you for your attention today, and thank you to the New York Fed for this invitation to speak. I am now looking forward to *listening* to the remainder of your fine program—and, if you don't mind, perhaps asking a few questions during the day.