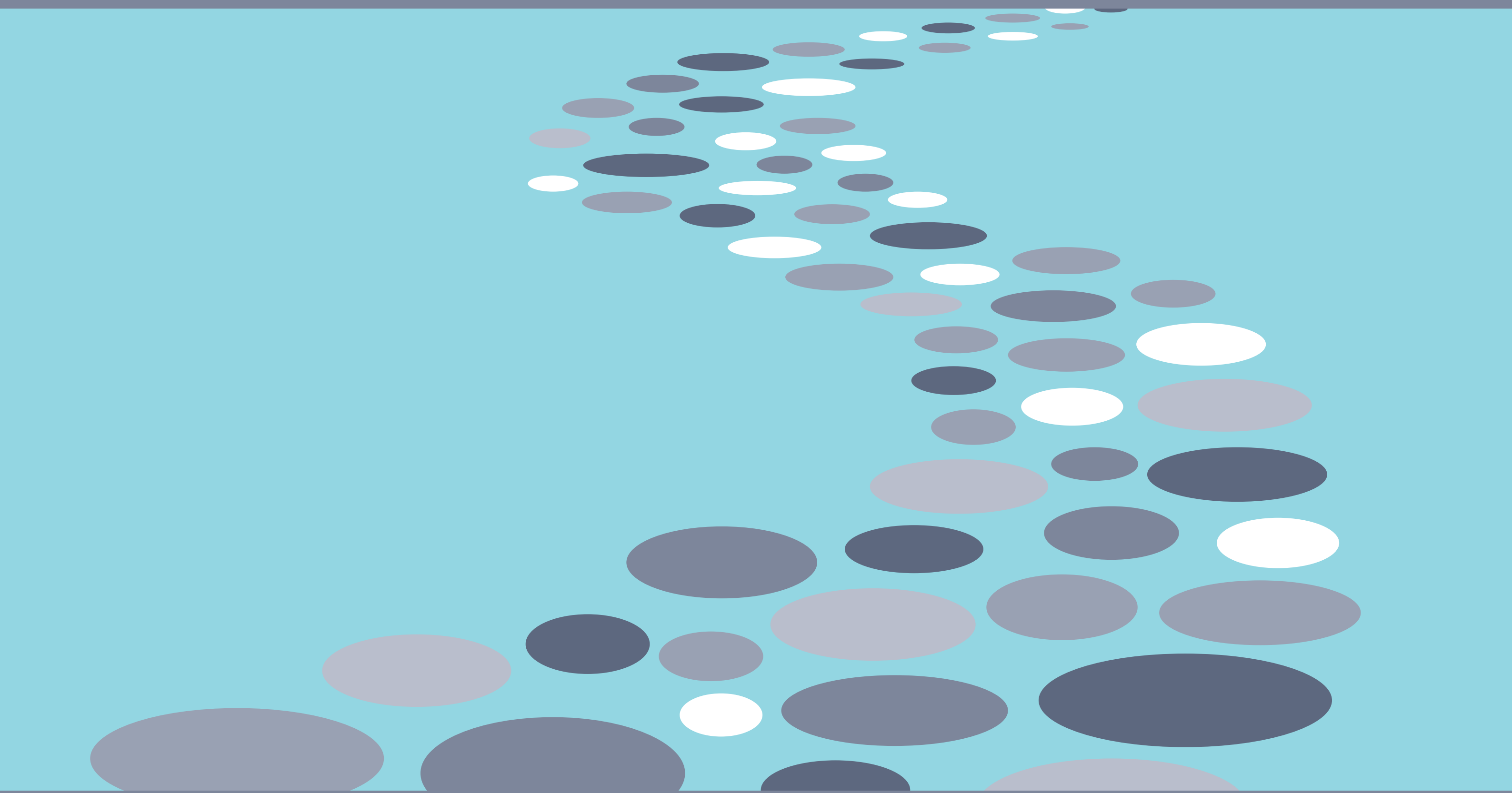
Pathway to Long-Term Value:

Identifying and Defining Long-term Value Drivers for Banks



A Final Report of the BankingFutures Dialogue

This report, and the process that led to its creation, is a team effort. The report is authored by Andy Griffiths, Sophia Tickell and Anne Wade, but would not have been possible without the research, project management and editorial support of the BankingFutures team – Sayo Ayodele, Becky Buell, Lydia Garrett, Marloes Nicholls, Prarthana Rao and Cassie Tickell-Painter. We are deeply appreciative of their work. Thank you also to Jane Garton and Corinne Welch, for their meticulous copy-editing and creative design work, but also for working so ably to such tight deadlines. Any misinterpretation or errors are the authors' alone.

Disclaimer: As a multi-stakeholder and collaborative project, the findings, interpretations and conclusions expressed herein may not necessarily reflect the views of all members of the group at all times. Members of all groups took part in a personal capacity.

BankingFutures

An Inclusive, Multi-Stakeholder Process

BankingFutures is a structured dialogue aiming to create a healthy, resilient and inclusive banking sector in the UK. It is a partnership run by Leaders' Quest and Meteos, two non-profit organisations committed to improving the role business plays in society.

The dialogue has taken place in two phases. Phase One began in June 2014 and sought to provide civil society, customer and regulatory input to a leadership group of senior banking executives, investors and experts on banking reform. The original leadership group committed significant time over the course of 14 months, for internal working group meetings and external roundtables with stakeholders. Over 200 stakeholders contributed views through these meetings and via interviews. The first phase of the project, which was described as one of the most societally inclusive projects on banking reform, concluded with the publication of the report, *Banking on Trust: Engaging to Rebuild a Healthy Banking Sector*.

This is a report on Phase Two of the project, which launched in May 2016 and created Action Groups to explore two topics in depth: how banks can better contribute to the real economy, and how communication and dialogue can be improved between banks, investors and other stakeholders in order to enhance banks' ability to deliver long-term value. The work of the groups was overseen by a Steering Group of senior banking leaders, investors, financial reform experts and civil society representatives (see Appendix A). Steering Group members agreed to use their positions of influence to further the project's final recommendations.

Action Group One sought to identify actions that would forge stronger links between the financial system and the small and medium enterprise (SME) sector of the real economy. The group was composed of bank leaders, representatives of SMEs, representatives of the responsible finance and community development financial institutions (CDFI) sector, and civil society organisations working on finance. Its work incorporated insights of academics, economists and policy-makers. The group met regularly over the course of 14 months and exchanged views between meetings; these took place in London, Bristol and Sheffield, with a view to engaging with cities and regions where there is a greater need for improved access to financial services. The meetings included site visits, with leaders from organisations working to understand and support the needs of the real economy.

Action Group Two was charged with exploring how to reintroduce a long-term culture into investing in banks, in partnership with the Investor Forum. It sought to identify practical measures to contribute to a longer time horizon in investment and management decision-making, as well as a more comprehensive definition of long-term value. This group was made up of bankers, investors and representatives of organisations seeking reform from within and outside of the investment community. This group met five times for day-long workshops over the course of the project's duration and, as above, participated in a combination of immersive learning with sector experts and site visits to underserved communities in London's East End, complemented by internal group discussions.

Introduction
from the BankingFutures Directors

We set up the BankingFutures dialogue three years ago to support the development of a healthy, resilient and inclusive banking sector in the UK, capable of underpinning UK economic development and enabling everyone to participate in the economy. This leadership dialogue is run jointly by our organisations, Leaders' Quest and Meteos, and in partnership with the Investor Forum for our work on long-termism. It is an invitation to senior bank leaders, institutional investors and civil society representatives to come together to agree what changes are needed in the sector, and to find common ground on how these can be achieved.

In this second phase of the project we have focused on two priorities: how banks can better support small and medium enterprises (SMEs) in the real economy, and how to improve communication and dialogue between banks, investors and other stakeholders in order to enhance the ability of banks to deliver long-term value. The dialogue concludes with a separate report on each topic.

Although seemingly different, these topics are ultimately interdependent. Banks' ability to adequately address the needs of SMEs is already challenging due to the high or unknown risk of doing so. This long-term challenge has been made more acute by recent changes to the banks' business models, which are partly a result of an increased focus on the demands of capital markets. For investors, SME lending and banks' contribution to society are a low priority because they are a small part of a global bank's balance sheet. As a result, investors are more likely to praise the introduction of efficiency measures – such as closure of bank branches – than to consider the effects of closures on a bank's ability to meet the needs of small companies. This matters because the SME sector is the backbone of the economy and critical to employment and social cohesion, making it vital it has access to the finance it needs. It also affects society's perception of banks.

Understanding how to encourage banks and investors to focus more on what is going to drive long-term value to all stakeholders, and less on short-term financials, is a crucial part of what will permit banks to make investments in the real economy that require patient capital. The BankingFutures participants committed themselves to trying to square this circle. Our desire was for the project to strengthen the bridges between people in the financial system and real economies. Our groups embraced the opportunity to meet some of the most financially excluded people in the UK. Hearing from them helped focus our minds on the need to fix the system. The groups worked together with the intellectual rigour you would expect of such leaders, but they also worked respectfully and carefully, listening to each other's perspectives even when they were at odds, and with a commitment to finding joint solutions. We are deeply grateful for their openness to work in this way and to such good effect. We would also like to thank the many experts who allowed us to interview them and who were more than generous with their ideas and suggestions.

The outcome of the process is this report and a counterpart report on SMEs, banks and the real economy. Each report is a standalone. However, to reach a solution on either will require tackling both issues simultaneously. There are ways to do this which we outline in each report, and we therefore encourage you to read them both.

We are proud to have achieved our original goals of identifying actionable things that can be done by specific people or institutions to make a difference. This is the result of adopting a comprehensive multi-stakeholder approach in which the views of all stakeholders are sought and actively considered. The virtue of this approach is that participants come to mutually acceptable outcomes. For some, the recommendations may be a stretch, for others they may not go far enough. This is not a weakness. Along the way participants have heard and acted on each other's concerns meaning that when the recommendations are finally launched, they are much more likely to get real traction in the real world. In this way, we hope that the creative energy that has gone into BankingFutures lives on in a tangible way that contributes to a healthy banking system, in service to society.

Sophia Tickell and Anne Wade • *July 2017*

Introduction
from the Investor Forum

The BankingFutures dialogue created a structured opportunity for a group of the industry's leaders to work together to identify tangible steps to contribute to a banking industry that can deliver value for all of its stakeholders.

In facilitating this dialogue on long-term value, Meteos, Leaders' Quest and The Investor Forum have been able to bring together executives from highly competitive institutions to collaborate, and have demonstrated that there is a more inclusive way to approach and address systemic challenges. The commitment by participants to step back from the day-to-day pressures and explore these important issues has been crucial. By listening and engaging with multiple stakeholders, BankingFutures offered a differentiated approach to address this complex issue.

The BankingFutures 'Pathway to Long-Term Value' and the associated recommendations represent a series of tangible steps that bank and investment leaders can take to focus discussions on the issues that really matter to understand value – culture, employees, customers, risk appetite and the impact on society – and to enhance confidence in order to create a banking system that is valuable for all. Banks can do much more to better articulate their approach to these important issues.

This process has revealed the need for a much broader dialogue if investors are to better understand long-term value and avoid an excessive focus on short-term issues and quarterly reports. New information will be required to inform this evaluation, and it is therefore incumbent on investors to demonstrate their appetite for this broader conversation and its value to decision-making.

On behalf of all the participants in this dialogue, I would like to offer a collective 'thank you' to Sophia Tickell of Meteos and Anne Wade of Leaders' Quest – together with their colleagues – for the skill, dedication and professionalism that they have brought to these conversations. The process has created a rich dialogue and a platform for lasting change.

The Investor Forum has been delighted to support this process given our twin objectives to make the case for long-term investment approaches and to create an effective model for collective engagement. We will continue to work in support of the practical application of both the pathway and the recommendations.

Andy Griffiths • *July 2017*

Executive Summary

Identifying and Defining Long-term Value Drivers for Banks

This is one of two reports on the findings of the second phase of the BankingFutures dialogue. It addresses the question of how to respond to the negative impacts of short-termism on investor decision-making and on internal bank culture. It reports on how banks, investors and other bank stakeholders can work together to share concerns and understand how profound, structural changes to bank business models will affect the ability of all banks to meet societal and shareholder expectations.

It is written at a time of intense change. Since 2007/08 the UK banking sector has experienced waves of external regulatory reform to promote financial stability and improve bank conduct, mirrored by internal restructuring processes to achieve the same goals. More recently, bank leaders have faced the additional tasks of accommodating the very significant financial consequences of the wrongdoings of the past, as well as new challenges, such as financial crime. All this is taking place as a technological revolution continues unabated, with artificial intelligence, automation and digitisation having profound impacts on business models.

It is clear that these revolutionary changes have huge implications for banks themselves, for their customers, for their employees, for their shareholders and, crucially, for society as a whole. As no one can be certain what the future holds, there is an extraordinary opportunity for bank leaders to engage more fully with stakeholders on these long-term value drivers to understand what their stakeholders hope and expect of this economically and socially vital sector.

Short-term pressures make this difficult. The focus on the latest quarter encourages management to feel pressured to deliver financial targets, in timescales that are significantly shorter than the business cycle. It affects employee morale, and it affects management's ability to implement strategic plans and to take bold decisions about investment expenditure. It means senior leadership teams spend disproportionate amounts of time talking to investors about short-term financial developments rather than the long-term trends affecting the sector or the volatile external operating environment.

All parties can see significant advantages to moving away from the current excessive focus on quarterly reporting, even if there appear to be many impediments to doing so. There is an important opportunity for bank directors and investors to come together to achieve that objective. A longer-term focus would allow bank managements to direct their energies to the longer planning cycle required by the business, rather than pursuing earnings growth to meet short-term expectations. It would allow investors to act on the growing realisation that understanding culture, attitudes to risk, and longer-term perspectives are key both to identifying the sustainable success stories of the future and increasing confidence in the quality and predictability of earnings.

Investors – some of the banks' most influential stakeholders – are also changing, in part spurred by growing political and regulatory scrutiny. Investors are beginning to reflect on how their own business practices are contributing to short-termism, and there is increasing pressure to provide greater transparency regarding their incentive systems. The timing for investors and banks to improve how they communicate on long-term value drivers could not be better. To do this well, three challenges need to be addressed:

- **Banks, investors and other stakeholders need to identify and understand the drivers of long-term value.** Information flowing between banks and investors currently contains too much financial reporting and not nearly enough indicators about the non-financial fundamentals that underpin the health of the business. Investors and banks need to work with other stakeholders to define what these are, and to find a way to incorporate them into bank evaluations.
- **Banks, investors and other stakeholders need to determine what non-financial information to communicate, and when.** Investors and other stakeholders are seeking independent information and increasingly determining for themselves the issues they consider to be essential to a bank's long-term future. Bank reporting on such information is currently situated in a number of different places, often published at different times during the year and against varying timeframes.
- **There is a need to address the absence of comprehensive and comparable non-financial data from the banks.** Specifically, there is strong demand from investors for banks to provide information on culture, conduct and other long-term value drivers – what is being incentivised and what rewarded, and how and whether management is tracking progress. Banks, however, are hesitant to meet to such demands. Having spent time and effort on developing and tracking such metrics, many now see their internal cultural reform processes as a source of competitive advantage and are therefore reluctant to make them public.

These rising demands for new and better communications offer banks a huge opportunity to demonstrate visible and forward-looking leadership on how they plan to engage with their stakeholders and on what they consider to be important for the long-term health of the business. If managed well, improved understanding should incentivise stakeholders to engage with those companies they believe to be serious about things they care about, and encourage the belief that banks care and are willing to meet society's desire for a more inclusive financial sector. In the process, it will improve perceptions about the trustworthiness of banks.

Investors, for their part, need to take leadership in ensuring they match their call to banks for comprehensive non-financial information, with a commitment to then embed that data into their valuation frameworks, and to actively prioritise discussion of these drivers of long-term value in their engagement with boards and management. This will create a positive feedback cycle that enables banks to know their material is being well received and valued, and for investors to clearly signal that these issues are important to them.

There are early signs that banks, investors and regulators are finally coming to an emerging consensus about how banks can create long-term value. There is growing alignment around the idea that a comprehensive evaluation of a bank should include an assessment of the value it is perceived to offer to employees, customers, civil society and regulators, as well as to shareholders.

BankingFutures is proposing a 'Pathway to Long-Term Value' which identifies five milestones and a series of practical recommendations that, if achieved, would create a comprehensive understanding of a bank's total value and resilience, by providing non-financial indicators to complement financial metrics. These interlocking, achievable and relatively small steps, when taken as a whole would contribute to significant change in both the evaluation of and support for total bank value. Each recommendation has identified a strategic partner that is able to further develop the work and comment publicly on progress. Some of these partners, like the Investor Forum,[1] are well established. UK Finance, however, does not formally begin work until after the report is published, so will need time to consider the recommendations before it responds. The five milestones on the Pathway are as follows:

1. 'UK Finance – Representing UK Finance and Banking' is the UK's new financial trade association, launching in July 2017. It is a merger between six bodies representing the finance industry: the Asset Based Finance Association, British Bankers' Association, Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Milestone 1

Improved dialogue between banks and their investors

The banking sector will be better placed to embrace the opportunities and weather the challenges it faces if all its stakeholders are more aligned about what is likely to drive value for the sector and society over the long term. To achieve this goal, information flows between banks and their investors must move from a focus on short-term financials to concentrate on other important indicators of total bank value. It will require banks to innovate and provide high-quality information about their franchises and to decide how to respond to investor desire for independently verifiable data. Investors will need to justify requests for additional disclosure by demonstrating that they do indeed take into account a broader range of multi-stakeholder considerations in assessing the value of a bank, and to signal to banks their clients' and customers' increasing interest in these issues.

Milestone 2

Collaborative agreement on determinants of long-term value

BankingFutures has demonstrated to banks the value of working collaboratively and engaging with their stakeholders on issues they believe to be material to the bank's long-term success. It has also shown investors the value of doing so. Finding a way to agree and regularly assess these determinants of long-term value would demonstrate the sector's interest in stakeholder concerns and, in the process, enhance trust and generate a better understanding of the sector. Banks should therefore commit to an ongoing collaborative process which results in agreement on key drivers or determinants of non-financial, long-term value. Once this agreement on the essential determinants of non-financial, long-term value has been reached, banks should be free to determine independently how they report on them, and on any additional issues they consider important.

Milestone 3

Improved insight into management thinking on long-term objectives, culture and value of the bank via the Strategic Report

The Strategic Report is the most logical place for investors and other bank stakeholders to find the bank's long-term strategy and management's views on the best path to value creation. There is an opportunity for banks to commit to improve the Strategic Report such that it provides easily accessible, fundamental information about the bank's long-term health. It should also be the primary means by which company directors disclose the execution of their duties under Section 172 of the Companies Act, which requires them to have regard for additional stakeholders (as well as members, i.e. shareholders).

Milestone 4
High-quality, consistently reported non-financial data

BankingFutures identified a number of issues on which stakeholders are seeking more information in order to evaluate a bank's ability to deliver value over time. Banks, investors, regulators, civil society and consumer advocates are largely in agreement that reliable, convincing information that provides insights into a bank's culture as well as its approach to customers and conduct, is absolutely key to such evaluation. However, understanding and measuring culture, in particular, is highly challenging and only truly understood by spending long periods of time inside the organisation and with senior leadership. As access of this kind is impracticable for most bank stakeholders, reasonable proxies need to be found.

Banks are understandably reluctant to use standard metrics on cultural issues, arguing that successfully managing conduct and culture will be a key determinant of competitive advantage. Further, they point out that culture is by definition distinct to each entity, and that the process of standardising and 'numerating' it risks losing the essence of that culture. Importantly, they are also sceptical about whether investors are genuinely interested in non-financial data.

For their part, investors and other stakeholders say that specific metrics on culture and values – both positive and negative trends – would enable them to identify those institutions which are best in class and those that are weaker on these crucial value drivers, and so they are seeking consistency and comparability between banks.

There is therefore a need for banks to identify and agree the essential determinants of non-financial value. However, once agreement has been reached on the themes on which to report, individual banks should be free to manage and report on them in innovative and creative ways that highlight the bank's approach and achievements.

Culture: An organisation's culture shapes management decision-making, reveals the degree to which there is scrutiny and challenge at senior levels of the organisation, demonstrates management approaches to risk, and – through incentive and reward systems – exposes what leadership really cares about. Information on how leadership and values shape the bank's culture can be found in employee views on leadership and organisational culture, incentives and total employee remuneration, and risk appetite.

Customer and Conduct: All banks say the customer is their number one priority, so bank stakeholders are calling for specific information on two other key metrics – customer outcomes and conduct. They argue that high-quality, comparable – and, ideally, independently verifiable – data on customers would permit stakeholders – investors, civil society and, most importantly, those customers – to evaluate how banks are managing this long-term strategic priority. To assess conduct, stakeholders are asking for data that allows them to understand a bank's historic performance by division. They want it to be comparable between banks, where possible, to allow sector-wide comparison, and to be consistently reported over time to permit assessment of progress against objectives.

Milestone 5
Annual structured stakeholder feedback

The importance of the views of other (non-shareholder) bank stakeholders in understanding a bank's long-term value was a consistent theme throughout the dialogue. These stakeholders include employees, customers, civil society, standards-setters and others who want to engage with companies in the financial sector. Value can be derived by ensuring that the relationships with these key stakeholders are well managed and that bank management listens to, and takes on board, the concerns they consider legitimate. Critical to this process is for stakeholders to feel heard, and to know that bank management has considered their input and acted upon it where appropriate. This will require company directors, as the ultimate owners of corporate strategy and culture, to engage with these stakeholders and to provide public feedback on how they have been influenced by their views.

Pathway to Long-Term Value
Recommendations

RECOMMENDATION ONE:

Investors signal to bank management (and report to their own stakeholders) their interest in understanding the range of value drivers that will impact long-term value

- Asset owners (and their investment consultant advisers) signal to asset managers their interest in long-term value delivery from investments in the banking sector.
- Asset managers, in their client reporting, to demonstrate the importance of both long-term timeframes and non-financial information in the evaluation of a bank's ability to deliver value.
- Asset managers to use their engagement with bank boards and management teams to explore and provide challenge on a comprehensive range of issues that drive long-term value, rather than excessively focusing on short-term financial measures.
- Asset owners and asset managers to adopt a model of inclusive engagement with banks to break down the silos that exist between 'ESG (environment, social and governance) engagement' and the process of traditional financial analysis.
- Asset managers to clearly communicate to banks where they require more information (e.g. long-term strategy, competitive positioning, customer and culture data, etc.); where information needs to be simplified/reduced (e.g. remuneration consultation, quarterly earnings); and what (financial) information they do not value, in order to prevent a further increase in the volume of company reporting.
- Asset managers to commit to embed non-financial information in their valuation frameworks, in order to demonstrate the importance of those investment criteria and this broader range of information to investee companies.
- Asset owners and asset managers to examine the structures within their own organisations in order to align investment timeframes and incentive structures to the long term.

Strategic Partner: **Investor Forum**

Investor Forum to survey investors and provide survey results by the end of 2017.

RECOMMENDATION TWO:

Banks to work with UK Finance to agree key elements of non-financial information disclosure

In recognition of the need for banks to both set their own strategic priorities and consult with stakeholders on their views, BankingFutures recommends that UK Finance convene regular roundtables between banks and their stakeholders to define priorities for non-financial reporting. UK Finance is encouraged to set up an initial meeting with the Investor Forum to jointly convene investors, banks and other capital market participants, to make the case for enhanced non-financial information and to review the requirements for quarterly reporting. UK Finance is then encouraged to convene multi-stakeholder roundtables including investors and civil society organisations to bring societal perspectives into the process. The roundtables should be run on BankingFutures multi-stakeholder principles of inclusion and diversity. They should build on the BankingFutures non-financial priorities outlined below, and may be informed by additional experience and insights of external experts in organisational culture. Banks should commit to an ongoing, regular process such that best practices are revisited on a structured and scheduled basis. The roundtables are designed to:

- Come to agreement on core themes that could help in the evaluation of culture.
- Demonstrate a commitment by the industry to embrace non-financial reporting.
- Identify what data is needed to allow bank stakeholders to evaluate and compare across banks, but be flexible enough not to constrain individual banks from innovating and communicating significant further progress.
- Attain a level of stakeholder confidence and trust in banks that existing ESG and corporate social responsibility (CSR) reports have not yet been able to deliver.

Strategic Partner: **UK Finance**

RECOMMENDATION THREE:

Banks to enhance and prioritise the Strategic Report

The Companies Act requires the Strategic Report in annual reports to be 'fair, balanced and understandable'. BankingFutures recommends that banks move beyond the minimum requirements prescribed in law and signal willingness to prioritise the Strategic Report as the bank's key all-stakeholder report, by including data-driven information on:

- The company's purpose.
- The culture sought by the bank's senior leadership and related incentives, clearly articulated.
- Long-term strategy, including information about which issues and stakeholders the bank considers to be a priority, and why.
- Key objectives relating to each of these issues and stakeholder groups.
- The systems and processes in place to deliver those objectives.
- Annual progress indicators against those objectives.
- How the bank is supporting the real economy, given the role of the sector in underpinning economic activities, social cohesion, job creation and innovation.[2]

BankingFutures recommends that the bank creates a two-page summary of this report, with specific indicators of progress against strategy, values and behaviours, and summarised evidence of its stakeholder engagement. Highlights of key topics of strategic interest should also be included in its investor updates throughout the year. With the upcoming adoption of the EU Non-Financial Reporting Directive there is an opportunity for the banking sector to take a lead in communicating a more holistic view of activities for the 2017 financial year.

Strategic Partner: UK Finance

To ensure consistency across the sector, BankingFutures recommends that banks work with the Financial Reporting Council (FRC) and UK Finance to create a model to strengthen, evaluate and provide feedback on the quality of Strategic Reports. Discussions with the FRC indicate strong support for companies to prioritise this enhanced role for the Strategic Report.

2. Real economy refers to activities undertaken by households and businesses, as opposed to transactions between financial entities.

RECOMMENDATION FOUR:

Individual banks to disclose company-specific, non-financial information to help stakeholders evaluate the bank's long-term health and prospects

The BankingFutures process revealed consensus among banks, investors, regulators, customers and other stakeholders that providing information on the non-financial topics generated by BankingFutures discussions and outlined below, would permit stakeholders to better understand and evaluate the bank's long-term health and prospects. This is a complex undertaking which will require achieving an appropriate balance between banks' desire to innovate and compete, and investors' desire for comparability and differentiation. Banks should be free, however, to decide which issues they consider to be priorities, and to find creative and innovative ways to comprehensively report on them.

BankingFutures recommends that banks commit to build on the themes identified during the dialogue and outlined below, and to report on related internally developed metrics consistently and over time (both positive and negative trends), to allow investors and other stakeholders to assess progress or change.

Culture:

- **Leadership and Values**
  - Banks to publish comprehensive internal metrics, which should be consistent over time, that demonstrate employee views of the bank's culture and leadership. This should include:
    - Information on systems and processes used to underpin the values articulated by senior leadership.
    - Evidence of open leadership culture.
    - Employee views and statistics regarding job satisfaction, training opportunities, retention, diversity and inclusion.
- **Incentives**
  - Banks to commit to adopt a simplified and enhanced statement on incentives to demonstrate how they are designed to generate long-term value creation (see Appendix B for an example of BankingFutures Performance Metrics and Remuneration Template).
  - Banks to articulate more fully how the pay structure is linked to long-term performance.
- **Risk Appetite**
  - Regulators should continue the recent trend of highlighting emerging potential sectoral risks for broader evaluation and scrutiny by investors and all stakeholders (e.g. the recent warnings from the Financial Policy Committee on growth in unsecured consumer credit and extended interest-free credit card product offers).
  - Banks should strengthen information in the Strategic Report about what they consider to be top and emerging risks, and how they will manage them. This disclosure should be the principal mechanism to enable stakeholders to understand and evaluate the likely opportunities and threats, and how the bank is responding to them.
  - Banks to take coordinated steps to give a clear explanation of the impact of IFRS 9 on historical risk data series and its potential impact on prospective future risk decisions.

Continued overleaf…

Customers:

- Banks to produce an annual public report on customer outcomes, articulating what they consider to be the most significant metrics to measure this, and why. This could include product and service offerings, and support to vulnerable customers or underserved communities.

Conduct:

- Banks to report a summary of annual findings on internal risk management, including a narrative statement on whistleblowing procedures and experiences.
- Banks to provide an explanation of how they apply their bonus-malus; and in a given year, the number of bonus-malus investigations undertaken, the number of times bonus-malus has been applied and the number of disciplinary actions taken.
- UK Finance to encourage the Financial Conduct Authority (FCA) to revise its website in order to make the significant quantity of conduct data it holds much easier to navigate, and to present it in ways that allow assessment of individual bank performance, by division and over time.

Strategic Partners: UK Finance

UK Finance to provide regular public commentary on banks' evaluation and disclosure of culture, including public customer survey information, as recommended by the Competition and Markets Authority review of retail banking. UK Finance to work with the FCA to make existing information on conduct more readily available, as part of its mandate to enhance market integrity, promote competition and protect consumers.

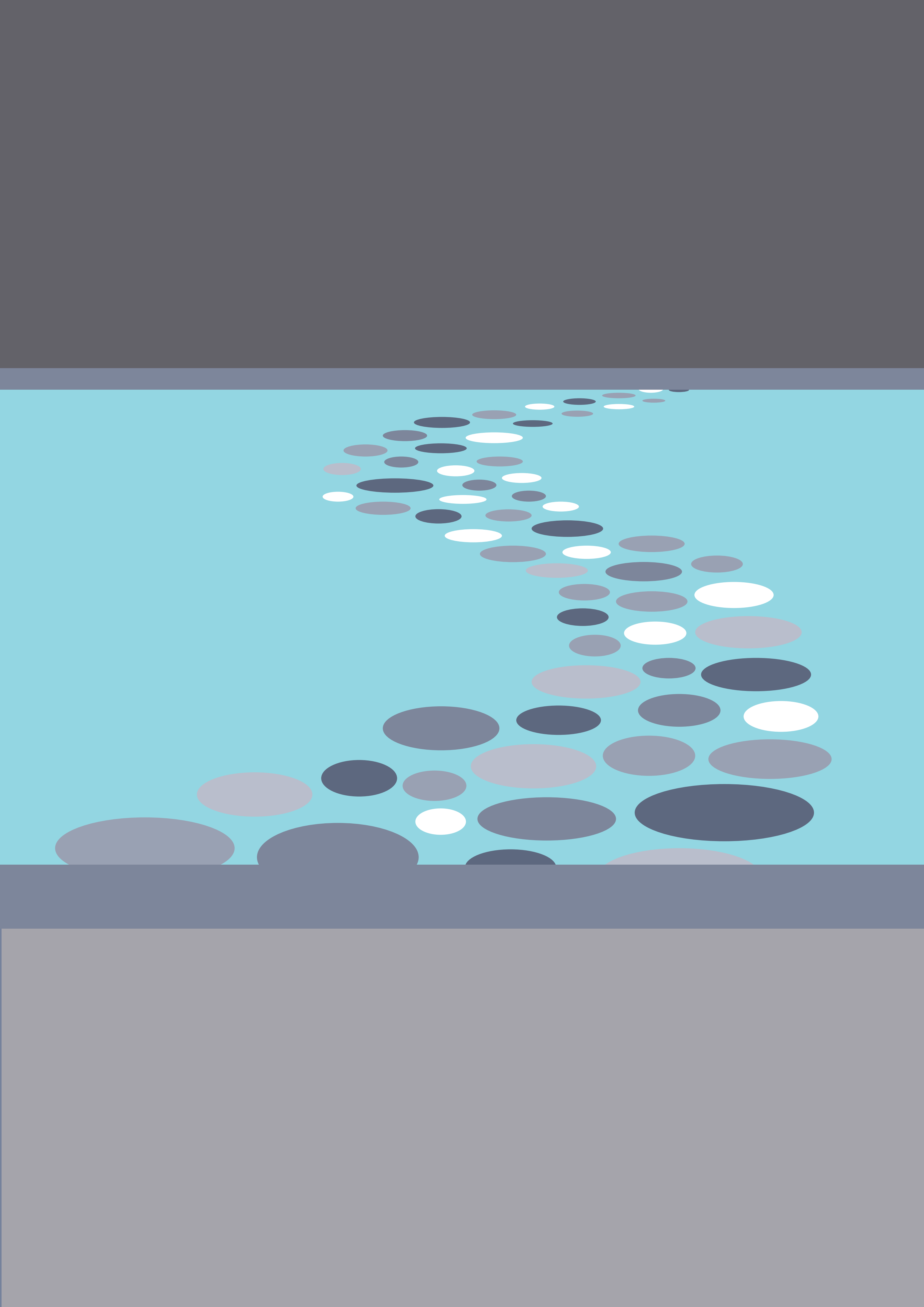
RECOMMENDATION FIVE:

Individual bank boards and senior management to provide annual public stakeholder feedback

- Bank directors to provide public feedback on how they have been influenced by stakeholders, including employees, trade associations, lobby groups, standards setters, customers and the third sector.
- Banks to give a specified board member responsibility for oversight of the feedback to ensure it provides evidence of how the bank's directors have discharged their duties under Section 172 of the Companies Act.
- Banks to commit to an easily accessible and widely disseminated annual feedback mechanism to present and obtain feedback on stakeholder issues. This could take the form of a report, a specific stakeholder meeting, or could be integrated into the bank's AGM.

Strategic Partner: Individual bank efforts supported by UK Finance

BankingFutures recommends that UK Finance supports bank efforts and enables sharing of best practices.



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Background: A Sector in Flux

As the period of adjustment to regulatory change draws to an end, the impact of technological innovation is beginning to redefine the banking service model and create a raft of new challenges and opportunities.

Since 2007/08 the UK banking sector has been in a state of perpetual flux. Waves of external regulatory reform, first to promote financial stability and then to improve bank conduct, have been mirrored by restructuring processes inside the banks that are designed to achieve the same goals. These internal changes have sought to demonstrate renewed financial strength and to persuade sceptical stakeholders – inside and outside the financial world – that bank leaders are focused on creating strong banks which put customers at the heart of the business model. Successive governments have sought not just to regulate, but also to encourage so-called 'challenger banks' to promote competition in the highly concentrated retail banking market and a degree of diversity through alternative finance providers. To the existing challenges of keeping the bank afloat, more recently bank leaders have faced the task of adjusting their approach to business to accommodate the very significant financial consequences of the wrongdoings of the past. Changing regulation and standards have dominated the agenda for a decade.

All this is taking place as a technological revolution continues unabated. Automation and digitalisation have already paved the way for new entrants in the banking market, and 'Fintech' (the development of software to provide new financial services) is accelerating this trend. The introduction of artificial intelligence into business models has barely begun, but it is already clear that it will herald further radical changes for banking, with huge implications for customers, employees and shareholders. As the period of adjustment to regulatory change draws to an end, the impact of technological innovation is beginning to redefine the banking service model and create a raft of new challenges and opportunities.

Profound, structural – and little recognised – changes to the business models of all banks and a shake-up of the sector are well underway. As the sector emerges from a decade of rehabilitation, and begins to grapple not only with new external challenges but also new ways of doing business, there is still much work to do if bank leaders are to create a virtuous cycle based on rebuilding investor confidence and stakeholder trust.

The Opportunity to Engage

These revolutionary changes provide multiple threats to, and opportunities for, the sector. The financial crisis cast a long shadow in the UK, and mistrust in banks remains a problem. Bank leaders have a way to go before customers are persuaded they are trustworthy, and at the same time they have to continue with the formidable task of keeping a firm hand on the tiller in very stormy seas. New regulations and ongoing litigation continue to take up considerable amounts of senior management time, as do the growing requirements to tackle financial crime. Investors remain wary. Years of disappointing results made it difficult to identify a compelling investment opportunity. Investors therefore want hard evidence of good management – of internal reforms, financial strength and future growth opportunities.

If banks cannot effectively manage and communicate their approaches to these business model changes they risk stifling the early and still fragile gains in trust that have been made in the UK in recent years. No one can be certain of precisely what the future holds, but ongoing changes to banking should provide an extraordinary opportunity for bank leaders to engage more fully with what their stakeholders hope and expect of the sector, as well as to raise the bar on what they seek to deliver in coming years.

BankingFutures was set up in 2014 to undertake just such a multi-stakeholder approach to articulating what a healthy UK banking sector looks like, and to recommend actions to achieve that goal. It sought to do this by addressing:

- The lack of visible leadership from within the banking sector on how to realign incentives to result in better societal outcomes.
- The limited direct civil society engagement with those undertaking banking reforms.
- The need for institutional investors to engage on their role in shaping bank behaviours.

Successfully bringing together diverse perspectives on the purpose of banking and how it might be realised, the dialogue concluded with three recommendations that would rebalance banking to better meet societal expectations and rebuild trust in the sector. Since then, BankingFutures has been exploring two topics in depth: how banks can better contribute to the real economy; and how to improve communication and dialogue between banks, investors and other stakeholders such that it enhances banks' ability to deliver long-term value.

The Impacts of Short-Termism

This is a report on the findings of one workstream of the BankingFutures dialogue, which sought positive responses to the negative impacts of short-termism on investor decision-making and on internal bank culture.

The pressure from investors to talk about the latest quarter makes it extremely difficult for bank leaders to focus on internal culture change that rewards long-term value creation. Short-termism encourages management to commit to – and then feel pressured to deliver – financial targets in timescales that are significantly shorter than the business cycle. It means senior leadership teams spend disproportionate amounts of time talking to investors about the last quarter, rather than running the business. It affects employee morale when they see a disconnect between aspirational goals and on-the-ground reality, and it affects management's ability to implement strategic plans and to take bold decisions about investment expenditure.

The short-term focus also crowds out conversations about the long-term trends affecting the sector and how management is positioning itself to respond to the highly volatile external operating environment. It inhibits banks from explaining to investors the pressures they are under and the (financial and social) expectations they seek – and are expected – to meet.

An excessive focus on the preparation of quarterly financial information and a constant re-evaluation of investment decisions based on such short-term developments has had a detrimental impact on the ability of companies and investors to focus resource and attention on long-term value generation. Crucially, it diverts investor attention away from an understanding of the bank's culture. For many stakeholders, a bank's culture – and the incentive structures that hold it in place – is the single most important determinant of its current and future performance. Both explicitly and implicitly, culture defines the values, standards and norms that employees are expected to meet; and vitally, it clearly defines what is really valued by senior leadership.

> *Investors too are beginning to recognise that culture, attitudes to risk, and longer-term perspectives are key to identifying sustainable future strategies. A long-term focus can improve total shareholder value.* ”

The Benefits of a Longer-Term Focus

For bank management teams, the value of focusing on the longer term is clear. It enables them to direct their energies to the longer planning cycle required by the business. It also frees up considerable time for strategic planning and creates the opportunity to make investments in businesses which have long gestation periods.

Investors too are beginning to recognise that culture, attitudes to risk, and longer-term perspectives are key to identifying sustainable future strategies. A long-term focus can improve total shareholder value. There is recognition that bank successes and failures during and since the financial crisis were caused less by individual items in a financial model, and much more by less tangible issues, such as treatment of customers, employee behaviour, risk appetite and culture, that require investors to take a broader perspective to fully understand the value and health of a bank.

A long-term focus can improve the quality and predictability of earnings, by allowing management to be more strategic and better able to focus the bank's resources on activities that can generate sustainable profits, rather than pursuing earnings growth at any cost to meet short-term expectations.

The identification of long-term value drivers allows investors and other stakeholders to evaluate the increasingly complex operating environment for banks, such as the implications of technological change and automation; changing demographics and consumer behaviour; or the impact on banks of the UK's decision to leave the EU. It also puts them in a better position to anticipate any future changes, and thus embolden management to make crucial investment decisions, confident that investors will understand their reasoning. The value of such an approach was recently demonstrated by Unilever's rebuttal of Kraft's hostile takeover bid, which would not have been possible without the support of both its long-term investors and its key stakeholders.

Finally, a longer-term perspective has other benefits for bank stakeholders. A bank culture and strategy with longer horizons makes it easier, for example, to make investments both in the real economy and new technologies – including to adapt to and mitigate climate change – which are all likely to benefit both employees and customers over time.

The Time is Right

The timing for a constructive dialogue between investors and banks on how to improve communications on long-term value drivers could not be better. The process of disintermediation, which is having such a profound impact on banks, is affecting other parts of the financial world too. Investors, who in their various guises constitute some of the banks' most influential stakeholders, are also changing. In part this change is spurred by growing political and regulatory scrutiny, and investors are beginning to reflect on how their own business practices are contributing to short-termism.

Investor tolerance of poor performance by the companies they invest in is at an all time low, in part because of the constant pressure from within the investment world to outperform investment benchmarks and peers. The quest by asset owners to maximise returns on committed capital, with little appetite to accept disappointing near-term financial returns, has resulted in the frequent switching of asset managers in the pursuit of performance. The internal incentive structures of investors themselves are often based on reward for short-term performance that is not always consistent with the long-term value creation. Combined with an ever-increasing media and market focus on quarterly earnings announcements, the result has been a reduced tolerance of disappointing short-term financial results and an increase in short-term trading. Some prominent investment houses are considering the implications of the resulting short-termism for their own long-term health, and for the economy as a whole, and identifying what to do about it.

The fact that investors are discussing the issue internally means that calls for greater engagement on long-term drivers of value for investee companies, including banks, is falling on fertile ground. BankingFutures discussions revealed broad agreement between these two influential actors that the narrow focus on financial information has not been the best way to determine value; paving the way for a conversation about how that broader debate should be framed.

Banks have already made a start. All banks now argue that a focus on the customer will be the biggest determinant of long-term value. They are all also acutely aware of how poor culture led to massive – on-going – value destruction and so are asserting that they are developing and incentivising different and better internal cultural metrics. The BankingFutures dialogue explored what could be done to communicate this change credibly and effectively.

Information Flows – What and When

The first challenge is to identify the drivers of long-term value and then to determine what information is needed to enable stakeholders to understand them. The financial crisis revealed just how narrow the focus of 'success' had become, and the lengths to which companies would go to meet and exceed stock market expectations. In pursuit of growth at almost any cost, a definition of shareholder value based on book value, profitability and earnings growth became the norm. Insufficient scrutiny of the product being sold or the financial risk being created, led banks to make – and investors implicitly to endorse – a series of decisions which resulted in huge value destruction. Despite this, short-term quarterly earnings remain the primary focus of communications from banks and the main evaluation tool for investors in banks; something which – if anything – is becoming more pronounced.

BankingFutures concluded that information flowing between banks and investors contains (much) too much reporting of one type of information – a dizzying overload of financial findings – and not nearly enough of other types – i.e. the non-financial fundamentals that underpin the health of the business. Investors and banks need to work with other stakeholders to define what these are, and to find a way to incorporate them into bank evaluations.

The second challenge concerns what information to communicate, and when. Investors and other stakeholders are seeking independent information to assess for themselves the issues they consider essential to a bank's long-term future. These range from culture, employee and customer outcomes satisfaction, to climate change, amongst many others. Some information might be sourced from the bank's own public documents, and some – especially on topics which banks have chosen not to communicate strongly – is sourced from independent analysts who propose their own targets and metrics. The resulting data may or may not be reliable indicators of health, or coincide with what banks themselves consider important. While there is much to do for investors to understand and incorporate signals on these issues into their decision-making, it is clear that investors and stakeholders are increasingly searching for better ways to evaluate these important issues, whether or not banks (or other companies) are prepared to engage in this debate.

Information flowing between banks and investors contains (much) too much reporting of one type of information – a dizzying overload of financial findings – and not nearly enough of other types – non-financial fundamentals that underpin the health of the business.

Bank reporting on information that would help investors and stakeholders to make a holistic evaluation of a bank's performance, health and societal contribution is currently situated in a number of places, often published at different times of the year and against varying timeframes. While different stakeholders will doubtless respond differently to the information provided, there is a compelling case that to be useful such information needs to be communicated as a package that is easily accessible, comprehensive and consistent.

The third challenge arises from the absence of comprehensive and comparable non-financial data from the banks. Investors and other stakeholders are looking for hard evidence in any claims that bank managements make about steps to improve the long-term health and resilience of the bank. There is strong demand from investors for banks to provide comparable information, such as the data provided by the employee survey of the Banking Standards Board, about how these reforms are being articulated internally, what is being incentivised and what rewarded, and how and whether management is tracking progress. Banks are resistant to such demands, preferring to rely on their own internal sources of information and providing only limited insight for external observers. Having spent time and effort on developing and tracking such metrics, many now see their internal cultural reform processes as a source of competitive advantage, and they are therefore reluctant to make them public. They are also concerned that trying to distil unique and complex issues such as culture into data points, will result in information that loses the essence of the culture. Finally, they point out that it is also difficult to manage such information well in an environment of mistrust, especially since many of the metrics are relatively new and little tested. It is by no means clear that setbacks or failure to meet targets would be met with tolerance by consumers or investors. Perhaps as a result, bank communications on 'soft' but essential drivers of value, such as customer outcomes or trust, tend to be anecdotal and hard to find. The problem for them is that their stakeholders – investors, regulators and consumers – all too easily (mis)interpret this as a failure to prioritise these soft value drivers. It also inhibits efforts by stakeholders to find and use information to understand and differentiate between companies.

The Leadership Opportunity

These rising demands for new and better communication create a huge leadership opportunity for banks to demonstrate how they are engaging more systematically with their stakeholders on what they consider to be important for the health and long-term prospects of the business. In so doing, each bank will be better able to differentiate its brand. More systematic engagement – and competition between banks to innovate – on these broader issues with customers, employees, regulators, policy makers, civil society and investors can only be a good thing, as bank leadership navigates a complex and changing environment.

The ideas that such engagement generates will provide essential input to strategy formation, as well as important ballast against the short-term headwinds of current investment practices.

Done well, this type of engagement does more than provide useful strategic input. It could demonstrate how visible and forward-looking leadership ensures that banks are being run for the long term. It would provide incentives to stakeholders to engage with those companies that they believe are serious about things they care about and support those banks that demonstrate their willingness to meet society's desire for a more inclusive financial sector. This process will improve perceptions about the trustworthiness of banks.

For their part, investors can play a dual role. First, by identifying for themselves those issues that they see as crucial to long-term health, they can then clearly signal them to banks. Second, by engaging with the complexity of the work in progress, they can help clarify which information is important, and which of the many competing initiatives are the most valuable. There is, after all, no magic key that will unlock value.

In doing so, investors will benefit from a more comprehensive and inclusive understanding of the societal expectations not just of banks, but also of investors. They too are not fully trusted as custodians of other people's money. If investors demonstrably engage with non-financial information from banks, they will show themselves to be in tune with both public and regulatory priorities and concerns. Importantly, there is also an opportunity for investors to demonstrate this interest to bank leaders, who remain sceptical of investors' motivations and remain to be convinced that they care about anything beyond short-term financial results.

These rising demands create a huge leadership opportunity for banks to demonstrate how they are engaging more systematically with their stakeholders on what they consider to be important for the health and long-term prospects of the business.

Banks, investors and the broader stakeholder groups each hold different views about what is important and the terms on which the debate is to be played out. Ultimately it falls to bank leaders to decide which of these non-financial value drivers is important for their companies, and to persuade their stakeholders that their version of what is important, and why, is more compelling than that of their peers.

No Easy Answers

Identifying the most important long-term value drivers, and understanding how those drivers impact a bank over time, is a truly complex challenge. An inclusive and comprehensive perspective requires an understanding of many interrelated issues which extend far beyond a quarterly financial report. However complex, ultimately these drivers determine the success, the health and the value of a company and drive the financial results. To understand and evaluate these broader constituent parts requires new tools and approaches, and is harder to model. If, for example, a bank views the relationship with its customers as a long-term and valued engagement over time, it is more likely to retain that customer and be recommended to others. If the relationship is purely transactional then the opposite is true. Even if investors agree with this logic, understanding and tracking management commitments to customer service is difficult.

A Pathway Forward

Ten years on from the crisis – and after a decade of intense flux – there are early signs that banks, investors and regulators are finally coming to an emerging consensus about how banks will create long-term value. There is growing alignment around the idea that a comprehensive evaluation of a bank should include an assessment of the value it is perceived to offer to employees, customers, civil society and regulators, as well as to shareholders. Indeed, that shareholder value may well be more consistently identified, generated and sustained through an understanding of these different perspectives. BankingFutures sought multiple stakeholder views on how such perceptions of value could be gathered and interrogated.

At the same time, there is some evidence of healthy competition emerging between banks to show that they have understood this societal agenda better than their peers, and are therefore more likely to generate long-term value and command increased trust. A 'race to the top' could generate positive results for the sector as a whole. The following 'Pathway to Long-Term Value' seeks to identify how this multi-stakeholder definition of value – which balances the information requested by stakeholders with banks' information about what they individually consider important – could be created.

Introduction to the BankingFutures Pathway to Long-Term Value

BankingFutures is a multi-stakeholder dialogue designed to demonstrate and reinforce the benefits to banks operating in the UK, investors and society of a closer alignment of their interests. Its findings are released at an important time as the banking industry faces a period of very significant change. Bank managements will need to explain to and convince their stakeholders that they are navigating this complex landscape well.

BankingFutures has identified the following multi-stakeholder 'Pathway to Long-term Value' to give a comprehensive view of a bank's total value and health (what investors might call 'franchise value'), seeking to complement financial metrics with other non-financial indicators. It combines specific information that bank stakeholders have indicated they want to hear about from banks to address the trust gap, as well as perspectives from bank leaders about how they seek to engage. It is flexible enough to allow the drivers under the main headings to change over time, in line with trends towards greatly enhanced transparency. Both investors and banks should assume that information provided will need to be supported by evidence. The Pathway covers the following five milestones:

Milestone 1
Improved dialogue between banks and their investors

The banking sector will be better placed to embrace the opportunities and weather the challenges it faces if all its stakeholders – and investors in particular – are more aligned about what is likely to drive value for the sector and society over the long term. To achieve this goal will require improved communications, with information flows between banks and their investors to move away from a focus on short-term financials to concentrate on other important indicators of total bank value. Banks will need to ensure that the significant internal effort to understand and analyse external concerns are aligned with what they consider to be the most important stakeholder priorities, and that their approach is also agile enough to respond to emerging issues, concerns and insights. They will be questioned on how they are responding, for example, to demands to address the Sustainable Development Goals and climate change, and be asked to provide quantitative data on what they have chosen to prioritise. In turn, there is a huge opportunity to improve the quality of their feedback to stakeholders.

To integrate non-financial information into traditional financial valuation frameworks will be challenging for both banks and investors. It will require banks to innovate and provide high-quality information on what they deem to be priorities, and why. They will also need to decide how to respond to investor desire for independently verifiable data which is comparable over time and across institutions. Investors, for their part – to justify requests for additional disclosure – will need to demonstrate that they do indeed take into account a broader range of multi-stakeholder considerations in assessing the value of a bank, and to signal to banks their clients' and customers' increasing interest in these issues. Investors will also need to recognise that this is work in progress, and that experimentation with what is most useful to publish is necessary and valuable. Recommendation One therefore describes the processes by which communications between banks and their stakeholders can be improved.

Milestone 2
Collaborative agreement on determinants of long-term value

BankingFutures has demonstrated to banks the value of working collaboratively and engaging with their stakeholders on issues they believe to be material to the bank's long-term success. It has also shown investors the value of doing so. Given its reluctance to use standardised measures to describe cultural issues, there is value in the banking industry working together on a precompetitive basis, and with a multi-stakeholder process, to identify the core principles which underpin a description and evaluation of culture.

Finding a way to agree and regularly assess these determinants of long-term value would demonstrate the sector's interest in stakeholder concerns, and in the process enhance trust and generate a better understanding of the sector. Banks should therefore commit to an ongoing collaborative process which results in agreement on key drivers of non-financial value.

Recommendation Two therefore proposes a process run on BankingFutures' multi-stakeholder principles of inclusion and diversity. It should seek to identify non-financial priorities and concerns common to the whole sector, and may be informed by additional experience and insights of external experts in organisational culture. Once this agreement on the essential determinants of non-financial value has been reached, banks should be free to determine independently how they report on them, and on any additional issues they consider important.

Milestone 3

Improved insight into management thinking on long-term objectives, culture and value of the bank via the Strategic Report

The Strategic Report is the most logical place for investors and other bank stakeholders to find the bank's long-term strategy and management's views on the best path to value creation. Despite this, current reports vary widely in quality and availability, and are often seen as a PR document rather than a fundamental management tool. All too often this report is not given sufficient attention by investors.

There is an opportunity for banks to commit to improve the Strategic Report such that it provides easily accessible, fundamental information about the bank's long-term health. It should also be the primary means by which company directors disclose the execution of their duties under Section 172 of the Companies Act, which requires them to have regard for additional stakeholders (as well as members, i.e. shareholders).

Recommendation Three therefore proposes that essential information on long-term value drivers should be contained in an enhanced Strategic Report. Stakeholders would benefit from a prominently displayed two-page summary of progress against key financial and non-financial metrics that support the bank's strategic objectives. A minimal commitment would be to strengthen the existing report, while the gold standard would be for the bank to make a commitment to fully integrated reporting.

Milestone 4

High-quality, consistently reported non-financial data

BankingFutures identified a number of issues on which stakeholders are seeking more information in order to evaluate a bank's ability to deliver value over time. Banks, investors, regulators, civil society and consumer advocates are largely in agreement that reliable, convincing information that provides insights into a bank's culture, as well as its approach to customers and conduct, is absolutely key to such evaluation.

Banks are understandably reluctant to use standard metrics on cultural issues, arguing that successfully managing conduct and culture will be a key determinant of competitive advantage. Further, they point out that culture is by definition distinct to each entity, and that the process of standardising and 'numerating' it risks losing the essence of that culture. Importantly, they are also sceptical about whether investors are genuinely interested in non-financial data.

For their part, investors and other stakeholders say that specific metrics on culture and values would enable them to identify those institutions which are best in class and those that are weaker on these crucial value drivers, and so they are seeking consistency and comparability between banks.

The group decided to settle first on issues that banks themselves state as their highest priorities: culture (including leadership, incentives and risk management); customer; and conduct. Second, the dialogue highlighted those issues on which there was broad consensus on the need for more information. There were diverse views of what should be included in the sub-topics under each of these headings. Many advocated, for example, the inclusion of climate change. This topic is not included as the Task Force of Climate-Related Financial Disclosures already sets out clear disclosure targets and metrics to achieve them.

Culture

For many investors, the biggest gap in information today is reliable, convincing data on culture. The underpinning of management decision-making, the culture of scrutiny and challenge that exists – or may not exist – at senior levels in an organisation, and the incentive and reward systems that drive key organisational behaviours are increasingly understood to be paramount to bank success or failure. That said, understanding organisational culture is very challenging. It can only be truly understood by spending long periods of time inside the organisation and with senior leadership. As access of this nature is impracticable for most bank stakeholders, reasonable proxies need to be found. Information on how leadership and values shape the bank's culture, and how incentive structures and risk appetite are set and monitored, can and should provide important indicators of what leadership really cares about.

To understand culture, many believe that data illuminating employee views on leadership and organisational culture are the most significant indicator of bank behaviour and decision-making, and hence value. Despite this, it is one of the hardest issues on which to find reliable information. There is an inherent tension between investors' desire for standardised and comparable data across banks, and the bank view that culture is unique to each organisation – and a source of competitive advantage that would be damaged by attempts to boil it down to templates or sector-wide surveys.

Without resorting to templates, there is much that banks can do to clearly articulate their own culture and, more importantly, the processes that underpin that culture. If this route is to be credible to external stakeholders, banks would benefit from finding ways to identify the core principles which should underpin a description and evaluation of culture for the whole sector, and allowing stakeholders to review the approach taken by their individual bank. Doing so presents an opportunity for the industry to develop a baseline that all banks should meet on culture, without constraining individual bank innovation. If banks do not lead, it is likely that other groups will continue to scrutinise available data and possibly create their own indices in an effort to shine light on these issues.

Stakeholders are also seeking more qualitative data about what a company values and the incentives at multiple levels in the organisation. A simplified and enhanced statement on incentives and total employee remuneration by each bank would enable stakeholders to easily track how incentives relate to a company's stated priorities. Finally, as risk management is a crucial driver of long-term value, there is a need for better communication by bank stakeholders – especially regulators – of what are considered key risks and how they are being managed, and for banks to highlight this information in their Strategic Reports. In the 'race to the top' there is much work to be done to improve the effectiveness of the discussion of highest and emerging risks.

Customer and conduct

Bank stakeholders are calling for specific information on two other key metrics – customer outcomes data and conduct. All banks say that the customer is their number one priority. Independent, high-quality, comparable data would permit stakeholders – investors, civil society and, most importantly, customers – to evaluate how banks are managing this long-term strategic priority.

Conduct is a function of culture and ethics, and drives all banks' long-term performance, both financially and in terms of achieving strategic objectives. Conduct performance has been a major drain on capital generation in recent years. To evaluate conduct, stakeholders need data that allows them to assess a banks' historic conduct performance by division, over time. The FCA holds such data. Given that much of it is historic, rather than a real-time insight into what is happening at the time of release, it would provide a useful means of understanding divisional culture and risk appetite, and enhance understanding of how the bank's approach to culture has evolved over time.

Stakeholders argue that to be credible, information provided on these topics must be of high quality and, ideally, independently verifiable. It should be comparable between banks, where possible, to allow sector-wide comparison, and it should be consistently reported over time to permit assessment of progress against objectives.

BankingFutures recognises that individual management teams are doing a great deal to highlight their bank's approach and achievements on these topics. Recommendation Four therefore seeks to combine stakeholder desire for comparability with bank desire for differentiation by proposing that once determined, each bank finds its own way, innovatively and creatively, to report on the themes identified during the BankingFutures process.

Milestone 5

Annual structured stakeholder feedback

The importance of other (non-shareholder) bank stakeholders in defining a bank's long-term value was a consistent theme throughout the dialogue. These include employees, customers, civil society, standard-setters and others who want to engage with companies in the financial sector. Value can be derived by ensuring that the relationships with these key stakeholders are well managed and that the bank management listens to, and takes on board, the concerns they consider legitimate.

Critical to this process is for stakeholders to feel heard, and to know that bank management has considered their input and acted upon it where appropriate. This will require company directors, as the ultimate owners of corporate strategy and culture, to engage with these stakeholders and to provide public feedback once a year on how the company has been influenced by their views. Recommendation Five therefore proposes that individual banks introduce a feedback mechanism that allows management to obtain feedback from stakeholders and demonstrate how their collective input has shaped and influenced the company over the past 12 months, and to provide essential evidence of how company directors have discharged their Section 172 responsibilities under the Companies Act. This feedback mechanism could take various forms, such as an additional forum in the AGM in order to create adequate space for multi-stakeholder concerns.

Pathway to Long-Term Value

The proposal to introduce a new Pathway to Long-Term Value is made in awareness of the many existing demands for data from banks, and is not made lightly. As far as possible it is designed to build on and use existing information and procedures, in order to be usable by smaller banks as well as larger banking groups. It aims to find the appropriate balance between the demands for quantified, comparable information on culture and conduct demanded by investors, and the claim from banks that this information is a key source of competitive advantage which should therefore remain subject to internal discretion. The tension between these very different perspectives is difficult to navigate, but the Pathway concludes that there are some cultural drivers that are common to all that should form a baseline for minimal disclosure. It does not prescribe how they should be managed, nor limit opportunities for innovation.

Five Milestones on the Pathway to Long-term Value

1. Improved dialogue between banks and their investors.
2. Collaborative agreement on determinants of long-term value, resulting from multi-stakeholder consultation.
3. Improved insight into management thinking on long-term objectives, culture and value, via the banks' Strategic Reports.
4. Individual banks to innovate to disclose specific key non-financial information to help stakeholders understand the company's long-term health.
5. Individual bank boards and senior management to identify mechanisms for annual public stakeholder feedback.

RECOMMENDATION ONE:

Investors signal to bank management (and report to their own stakeholders) their interest in understanding the range of value drivers that will impact long-term value

- Asset owners (and their investment consultant advisers) signal to asset managers their interest in long-term value delivery from investments in the banking sector.
- Asset managers, in their client reporting, to demonstrate the importance of both long-term timeframes and non-financial information in the evaluation of a bank's ability to deliver value.
- Asset managers to use their engagement with bank boards and management teams to explore and provide challenge on a comprehensive range of issues that drive long-term value, rather than excessively focusing on short-term financial measures.
- Asset owners and asset managers to adopt a model of inclusive engagement with banks to break down the silos that exist between 'ESG (environment, social and governance) engagement' and the process of traditional financial analysis.
- Asset managers to clearly communicate to banks where they require more information (e.g. long-term strategy, competitive positioning, customer and culture data, etc.); where information needs to be simplified/reduced (e.g. remuneration consultation, quarterly earnings); and what (financial) information they do not value, in order to prevent a further increase in the volume of company reporting.
- Asset managers to commit to embed non-financial information in their valuation frameworks, in order to demonstrate the importance of those investment criteria and this broader range of information to investee companies.
- Asset owners and asset managers to examine the structures within their own organisations in order to align investment timeframes and incentive structures to the long term.

Strategic Partner: **Investor Forum**

Investor Forum to survey investors and provide survey results by the end of 2017.

RECOMMENDATION TWO:

Banks to work with UK Finance to agree key elements of non-financial information disclosure

In recognition of the need for banks to both set their own strategic priorities and consult with stakeholders on their views, BankingFutures recommends that UK Finance convene regular roundtables between banks and their stakeholders to define priorities for non-financial reporting. UK Finance is encouraged to set up an initial meeting with the Investor Forum to jointly convene investors, banks and other capital market participants, to make the case for enhanced non-financial information and to review the requirements for quarterly reporting. UK Finance is then encouraged to convene multi-stakeholder roundtables including investors and civil society organisations to bring societal perspectives into the process. The roundtables should be run on BankingFutures multi-stakeholder principles of inclusion and diversity. They should build on the BankingFutures non-financial priorities outlined below, and may be informed by additional experience and insights of external experts in organisational culture. Banks should commit to an ongoing, regular process such that best practices are revisited on a structured and scheduled basis. The roundtables are designed to:

- Come to agreement on core themes that could help in the evaluation of culture.
- Demonstrate a commitment by the industry to embrace non-financial reporting.
- Identify what data is needed to allow bank stakeholders to evaluate and compare across banks, but be flexible enough not to constrain individual banks from innovating and communicating significant further progress.
- Attain a level of stakeholder confidence and trust in banks that existing ESG and corporate social responsibility (CSR) reports have not yet been able to deliver.

Strategic Partner: **UK Finance**

RECOMMENDATION THREE:

Banks to enhance and prioritise the Strategic Report

The Companies Act requires the Strategic Report in annual reports to be 'fair, balanced and understandable'. BankingFutures recommends that banks move beyond the minimum requirements prescribed in law and signal willingness to prioritise the Strategic Report as the bank's key all-stakeholder report, by including data-driven information on:

- The company's purpose.
- The culture sought by the bank's senior leadership and related incentives, clearly articulated.
- Long-term strategy, including information about which issues and stakeholders the bank considers to be a priority, and why.
- Key objectives relating to each of these issues and stakeholder groups.
- The systems and processes in place to deliver those objectives.
- Annual progress indicators against those objectives.
- How the bank is supporting the real economy, given the role of the sector in underpinning economic activities, social cohesion, job creation and innovation.[2]

BankingFutures recommends that the bank creates a two-page summary of this report, with specific indicators of progress against strategy, values and behaviours, and summarised evidence of its stakeholder engagement. Highlights of key topics of strategic interest should also be included in its investor updates throughout the year. With the upcoming adoption of the EU Non-Financial Reporting Directive there is an opportunity for the banking sector to take a lead in communicating a more holistic view of activities for the 2017 financial year.

Strategic Partner: UK Finance

To ensure consistency across the sector, BankingFutures recommends that banks work with the Financial Reporting Council (FRC) and UK Finance to create a model to strengthen, evaluate and provide feedback on the quality of Strategic Reports. Discussions with the FRC indicate strong support for companies to prioritise this enhanced role for the Strategic Report.

RECOMMENDATION FOUR:

Individual banks to disclose company-specific, non-financial information to help stakeholders evaluate the bank's long-term health and prospects

The BankingFutures process revealed consensus among banks, investors, regulators, customers and other stakeholders that providing information on the non-financial topics generated by BankingFutures discussions and outlined below, would permit stakeholders to better understand and evaluate the bank's long-term health and prospects. This is a complex undertaking which will require achieving an appropriate balance between banks' desire to innovate and compete, and investors' desire for comparability and differentiation. Banks should be free, however, to decide which issues they consider to be priorities, and to find creative and innovative ways to comprehensively report on them.

BankingFutures recommends that banks commit to build on the themes identified during the dialogue and outlined below, and to report on related internally developed metrics consistently and over time (both positive and negative trends), to allow investors and other stakeholders to assess progress or change.

Culture:

- **Leadership and Values**
  - Banks to publish comprehensive internal metrics, which should be consistent over time, that demonstrate employee views of the bank's culture and leadership. This should include:
    - Information on systems and processes used to underpin the values articulated by senior leadership.
    - Evidence of open leadership culture.
    - Employee views and statistics regarding job satisfaction, training opportunities, retention, diversity and inclusion.
- **Incentives**
  - Banks to commit to adopt a simplified and enhanced statement on incentives to demonstrate how they are designed to generate long-term value creation (see Appendix B for an example of BankingFutures Performance Metrics and Remuneration Template).
  - Banks to articulate more fully how the pay structure is linked to long-term performance.
- **Risk Appetite**
  - Regulators should continue the recent trend of highlighting emerging potential sectoral risks for broader evaluation and scrutiny by investors and all stakeholders (e.g. the recent warnings from the Financial Policy Committee on growth in unsecured consumer credit and extended interest-free credit card product offers).
  - Banks should strengthen information in the Strategic Report about what they consider to be top and emerging risks, and how they will manage them. This disclosure should be the principal mechanism to enable stakeholders to understand and evaluate the likely opportunities and threats, and how the bank is responding to them.
  - Banks to take coordinated steps to give a clear explanation of the impact of IFRS 9 on historical risk data series and its potential impact on prospective future risk decisions.

Customers:

- Banks to produce an annual public report on customer outcomes, articulating what they consider to be the most significant metrics to measure this, and why. This could include product and service offerings, and support to vulnerable customers or underserved communities.

Conduct:

- Banks to report a summary of annual findings on internal risk management, including a narrative statement on whistleblowing procedures and experiences.
- Banks to provide an explanation of how they apply their bonus-malus; and in a given year, the number of bonus-malus investigations undertaken, the number of times bonus-malus has been applied and the number of disciplinary actions taken.
- UK Finance to encourage the Financial Conduct Authority (FCA) to revise its website in order to make the significant quantity of conduct data it holds much easier to navigate, and to present it in ways that allow assessment of individual bank performance, by division and over time.

Strategic Partners: **UK Finance**

UK Finance to provide regular public commentary on banks' evaluation and disclosure of culture, including public customer survey information, as recommended by the Competition and Markets Authority review of retail banking. UK Finance to work with the FCA to make existing information on conduct more readily available, as part of its mandate to enhance market integrity, promote competition and protect consumers.

RECOMMENDATION FIVE:

Individual bank boards and senior management to provide annual public stakeholder feedback

- Bank directors to provide public feedback on how they have been influenced by stakeholders, including employees, trade associations, lobby groups, standards setters, customers and the third sector.
- Banks to give a specified board member responsibility for oversight of the feedback to ensure it provides evidence of how the bank's directors have discharged their duties under Section 172 of the Companies Act.
- Banks to commit to an easily accessible and widely disseminated annual feedback mechanism to present and obtain feedback on stakeholder issues. This could take the form of a report, a specific stakeholder meeting, or could be integrated into the bank's AGM.

Strategic Partner: **Individual bank efforts supported by UK Finance**

BankingFutures recommends that UK Finance supports bank efforts and enables sharing of best practices.

BankingFutures Participants

The BankingFutures dialogue took place between two multi-stakeholder Action Groups, one working on the real economy and the other on long-termism in the capital markets. Each Action Group shaped the analysis and recommendations on their respective reports. The work of the Action Groups was overseen by a Steering Group and benefitted from inputs from many other participants who provided expert advice and knowledge. The full list of BankingFutures participants on both work streams is listed below:

BankingFutures Long-Termism Action Group Participants

Carla Antunes da Silva	Deputy Group Strategy Director	Lloyds Banking Group
Stephen Atkinson	Chief of Staff	Standard Chartered
Justin Bisseker	Pan-European Banks Analyst	Schroders
Albert Coll	Institutional Policy and Market Relations Director	Banco Sabadell
Paul Cox	Senior Lecturer of Finance; Investment Advisor	University of Birmingham; NEST
Lawrence Dickinson	Senior Advisor to the Board and Group Chief of Staff	Barclays
John Flint	Chief Executive, Retail Banking and Wealth Management	HSBC Holdings Plc
Andy Griffiths	Executive Director; Operating Partner	Investor Forum; Corsair Capital
Sue Harding	Managing Director	Harding Analysis
Will Hutton	Principal; Chair of the Steering Group	Hertford College, University of Oxford; Big Innovation Centre
Stephen Jones	Incoming CEO	UK Finance
Hendrik-Jan Laseur	Founder	Lead the Change
Sacha Sadan	Director of Corporate Governance	LGIM
Simon Samuels	Consultant	Independent
Eugenia Unanyants-Jackson	Director; Head of ESG Research	Allianz Global Investors GmBH

BankingFutures Steering Group

Heather Buchanan	Director of Policy and Strategy	All Parliamentary Group on Fair Business Banking
John Flint	Chief Executive, Retail Banking and Wealth Management	HSBC Holdings Plc
James Garvey	Managing Director, Head of Commercial Banking Markets	Lloyds Banking Group
Tony Greenham	Director of Economy, Enterprise and Manufacturing	RSA

Andy Griffiths	Executive Director; Operating Partner	Investor Forum; Corsair Capital
Jessica Ground	Global Head of Stewardship	Schroders
Matt Hammerstein	Head of Retail Products and Segments	Barclays UK
Will Hutton	Principal; Chair of the Steering Group	Hertford College, University of Oxford; Big Innovation Centre
Stephen Jones	Incoming CEO	UK Finance
Stuart Lewis	Chief Risk Officer and Member of the Management Board and Group Executive Committee	Deutsche Bank AG
Francesca McDonagh	Former Head, Retail Banking & Wealth Management, UK and Europe	HSBC Holdings Plc
Glen Moreno	Chairman	Virgin Money
Nick Robins	Co-Director, Inquiry into the Design of a Sustainable Financial System	UNEP
Simon Samuels	Consultant	Independent
Bevis Watts	UK Managing Director	Triodos Bank
Helen Wildsmith	Stewardship Director	CCLA

Long-termism Experts & Interviewees

James Ayre	Fund Manager	CCLA Investment Management
Edward Booth	Global Banks & Financials Analyst	M&G
Roland Bosch	Associate Director	Hermes Investment Management
James Corah	Head of Ethical and Responsible Investment	CCLA Investment Management
Yolanda Courtines	Senior Managing Director, Global Industry Analyst	Wellington Management International
Mikael Down	Director of Policy and Analysis	Banking Standards Board
Jerry During	Director	Money A&E
Elizabeth Fernando	Head of Equities	USS
Paul George	Executive Director, Corporate Governance and Reporting	Financial Reporting Council
Catherine Howarth	Director	Shareaction
David Korsland	Senior Advisor	Global Alliance for Banking on Values
Karina McTeague	Director of Retail Banking Supervision	Financial Conduct Authority

Peter Michaelis	Head of Equities	Liontrust Investment
My Linh Ngo	Senior ESG Analyst	Blue Bay Asset Management LLP
Paul Novelle	Former Head of External Relations	Banco Sabadell
Sven Oestmann	Senior Banks Analyst	Fidelity Worldwide Investment
Chris Pond	Chairman	Lending Standards Board
Deepa Raval	Project Director	Financial Reporting Council
Fred Rizzo	Portfolio Manager	GIC
Euan Stirling	Head of Governance	Standard Life
Robert Swannell	Chairman	Marks & Spencer
Bob Wigley	Incoming Chairman	UK Finance
Stuart Woollard	Managing Director	Maturity Institute
Farida Yesmin	Chief Executive	Limehouse Project

Real Economy Action Group Participants

Tony Baron	Chair of the Treasury Policy Unit	The Federation of Small Businesses
James Cliffe	Head of Business Banking UK	HSBC Holdings Plc
James Corah	Head of Ethical and Responsible Investment	CCLA
Tony Greenham	Director of Economy, Enterprise and Manufacturing	RSA
Will Hutton	Principal; Chair of the Steering Group	Hertford College, University of Oxford; Big Innovation Centre
Neil Johnston	Chief Executive Officer	Paddington Development Trust
Martin McTague	Policy Director	The Federation of Small Businesses
Marloes Nicholls	Innovation Programme Manager	The Finance Innovation Lab
Steve Pateman	Chief Executive Officer and Director	Shawbrook Bank
Stephen Pegge	Group Competitive Markets and Business Policy Director	Lloyds Banking Group
Rebecca Pritchard	Head of Business Banking	Triodos Bank
Nick Robins	Co-Director, Inquiry into the Design of a Sustainable Financial System	UNEP
Jennifer Tankard	Chief Executive	Responsible Finance
Stephan Wilken	Managing Director, Head of Enterprise and Model Risk	Deutsche Bank AG

Real Economy External Experts and Interviewees

Matt Adey	Director and Senior Economist	British Business Bank
Christine Allison	Financial Inclusion Fellow	CSFI
Lucy Armstrong	Chair	Professional Standards Council
Andrew Austwick	Fund Manager	Finance for Enterprise
Saleem Bahaj	Research Economist	Bank of England
David Bainbridge	Head of External Relations	Financial Ombudsman Service
Saida Bairak	Founder/Owner	Saida Mia Sauces
Liz Barclay	Broadcaster and Writer	FCA Consumer Panel
Martin Binks	Professor	Nottingham University Business School
Fran Boait	Executive Director	Fair Life Charity
Paul Boscott	Executive Team	Fair Life Charity
Dr Martin Brassell	Chief Executive	Inngot Consultancy
David Carrington		Independent Consultant
Ian Cass	Managing Director	Forum of Private Business
Mark Chidley	Non-executive Director	FCA Consumer Panel and North East Access to Finance Ltd
Mike Conroy	Executive Director, Corporate and Commercial Banking	British Banking Association
Peter Coverdale	Policy Advisor	Department for Business Energy and Industrial Strategy
Matthew Davies	Director of Policy and Communications and Deputy Chief Executive Officer	Asset Based Finance Association
Mikael Down	Director of Policy and Analysis	Banking Standards Board
Tony Duggan	Director	International Association for Alternative Finance
Antony Elliot	Chief Executive	Fair Banking Association
Joanna Elson	Chief Executive	Money Advice Trust
Francis Evans	Assistant Director of Business	Department for Business Energy and Industrial Strategy
Graeme Fisher	Managing Director, Policy, Communications and Marketing	British Business Bank
Arthur Foreman	Managing Director	Finance for Enterprise

Stuart Fraser	Associate Professor of Enterprise	Enterprise Research Centre
Steve Glover	Director	Severn Project
Susie Goldring	Director	Visa Innovation
Deborah Henderson	Managing Director	Centre for Inspired Leadership
Robert Hewitt	Senior Policy Advisor	Government Inclusive Economy Unit
Charlotte Hopwood	Senior Manager, Policy	British Business Bank
Lord David Hunt	Partner and Chairman	DAC Beachcroft LLP Solicitors
Merlin Hyman	Chief Executive	Regen SW
David Korsland	Senior Advisor	Global Alliance for Banking on Values
Bella Landymore	Policy Officer	Government Inclusive Economy Unit
James Leigh-Pemberton	Chairman	UK Financial Investments Limited
Vivienne Lopez	Founder/Owner	Vevian Handmade in London
Nadia Lyassimi	Founder/Owner	Berber Dew
Laurie MacFarlane	Economist	New Economics Foundation
Paul Marston	Head of Commercial Finance Divisions	RateSetter
Claire McCarthy	General Secretary	The Co-Operative Party
Andrew McKenna	Head of Access to Finance Centre of Expertise	Sheffield Growth Hub
Karina McTeague	Director of Retail Banking Supervision	Financial Conduct Authority
Oliver Mochizuki	Co-Founder	Fundsurfer
Vanessa Morphet	Head of Investment Models	Government Inclusive Economy Unit
Frida Owusu	Founder & Director	Insight
Duncan Parker	Chief Executive	Fredericks Foundation
John Peters	Managing Director	SWIG Finance

Chris Pond	Chairman	Lending Standards Board
Frank Porritt	Financial Controller	HAB Housing
Tim Renshaw	Chief Executive	Cathedral Archer Project
Faith Reynolds	Independent	Independent
Matthew Rimmer	Assistant Director, Access to Finance	Department for Business Energy and Industrial Strategy
Kim Sadler	Business Support Officer	Paddington Development Trust
Richard Samuel	Barrister at Chambers of Peter Knox QC	3 Hare Court
Emmanuel Schizas	Senior Associate	Financial Conduct Authority
Anna Shiel	Head of Organisation	Big Society Capital
Luigi Shreider	Founder/Owner	Aggregated Pharmaceutical Distribution (APD) – Condoms
Maria Stammers	Senior Business Advisor	Paddington Development Trust
Christian M. Stiefmüller	Senior Policy Analyst	Finance Watch
Suren Thiru	Head of Economics and Business Finance	British Chambers of Commerce
Geoff Tilly	Senior Economist	Trade Union Congress
Fionn Travers-Smith	Social Impact Officer & Founding Member	Greater London Mutual
Adam Tyler	Chief Executive	National Association of Commercial Finance Brokers
Adam Waters	Senior Policy Advisor	IPSE
Stephen Waud	Chief Executive	Business Enterprise Fund
Caroline Wayman	Chief Ombudsman and Chief Executive	The Financial Ombudsman Service
Bob Wigley	Incoming Chairman	UK Finance
Ted Wigzell	Co-Founder	Your Business Community

BankingFutures Performance Metrics and Remuneration Template

Pay cohort	Number of staff	Average fixed pay	Average variable pay	Deferred as % variable pay	Average deferral period
£0 - £25,000	50,000	£17,500	£600	20%	0.5 years
£25,001 - £50,000	20,000	£34,000	£1,800	30%	1.1 years
£50,001 - £100,000	10,000	£67,000	£7,500	28%	2.5 years
£100,001 - £250,000	2,000	£160,000	£20,000	33%	3.4 years
£250,001 - £500,000	1,000	£209,000	£45,700	36%	3.5 years
£500,001 - £1,000,000	500	£330,000	£150,000	40%	3.5 years
£1,000,001 - £2,000,000	40	£420,000	£975,000	52%	3.5 years
>£2m	4	£585,000	£1,740,000	67%	3.5 years
Group average		**£35,000**	**£4,500**	**25%**	**1.0 years**

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