

## Research and Analysis of Banking Governance and Culture

### Background

*“In recent years, the incidence of financial sector misconduct has risen to a level that has the potential to create systemic risks by undermining trust in both financial institutions and markets.”* Mark Carney, G20 Letter, 30 August 2016

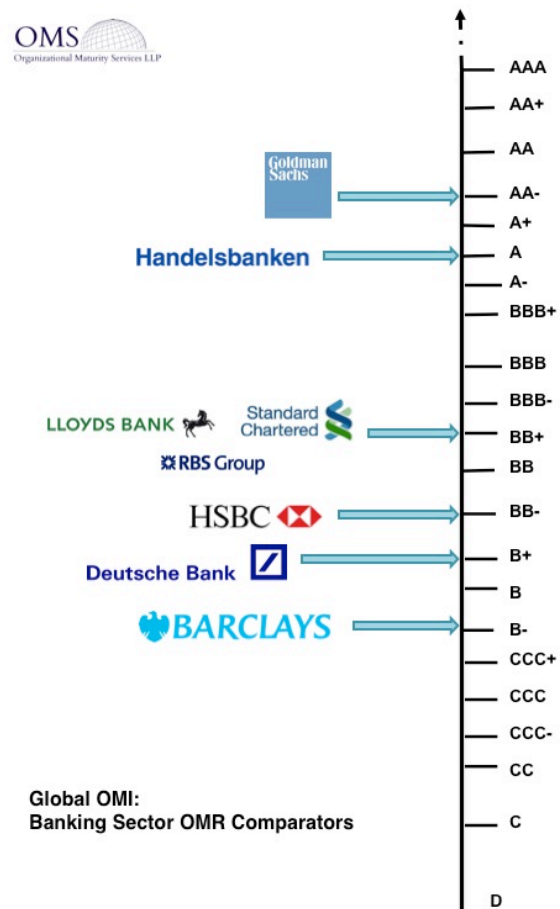
Research into banking conduct costs between 2011-2015<sup>i</sup> produced a list of 20 worst performers, including banks based in (in order of country totals) the US; the UK; France/Germany/Switzerland; Australia/Netherlands/Spain. While this provides damning evidence of the banks’ past governance failures, we have been asked by several institutional stakeholders to consider further research to:

- Build a richer and more informative picture of banking governance today
- Assess the extent to which banks continue to carry significantly higher business risk for the future and achieve sub-optimal value outcomes
- Identify the role that more effective *human* governance, in particular, could play in informing and influencing banking culture and regulation to reduce the likelihood of corporate failures and any recurrence of global financial instability.

### OMINDEX<sup>®</sup> - Organisational Maturity Rating (OMR)

OMS LLP’s OMINDEX<sup>®</sup> currently includes 8 major banks<sup>ii</sup>, 6 of which are carrying unacceptable levels of business risk arising from poor or inadequate governance.

OMRs are leading indicators of material value and risk arising from each bank’s ability to govern effectively. In this way, they offer a current picture of corporate health, a codification of culture and predictive insight into longer-term value arising from governance and management capability. The wider questions are whether these banking ratings are indicative of the sector as a whole and what lessons can be drawn from a broader analysis and assessment?



## Project Objectives: Where is banking governance and culture today?

We have considered how to examine the question of the banking sector's response to external and internal efforts to encourage and regulate for improved governance and more appropriate culture since the GFC. Our core aims for this work are to:

- A. Analyse and rate (OMR) a designated group of global banks e.g. the top 20 worst performers in terms of misconduct costs.
- B. Identify the areas in which most value has been lost and the risks that remain inadequately assessed and unmitigated.
- C. Delineate superior and inferior governance; with a specific focus on the absence or effectiveness of human governance.
- D. Identify key governance issues that need improvement; good management practice where found; material value opportunities and critical risk areas.
- E. Offer a set of recommendations to individual banks, banking stakeholders and regulators to help, enable and facilitate governance improvements, enhanced cultural health and long-term value outcomes.

## A 5-Step, Project Process

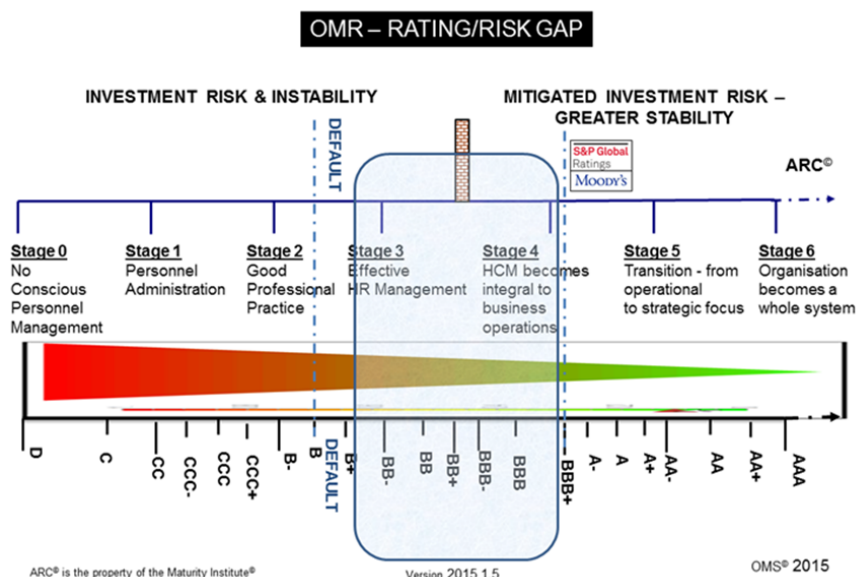
OMS LLP's methodology is directly founded on the Maturity Institute's principles (10 Pillars) and strategic framework. All OMR ratings relate to this standard.

1. We will use OMS LLP's OM30+ methodology to rate (and re-rate where appropriate) the 'designated banks. This will provide comparative, baseline governance ratings for the banking sector as a whole. We will work to positively engage with each bank to encourage their active participation in the process. However, we will use our standard analysis using external, publicly available, information in the event that none choose to do so.
2. We will further analyse each bank's rating to create a banking sector [Human] Governance Scorecard (HGS) against an agreed selection of key indicators; some examples are illustrated below:
  - **Societal value:** The core legitimacy test: the extent to which each bank is ultimately focused on providing value that benefits society (as opposed to particular vested interests e.g. shareholders).
  - **Corporate Purpose:** The nature and extent of corporate commitment to a clear and unequivocal organisational purpose defined against the MI standard, i.e. the provision of the best quality product or service at the lowest possible cost (having minimised the risk of external harm e.g. environmental impact).

- **Business risk** – the capability to assess and mitigate critical human capital, governance and ‘cultural’ risk.
- **Human Governance:** The quality and capability of board, leadership and senior management (in terms of human governance and human capital management) to manage material long-term value.
- **Innovation** – a measure of systemised human capital innovation across product/service and business operations.

OMINDEX scoring scheme										
0	1	2	3	4	5	6	7	8	9	10
Company	OMR	Societal value	Corporate purpose	Human governance	Innovating people	Realizing human value	Supply chain health	Business risk		
AT&T	●	●	●	●	●	●	●	●	●	●
Handelsbanken	●	●	●	●	●	●	●	●	●	●
Microsoft	●	●	●	●	●	●	●	●	●	●
Nestlé	●	●	●	●	●	●	●	●	●	●
Pfizer	●	●	●	●	●	●	●	●	●	●
Toyota	●	●	●	●	●	●	●	●	●	●

3. We will conduct a “risk – ratings gap” analysis comparing existing credit ratings to governance ratings (see example for Deutsche Bank below) for the banks rated, highlighting the extent to which traditional financial analysis succeeds or fails to provide adequate insight and assurance of current and future corporate health.



4. We will provide an in-depth analysis and commentary of our findings (in terms of both the above and other critical governance factors below): measured and evidenced within the OM30+, including:
  - Executive remuneration
  - Strategic decision-making
  - Trust in senior leadership
  - Workforce engagement and cooperation
  - Learning and quality systems
  - Corporate cohesion (whole system operations, controls etc)
5. We will identify a set of recommendations and issues to consider for:
  - Bank Boards and ExcOs
  - Government and regulators
  - Key stakeholders (Investors, Exchanges, Reporting bodies)

The overall deliverable will be a comprehensive report to be made publicly available, together with a presentation for interested parties.

### **MI/OMS LLP team**

OMS LLP is approved by the Council of the Maturity Institute (MI) to carry out the work and produce the above report. This requires a multi-disciplinary team working to the same standards, within a common framework. The result will be a seamless, whole system review. Our team is from a variety of backgrounds with expertise and many years experience in accounting, leadership, human capital management reporting and investment analysis:

- Nick Shepherd - FCPA, FCGA, FCMC, FCCA (MI Council)
- Paul Kearns - Chair, Maturity Institute; Senior Partner, OMS LLP
- Stuart Woollard - Managing Partner, OMS LLP; MI Council

As with other MI/OMS collaborations, we will actively seek the insights and expertise of project partners willing to sponsor the work to help shape the analysis and produce a compelling report to create maximum influence.

### **Investment and returns**

We view this project as having potentially great significance for the wider debate around modern capitalism and corporate governance. It can break new ground in analysing and evaluating governance and culture within the global banking sector and help to bring about long needed change to the way these (and other) corporate organisations are viewed and valued.

An MI/OMS LLP project will be taken seriously because of the powerful proposition that comes from a compelling methodology supported by independent council

members of a new, purpose-built, professional institute. Our progress in helping the investment community to understand the crucial importance of human governance gives us confidence that this project can influence global actors in governance as well as banks themselves.

## **Timeline and costs**

We can commit to the delivery of the comprehensive report within a 4-6 week timeframe upon commencement. We estimate that minimum project costs will be £50-75,000. Funding for this project will be made through MI's not-for-profit, community interest company and OMS LLP will be reimbursed for all agreed work to be undertaken.

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<sup>i</sup> <http://conductcosts.ccpresearchfoundation.com/>

<sup>ii</sup> All Banks were rated in March 2015 except Barclays who were re-rated and downgraded in February 2016