The Financial Sector: Redefining a Broader Sense of Purpose

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Master, Wardens, Sir David, my Lords, Governor, Aldermen, Sheriff, Chief Commoner, Ladies and Gentlemen.

I am honored to have been invited to deliver the Tacitus lecture in this magnificent Guildhall. I am also fortunate to be among so many friends, including former colleagues, who know that I have a weakness for good stories.

So let me start with a Hollywood story. As you may know, Disney was recently faced with the challenge of creating a sequel to the original **Mary Poppins** movie, which has delighted children and adults for more than half a century.

The producers of the new film recreated the magical nanny from P.L. Travers's books, but they also featured a *new* cast of characters—including a villain who could give everybody a good scare. That villain—yes, you guessed it—is a slick banker who is cheating his way to fortune. In the end, of course, the villain is defeated with a touch of magic.

So here is the question: why is the banker the villain? After all, a *healthy* economy requires a *healthy* financial sector that is **at the service of people** as they pursue better lives for themselves and their children.

You might call it the "everyday magic" of finance: helping families buy a home or save for retirement; helping businesses raise capital to support growth and employment; and helping ordinary people manage risks and prepare for a rainy day. That is what **most financial professionals** do every day, with dedication and a sense of pride.

And yet, despite these good aspects, the caricature of the "bad banker" has resonated with audiences since the dawn of civilization. And its latest version—seen by millions of children around the world—is telling us something about the **deeply felt sense of unease about the role of finance in today's world.**

It does not take magic to trace much of this most recent frustration back to the global financial crisis, which has left painful economic and psychological scars on millions of people. We know also that many people are angry about the steady drip-drip of financial scandals and misconduct that have occurred all over the world.

Indeed, financial globalization has been one of the key drivers of what Theodore Roosevelt called the "***swollen fortunes for the few***"[1], a new *Gilded Age* with high economic inequality and low social mobility. On Wall Street, for example, overall compensation levels have been

[1] Theodore Roosevelt: Speech in Osawatomie, Kansas, August 31, 1910.

reaching record highs[2], and there is a similar trend of moving back to pre-crisis pay levels in other financial centers.

No wonder that growing concerns about finance can be heard across the political spectrum—and not just about the issues of the day, but about the **fundamental purpose** of this industry. In too many cases, the financial sector has **strayed from its original, noble purpose**. And too often, it has worked hard to serve itself rather than serve people and the economy at large.

Surely, there must be a better way forward—which brings me to my theme:

I believe that we can build a *better* financial sector—one that is *safer*, more *sustainable*, and *ethically sound*. A financial industry with a **broader sense of purpose**.

This goal is not just morally just; it is economically right. Why? Because a better financial sector is more important than ever to help deliver on what our 21st century so badly needs: higher employment, greener growth, and good living standards for all.

The key to achieving this goal is to reshape finance into something that is more aligned with societal values and more connected to the interests of *all* stakeholders: from customers, to workers, to shareholders, to local communities and future generations.

To do this, we will need more than just a touch of Mary's famous brolly. So let me propose two questions:

- First, how can we make the financial system safer—to encourage the good, not the bad, side of finance?

- Second, how can the financial sector support long-term growth that is more sustainable and more inclusive?

1. How can we make the system safer?

Let me begin with a simple observation: if finance is to become safer and more trustworthy, it will need to harness good **innovation**, better **regulation**, and a broader sense of **responsibility**.

a) Good innovation

Students of history will tell us that these issues have resonated through the ages. For one, it is remarkable just how much influence **financial innovation** has had on human progress. Think of its instrumental role in the development of writing, mathematics, accounting, and probability theory.

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[2] Bloomberg News article.

Consider Chinese paper money introduced in the 9th century, or the 13th century Venetians who eagerly bought *prestiti*, the first true government bonds.[3] And think of how we can draw a line from the first stock exchanges—in Antwerp and Amsterdam—to our modern investment apps that put the global financial markets at our fingertips.

At the same time, history tells us about unsustainable credit booms and speculative bubbles that were driven by bright new financial ideas.

In ancient Rome—in the year 33 AD—land prices crashed after noble families took out loans to bet on ever rising land prices. Ultimately the government of Emperor Tiberius bailed out the investors by extending three-year, interest-free budgetary loans. How do we know this? Tacitus himself briefly described this financial crisis in his final works.[4]

But this is only one of many examples. In the 17th century Tulip Mania, it was a new market for futures contracts. In the 18th century South Sea Bubble, it was the promise of a mythical new land. In the 19th and 20th century, it was often new technology, from the Railway Mania to the dot.com bubble.[5]

And of course, in the run-up to the global financial crisis, it was financial engineering that helped drive a **frenzy of reckless risk taking**. So, when Lehman Brothers collapsed, policymakers were facing what I once referred to as a "holy cow" moment".

The most striking thing for all of us back then was the **incredible fragility** of so many advanced economy banks. At their very core, these firms had been weakened by inadequate equity capital, flawed business models, and the blindness of powerful men—a toxic combination that left taxpayers on the hook for massive bank bailouts.

Fast-forward to the present, and the question is whether financial systems are safer today. The short answer is that they are **safer, but not safe enough**.

b) Better regulation

The good news is that, over the past decade, countries have worked together to reform global financial regulations to help rebuild trust and restore financial health. This ambitious effort—in which the IMF, the FSB, the G20 and many others have been involved—has made a substantial difference.

Banks have **much higher capital and liquidity** positions. Big banks face tighter regulation, and their leverage is lower. Winding down failing banks has become much easier in all major jurisdictions and in many emerging economies. And a big chunk of the derivatives market has become significantly more transparent.

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[3] William Goetzmann (2016): *Money Changes Everything: How Finance Made Civilization Possible*.

[4] The Annals, Tacitus's final work, covers the period from the death of Augustus Caesar in 14 AD until 66 AD.

[5] Financial Times article.

This is all good, but still not good enough.

We need further efforts to address the potential dangers of "**too-big-to-fail**" as banks become even bigger and more complex. In the United States, for example, the top five banks now hold about **45 percent** of total banking assets, compared with about 40 percent in 2007.[6]

Meanwhile, leading economists and industry experts have been calling for further *increases* in equity funding—beyond the current capital requirements—to ensure that banks can withstand a potential storm.[7]

Others are not so sure—because further *increases* in equity funding might come with negative side-effects, such as reduced lending. So far, the evidence points to relatively small costs of higher capital.[8]

Above all, we must be concerned about increasing efforts to **roll back** some post-crisis regulations. Countries need to resist these pressures. Indeed, they need to push on because more work and political will is required to fully implement the *existing* reforms.

And even as policymakers are still internalizing the lessons from the last crisis, they need to be vigilant about new risks. For example, the IMF has recently estimated that cyber-attacks could potentially lead to net income losses in the global banking system of up to **$350 billion**.[9]

Or think of a sharp adjustment in asset prices that could affect the fast-growing shadow banking sector. That part of the financial world comes with many regulatory blind spots that should be addressed. For instance, we believe that countries need to **regulate underwriting standards** in high-risk debt markets, including leveraged loans.

Of course, making finance safer and more trustworthy is not just about good innovation and better regulation. It is also about a broader sense of individual and collective responsibility.

c) Broader responsibility

Responsible behavior has a lot to do with incentives, especially monetary incentives. There is no question that remuneration policies in the banking sector were driving reckless risk-taking before the financial crisis.

As one analysts[10] put it: "*Employ as little equity as one can; promise a high return on equity; link bonuses to the achievement of this return target in the short term; and ensure that as few as possible of those rewards are clawed back in the event of catastrophe*."

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[6] IMF calculations.

[7] John Vickers, University of Oxford, Speech: *Safer, But not Safe Enough*, November 29, 2018.

[8] The IMF and standard setters are currently assessing the unintended consequences of higher bank capital.

[9] IMF blog: *Estimating Cyber Risk for the Financial Sector*.

[10] Financial Times article: *Financial reform: Call to arms*.

We know how that story ended. And we know that there is a widely-shared perception that those who caused the crisis did not face the consequences, while ordinary people paid a heavy price. Many people actually saw this as the ultimate breach of public trust.

So what has changed since then? For one, post-crisis reforms have significantly moved the needle by better aligning individual pay with the health of the firm.

If you are a senior banker here in the City, **40 to 60 percent** of your variable remuneration is deferred over **3-7 years**.[11] And it can be reduced, cancelled, or clawed back in case of poor performance and misconduct.

In other words, bankers have more skin in the game. In the U.K., senior bankers and traders also have to comply with the so-called Senior Manager and Certification Regime, which has increased accountability and is helping firms to set a better "tone at the top".

Here I would like to commend my former IMF colleague, Minouche Shafik, who in her role as deputy governor of the Bank of England did so much to promote codes of conduct for financial markets.

Certainly, more can be done: from making claw-backs more consistent across countries, to enhancing the disclosure of disciplinary actions within firms, to creating a **global code of conduct**.

And let us not forget the power of criminal and civil liability. In major financial centers, we see a more forceful pursuit of individual wrongdoing. But the brunt of legal action—amounting to billions of dollars in fines—is borne by financial firms, where it is too often perceived simply as a cost of doing business.

Values and ethics

The reality is that even the toughest legal sanctions, and the smartest compensation and governance rules, cannot be substitutes for a **strong individual responsibility that is grounded in values and ethics**. For it is not just the "tone from the top" but the "response from the bottom" that creates a better and more trusted corporate culture.

That is why the financial industry needs what I call an "ethics upgrade". What do I mean? For financial professionals, it simply means doing the right thing—even when nobody is watching. It sounds so simple, and yet it is perhaps the hardest thing to do.

Remember: the word "credit" comes from the Latin word for "trust", which is the lifeblood of the financial system. But trust itself cannot be manufactured or mandated. It must be earned through virtuous behavior that is intrinsically motivated—again, done even when nobody is watching.

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[11] Source: U.K Financial Conduct Authority.

Here one could draw inspiration from Aristotle, who argued that we are all driven by a sense of purpose. We can achieve our purpose by developing virtues, such as justice, courage, self-control, prudence, generosity, and honesty. Aristotle believed that this was the key to genuine happiness.

That spirit can also help achieve a **purposeful banking career and a safer and more trusted financial system**. But this is not the whole story. Aristotle also believed that *individual purpose* must always be linked to *social purpose*, to the common good.

This applies to all aspects of our life—including corporations and financial firms. The "goal" of a corporation cannot be just about its own narrow financial interest. It must also encompass a broader common responsibility.

It is not surprising, therefore, to see growing debates about the nature of modern corporations and the concept of maximizing shareholder value.

As the British economist **Colin Mayer**[12] put it: "*For nearly all of its 2,000-year history, the corporation has combined a public purpose with its commercial activities. It is only over the last 60 years that the idea that profit is the only purpose of business has emerged*."

I believe that encouraging a broader common responsibility is now more important than ever—not just for *today's* stakeholders, but for *future* generations.

Which brings me to my second question: how can the financial sector support long-term growth that is more sustainable and more inclusive?

2. How can finance support sustainable and inclusive growth?

Let me start with a data point. Over the next 15 years, **$24 trillion** of wealth will be inherited by millennials—and they are more than twice as likely as other generations to invest in companies or funds that target social or environmental outcomes.[13]

The financial industry has seized this opportunity by offering various forms of **impact investing**, **green bonds**, and a panoply of fund products that take account of "**ESG**"—environmental, social, and governance issues.

Clearly, sustainable investing is booming. But it also points to a deeper issue: whether you are a banker, fund manager, or fintech entrepreneur, you are probably wondering how to take a more sustainable approach that is both economically and ethically right.

This offers us a huge opportunity to redefine the magic of finance, to pursue a **broader sense of purpose**.

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[12] Colin Mayer, Saïd Business School at the University of Oxford, blog.

[13] Morgan Stanley report; Deloitte report.

a) Fintech

The immediate priority should be to foster **cutting-edge financial technology**. This means creating fintech products that are substantially cheaper and more accessible. It means serving customers and communities in new and better ways. It also means rethinking the economics of the financial industry itself.

In the United States, for example, the unit cost of financial intermediation has remained largely unchanged over the past century, while income from finance has risen and fallen with the value of financial assets.[14] That suggests a significant amount of rent extraction.

The fintech response is to increase competition, reduce inefficiencies, and provide better value for money to individuals and small businesses. In doing so, fintech can help drive an "**inclusion revolution**".

In Kenya and China, mobile payment systems have brought millions of previously "unbanked" people into the financial system. In Latvia, Brazil, and elsewhere, peer-to-peer lending has opened up new sources of credit for small businesses. Around the world, blockchain enables faster and cheaper transactions—from trading securities to sending money to relatives abroad. And this is just the beginning.

Let us not forget that **1.5 million**[15] adults in the U.K. still have no bank accounts, and **about 33 million** U.S. households are *under*-or *un*banked[16]—and those numbers are multiplied in emerging and developing countries.

So there is a huge opportunity to boost financial inclusion which—as we know—leads to **stronger growth and higher employment**. This in turn requires vibrant digital ecosystems, such as London—which is home to the biggest cluster of fintech startups in Europe.

But fintech cannot do it alone. We also need better regulation and smarter supervision to ensure that fresh sources of credit do not encourage people to overborrow and that personal data is protected against prying eyes and criminals.

In other words, banking-type fintech services should be subject to banking regulations, especially when it comes to consumer protection. For new firms, this means working with regulators to unlock the immense potential of fintech, while managing the risks.

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[14] Andrew Haldane, Bank of England, speech, 2016; Philippon (2014), "*Has the U.S. Finance Industry Become Less Efficient? On the Theory and Measurement of Financial Intermediation*".

[15] Rowlingson, K. & McKay, S., 2014. Financial Inclusion: Annual monitoring report 2014, Birmingham: University of Birmingham.

[16] 2017 survey by the U.S. Federal Deposit Insurance Corporation: about **8.4 million** household have no bank accounts; an additional **24.2 million** households have accounts but no access to other financial services.

That is the goal of the Bali Fintech Agenda launched by the IMF and World Bank last October.[17] It provides key principles—including on promoting competition and consumer choice, and fighting money laundering—which can help guide our joint endeavors in the period ahead.

b) Female leadership

Of course, the inclusion revolution goes beyond fintech. It also encompasses the need for **more diverse leadership in finance**.

I say this for two reasons. First, greater diversity always sharpens thinking, while reducing the potential for groupthink. And second, diversity also leads to more prudence and better decision-making.

Our own research[18] bears this out: a higher share of women on the boards of banks and financial supervision agencies is associated with greater financial stability—which underpins **stronger and more durable growth**.

There is a long way to go here. Across the globe, only **two percent** of bank CEOs are women; and **less than a fifth** of bank board members are women.[19] Here in the U.K., the Hampton-Alexander review has been urging the largest listed companies to increase the proportion of women on boards to at least one-third by 2020.[20]

Would quotas make a difference? The answer is 'yes', so long as they are properly designed and implemented. A good example is Norway where, over five years, mandatory quotas supported a **fourfold increase** in the proportion of women on corporate boards.[21]

Clearly, more female leadership is critical—and not just at the top, but as consumers of financial services. Women all over the world are making their voices increasingly heard when it comes to investing their *own* money.

For example, recent surveys[22] show that women are far more likely to engage in sustainable investing than men. And they are driving demand for new products, such as funds targeting gender equality in corporations.

That spirit is beautifully captured by the "**Fearless Girl**" statue on Wall Street—which brings me to my final point.

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[17] Bali Fintech Agenda, 2018

[18] IMF Staff Discussion Note: *Women in Finance: A Case for Closing Gaps*.

[19] ibid.

[20] Financial Times article: "Shareholders hold the key to unlocking boardrooms for women."

[21] In Norway, the proportion of women on boards was 9 percent in 2003, and almost 40 percent five years later.

[22] Morgan Stanley survey, 2017, The Economist article.

c) Investing for the global public good

I believe that fearless action and fresh ideas are needed more than ever to invest for the *global* common good.

Think about it: trillions of dollars in **private-sector investments** will need to be mobilized to tackle climate change and to achieve the Sustainable Development Goals (SDGs)—which are aimed at eliminating poverty by 2030 and, more than this, making the planet a better place for our children and grand-children.

These goals—endorsed by the global community—constitute a daunting *challenge*. But they are also a huge *opportunity*—especially for the financial sector.

Only a few years ago, the financial industry perceived climate risk as a distant threat. Governor **Mark Carney** famously called it the "*tragedy of the horizon*".[23]

That time horizon has since shifted much closer to the present.

Major hurricanes in the Caribbean, wildfires in California, severe flooding in parts of the U.K: these are but a few of the powerful reminders of an economic threat that is already affecting the livelihoods of too many individuals and communities.

And there are now growing economic debates over the likely effects of climate change on productivity, incomes, financial stability—even monetary policy, not to mention migration pressures.

What does it mean for the financial sector? It means shifting to a more sustainable form of finance that is grounded in better risk management and longer-term thinking. It also means mobilizing more finance for investment opportunities in people and infrastructure.

For example, the IMF recently estimated that the additional spending needed by low-income countries to achieve the SDGs—in key sectors such as health, education, and low-carbon infrastructure—is about **$520 billion** per year in 2030.[24]

That gap can only be filled through a combination of public and private resources: from bank lending, to project finance, to so-called "blended finance"—which brings together grants, concessional financing, and commercial funding.

The key is for public and private investments to be *complements*, not *substitutes*. They must go hand-in-hand to create the right conditions for investment. This includes sound economic policies, strong legal frameworks, good governance, and zero tolerance for corruption—whether in the public or private sector.

[23] Mark Carney speech (2015): *Breaking the Tragedy of the Horizon – climate change and financial stability*.

[24] IMF research; IMF blog.

And remember: the SDGs are not just about developing economies. They are designed to promote global growth that is stronger, fairer, and environmentally friendly.

If the SDGs are to deliver on that promise, we will also need to harness the momentum of the sustainable investing sector—which already accounts for **$23 trillion**, or **26 percent** of global assets under management.[25]

How might this be done? Fund managers could, for example, launch **new investment products** that encourage corporations to align their business model with the SDGs. They could also work with policymakers to create **global standards** for sustainability accounting and reporting—this would boost transparency and strengthen the credibility of sustainable investing.

As I said: this is the moment when fearless action is absolutely critical; when fresh ideas can help us break the mold; when we join hands to foster the global common good.

Conclusion

Let me conclude by returning to Mary Poppins. Remember the scene where the "good banker" teaches his children a lesson about purpose. He argues that they should follow in his footsteps, and he sings the following lines [*…don't worry, I won't sing*]:

"*A British bank is run with precision. A British home requires nothing less! Tradition, discipline, and rules must be the tools. Without them—disorder! Chaos! Moral disintegration! In short, you have a ghastly mess!*"[26]

Well, that is one way of putting it. But the question is whether young people today should consider joining the financial industry. For many of them, the answer comes down to finding a **broader sense of purpose**—much like Mary Poppins.

The genius of her character is that she is **serving others**—with dignity, with a kind heart, with honesty, and with a wicked sense of humor. I think this is a good description of what the financial industry should be all about.

Serving others, not yourself—that is the real magic of finance.

Thank you.

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[25] Source: Global Sustainable Investment Alliance (GSIA); The Economist article.

[26] Mary Poppins: Song: *A British Bank*.