The Institute for Global Financial Integrity

Fostering good governance at an international private bank: a practical experience

Talk by Charles Hamer, former CEO of Credit Agricole, Luxembourg, to The institute for Global Financial Integrity, Luxembourg, 24 May 2011

I have been a supporter of TIGFI since its inception and was delighted to accept your invitation to address you.

What can I, a retired Managing Director of an international bank, bring to the members of TIGFI?

I bring my practical experience after 15 years in business in Luxembourg, 10 years of which was with Credit Agricole.

What are the pre-requisites of good governance in an international private bank?

- Legislation. This should be clear but not in too much detail, otherwise it induces a bureaucratic attitude and the following of the letter rather than the spirit of the law. Deconsolidation vehicles are a result of this approach.
- Regulator who should be strict but ready to discuss issues with the regulated and to agree changes. A rigorous regulator is a good thing. You know you can't get away with foolishness and the playing field is level for all participants. But you can also voice your opinion, discuss issues and get answers. A good example of this is the attitude of the CSSF > see the recent press interview with Jean Guill.
- Shareholder (mother company)
    - enforces strict rules for all entities in the group;
    - lays down clear objectives
    - is practical, limiting bureaucratic reporting (avoiding duplication of reports resulting from a lack of communication at Head Office)
    - is open for dialogue
    - in a nutshell, prove their value added.
- Managing Director –
    - has to be the driver of good governance

  - has everyday responsibility
  - has to be an example to staff
  - has to bring added value to legislators, regulators, shareholders and customers.

I will revert to this during my presentation.

As a Managing Director what are your objectives in terms of governance?

I sometimes said to heads of control and audit that my objective was to be able to sleep soundly at night and that their objective was to enable me to do this. That may have been something of a joke but there is much truth in it.

The main objectives are:

- The good reputation of the bank
  - Essential for legislators and regulators
  - Essential for shareholders
  - Essential for customers
    - Good governance is protection for customers
  - Essential for staff self-esteem and recruitment.

  Good reputation must be earned. Trust has to be established through transparency.

- Be profitable but on a healthy basis.
  - Internal and external factors
  - Product placement
  - Credit
  - Cost control
  - Avoid internal and external conflicts which waste time
- Develop sense of responsibility.
  Private banking is about long-term relationships, putting the interests of customers foremost, and not short term.

How does one develop good governance?

- <u>Start with the organisation chart</u>

I have seen many with double, even triple, reporting lines, dotted lines, straight lines etc. with the organisation chart looking like the plan of a petrol refinery. In consequence nobody knows who is responsible for what and subordinates will play on this for their own interest. An example is a commercial desk in private banking but under the authority of the head of capital markets.

The problem is trying to make staff happy with a temptation to organise the bank's accounting to the satisfaction of individual groups and not in the long-term interests of the bank. This creates conflicts of interest for these people or their successors. I have seen a case where internal controller also managed customer relationships.

Organisation charts should be simple and logical and avoid potential conflicts of interest.

- Clearly distinguish levels of control
    - Auto-controls by staff themselves
        - All staff
        - Controls to be controlled
    - Internal control
    - Internal audit
    - External audit.

The bank I was in charge of originally had very strong centralised internal control but no auto-controls. This de-motivates staff. Now auto-controls defined by internal control together with them through an electronic reporting tool; this is checked by internal control who themselves have their internal control programmes.

Internal controls checked by internal audit though inspections on a three year rolling basis.

Respect has to be given to controls by regulator but also to those imposed by external auditors. This is achieved by an internal control committee headed by the Managing Director and meeting every two months - *"COPIREC" Comité pour le Pilotage des Recommandations*. It is essential to ensure that there is a rigorous follow up of audit points. When I started at Credit Agricole, Luxembourg there were 350 outstanding and overdue audit points which had been reduced to 10 by the time that I left.

- Training. This is essential for the compliance and control culture in the bank. Trust commercial staff but only if the governance culture and control functions are in place. There can be no trust without controls.
- Execution departments. These are as important as commercial departments in this respect. Commercial staff improve the profitability of the bank, but execution departments avoid losses; they should know it and act accordingly.

- A general system of checks and balances should be in place. Commercial and control functions should have respect for each other and should work together on a day-to-day basis. This is easier said than done.
    - Commercial staff criticise support functions
    - Support staff criticise commercial functions

    At Credit Agricole Luxembourg this attitude was only resolved in the crisis of 2008 when everyone realised that they needed the other.

    Role of managing Director was to ensure that there was a balanced functioning of the bank.

- Areas of danger
    - Credits: Ensure equal weight is given to the opinions of commercial staff and the risk department though the latter should always have right of veto subject to arbitration by Managing Director, after hearing both sides.
    - Products. It is easy to tell toxic products.
        - Customers want them
        - Account managers want them
        - Even Head Office want them

        >A product is not good because customers want it: an example was a product based on 40 structured bonds which proved to be popular with personal banking customers.

        >a product is not good because it has been offered by Head Office.

        - Head Office will give global approval of a product for all group entities but that does not mean it is suitable for all types of client
        - The fashion factor should also be considered

    In the end responsibility is with the local entity which **should establish a local product committee.**

    - Country risk. Underestimated for a long time, e.g. peripheral European country debt clear in crisis of 2008 not in customers' interest to keep such debt. But annual yield leads to greed factor.

    Difficult situation for Managing Director with a risk of appearing anti-commercial. **Problem of being right too soon**.

- General rules:
    - Use common sense
    - First gut feeling is the right one
    - Consider first and foremost the long term interests of the customers
    - Only sell what you understand; the customer will understand even less.
- Conclusion

Everybody complains about governance costs, impediments to developing customer assets, profitability and lack of trust shown to commercial staff.

But:

- You cannot short circuit good governance
- It is in fact a commercial asset, leading to a sound reputation, seriousness and the self esteem of staff.

Therefore regulatory developments over the last 10 years have generally been positive but **the message to regulators is - don't overdo it**.