

# **The Role of Culture and Governance in the Banking Industry**

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**I will deal mainly with the issue of Governance in the European Banking industry**

**Governance is a key feature of any company**

**Good Governance is a pre-requisite for a sustainable and profitable company**

**Governance is a very complex issue**

## **Governance is a complex issue:**

- no optimal model (evolution over time)**
- difference between theory and practice**
- specificities of sectors (banking) and countries (in the EU)**
- multiplicity of ownership models**
- asymmetry of information**
- conflicts of interests**

**Governance is a complex issue because it ultimately involves relationship between people**

**Governance is complex both:**

- for companies (including banks) to design and implement**
- for supervisors and regulators to shape and monitor**

**In 10 Years of (an incomplete banking union), a lot of progress has been made in achieving sound corporate governance in European banks.**

**This has been the result of hard work, both by the banks and the supervisors.**

**There is however still room for improvement.**

**I will focus on the progress that could be made  
(including by supervisors)**



# **1. More holistic approach to Governance**

**Traditional focus of regulators/supervisors on banks' Governance**

**Relationship: Management >< Board**

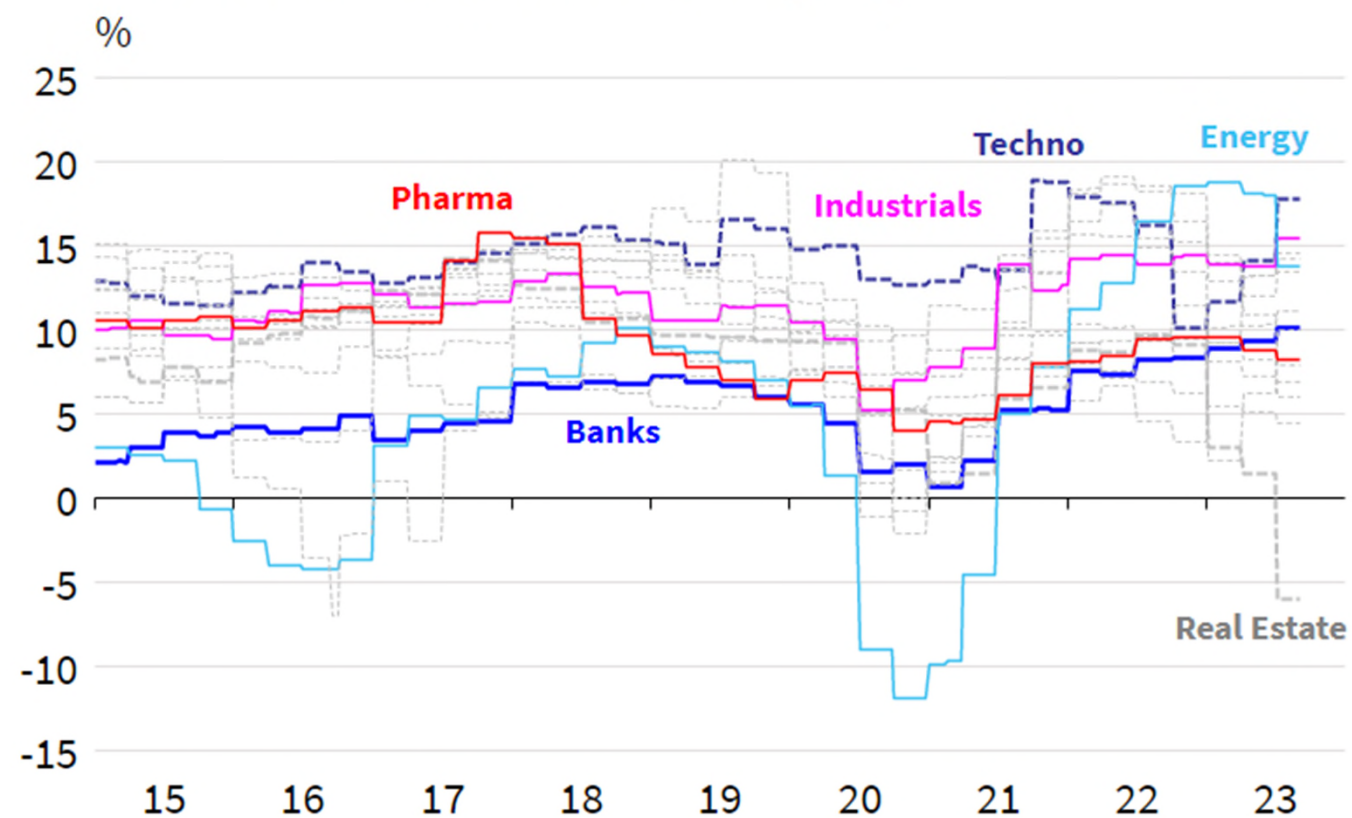
**There is in practice little or no attention to shareholders**

**Shareholders play a key role for the sustainability and viability of the Bank (example: SVB, CS...)**

**There are different shareholders model in European banks (cooperative, listed companies, public companies, large shareholders, charities, employees...) which may entail different governance systems**

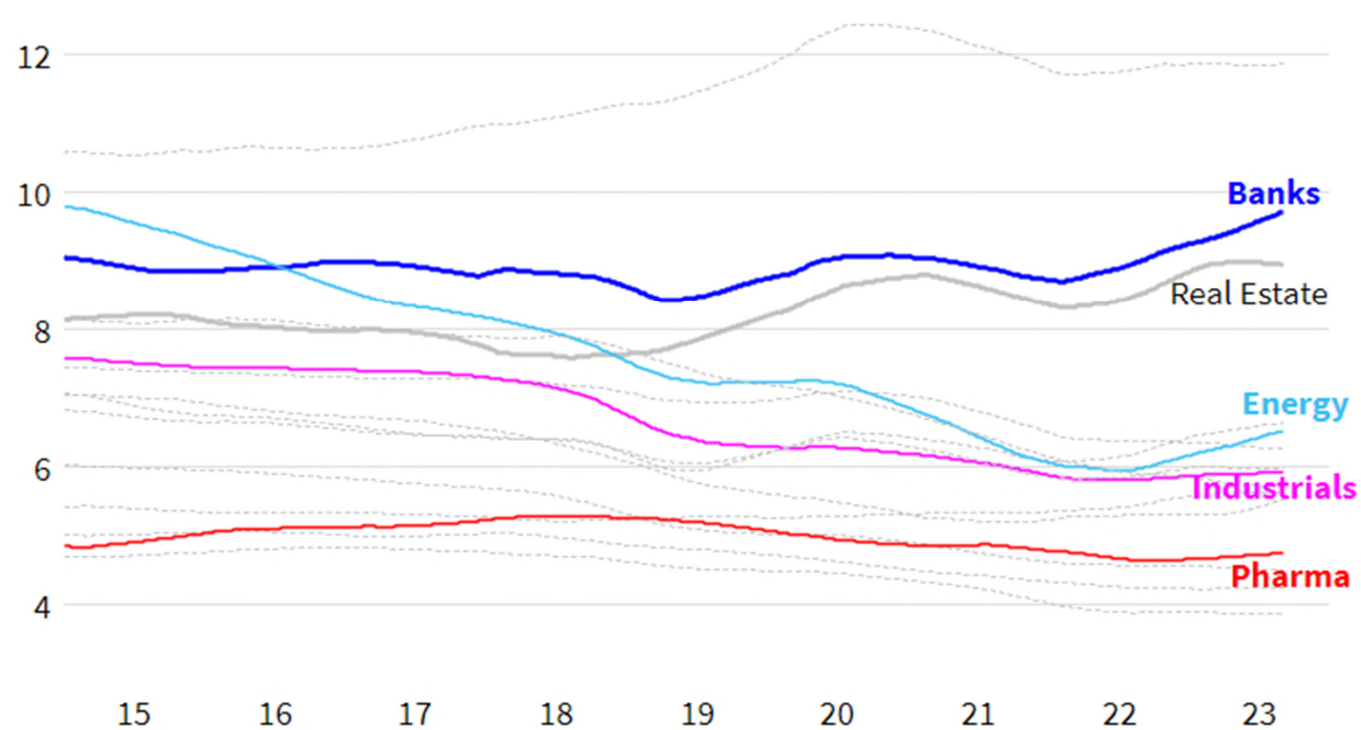
**Shareholders are generally not “trapped” into holding bank shares**

## Euro area - Return on equity



## Euro area - Cost of equity

% (inverse Shiller's CAPE ratio)

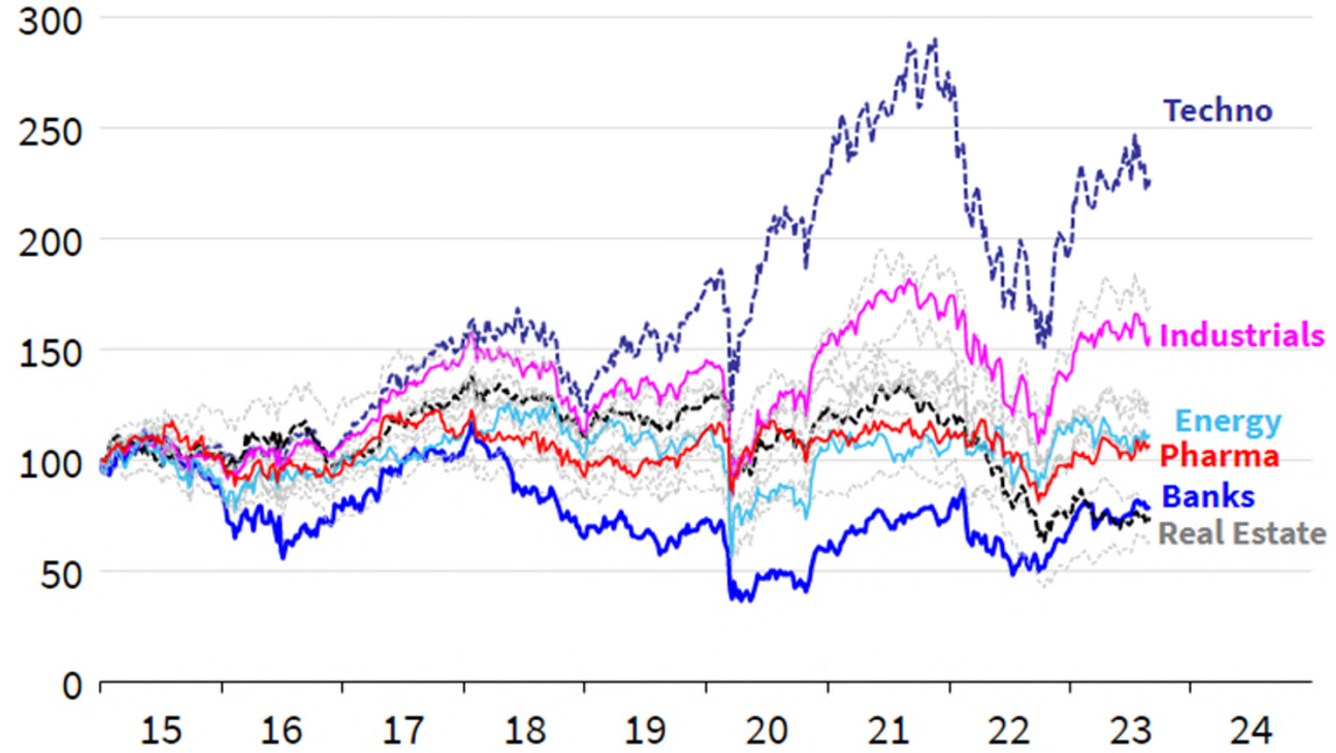


**The below par Price-to-Book valuation of the largest part of the banking sector is a signal given by shareholders that the system is hardly investable**

**The still high Cost of equity suggests that regulation has not reduced the risks in investing in the banking system; it may actually have increased it (eg: dividend ban)**

## Euro area - Stock prices

Index Jan 2015=100



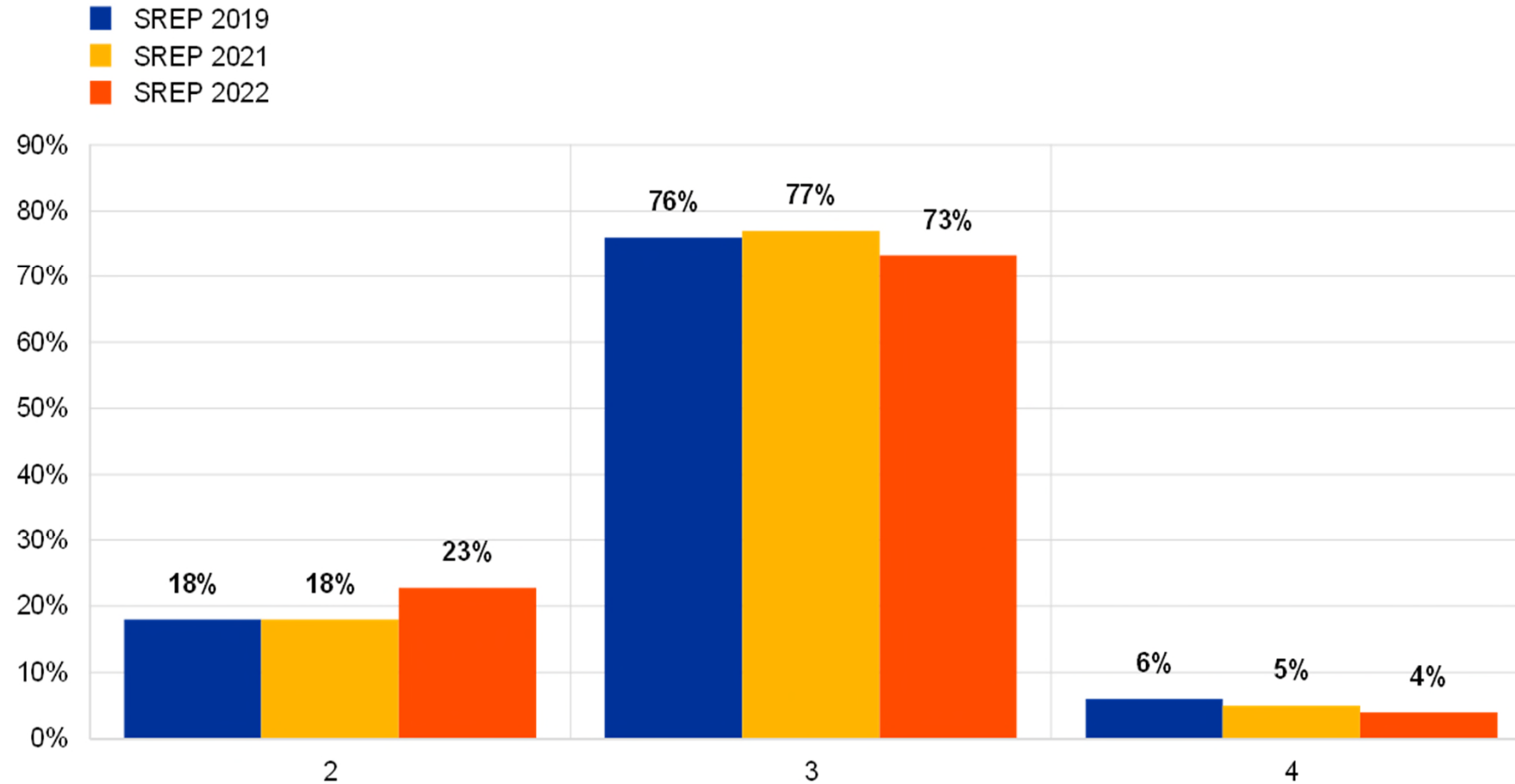
## **2. Form vs Substance**



## **Distinction between:**

- Defining principles of good governance**
- Setting criteria**
- Monitoring and Rating**
- Public Communication**

# Internal Governance SREP Scores



Source: ECB (SREP database).

Notes: 2019 SREP values based on 109 decisions; 2021 SREP values based on 108 decisions; 2022 SREP values based on 101 decisions. Banks were given scores from 1 to 4. There were no banks with an internal governance score of 1.

*«One major concern is the effectiveness of management bodies in terms of their composition, collective suitability and oversight role. Almost half of the supervised banks were subject to at least one measure concerning their management body. Weak decision-making procedures and the absence of a healthy challenge culture hamper effective governance and strategic steering.»*

McCaull, May 2023.

**Which measure? How relevant and substantive is it? The objective is to have zero measure, or to have good governance?**

**How far one can go in assessing good governance?**

**What are the limits?**

*«Whereas we look at elements like the composition of a board as part of a more standard governance assessment, in a broader supervisory governance assessment, including behaviour and culture, we could, for example, seek to identify the patterns of board discussions.*

*Which subjects generate tension? Which topics tend to be neglected? Which board members are the most influential when it comes to making a decision? Do board members include the bank's declared set of values and norms in their decision-making? Do they walk the talk, when facing the rest of the organisation? Are discussions in the boardroom or between members of executive committees dominated by one person or a small group of individuals?»*

Elderson, 11 June 2022

We attend the board meeting with two colleagues **and are not specifically focused on the content of the meeting.** Instead, the focus is on the process; how the meeting is held. **More particularly, we observe verbal behaviour, such as the way the board members speak to each other, the amount of time someone speaks up and the frequency, the impact of the comments made and non-verbal behaviour, such as facial expressions, posture, listening behaviour.**

For example, we sometimes observe one or two people dominating the meeting while other board members hardly say anything. Another example is that we only observe decisions being ticked off with very little dialogue based on different perspectives and arguments.

**Questions we want to answer during an observation are: How much room is there for divergent views? Who gets the floor from the chairman and who doesn't? Who has the informal leadership and impacts the discussion the most? The chapters on communication and group dynamics will elaborate on these topics more extensively.**

During one of our inspections we attended a (one-tier) board meeting and observed the following dynamics in the group. The CEO and CFO whispered to each other several times when the chairman was speaking. The CEO's chair was an arm's length from the table, he sat with his arms folded across his chest, squinted his eyes and extensively perused his papers. Another board member was staring at the ceiling and looked out the window on numerous occasions. It gave us the impression that there were interpersonal tensions, board members seemed to feel obligated to be there and there appeared to be a lack of trust. Moreover, after the meeting, all members of the board admitted there was an atmosphere of distrust.



### **3. Excessive benchmarking**

## **Dilemma:**

- need to measure in an objective way and rank**
- take into account diversity (legal, structure, business model, functioning,...)**

**There is no one-size fits all governance structure. Comparisons don't always make sense**

## **4. The role of the Board vs Management**

## **Dilemmas:**

- independence of the Board and involvement with executive decisions**
- effectiveness of Board and organization of the Board**
- Board role: challenge vs support of management**

## **Conclusion:**

- Learning by doing**
- Learning from each other**
- Principles vs Rules**

## **Good Governance is an Art as much as a Science**

**«Moving forward, we must remain clear in our objectives, flexible in our analysis and humble in how we communicate.»**

Christine Lagarde, Jackson Hole 25 August 2023