What is sound banking?

Sound banking is not
(a) excessive risk taking;
(b) irresponsible or unfair treatment of customers and counter-parties; and
(c) maximisation of short term profits.

Sound banking is:
(a) Prudent and profitable;
(b) responsible and fair to customers; and
(c) sustainable.

Trilogy of sound banking

(I) Robust Regulation and Supervision – it will provide an externally imposed set of rules and codes that define what is acceptable and what is not. However, no matter how well designed and robust the regulatory regime is, it normally works better in setting minimum standards for compliance and is not so effective in promoting good or best practices.

(II) Good Corporate Culture – culture consists of a set of formal and informal values that guide the mindsets and behaviours of management and staff. Unlike externally imposed rules and regulations, which normally entail sanctions if breaches are detected, good corporate culture and values reflect the attitude that “we do things the right way not because we are afraid of being caught but because this is the way it ought to be done”. A simple illustration of the importance of culture and values is the example of combatting littering on the streets. It is a lot easier to ensure that our streets are clean when people don’t think it is morally right to litter rather than having thousands of street cleaners sweeping the streets day and night, or having thousands of health inspectors giving out penalty tickets to those who litter.

(III) Appropriate Incentives System – it refers mostly to financial incentives but there could be non-financial incentives, that accrue to the staff members at different levels within a bank. It is crucial that the incentive system aligns with the letter and spirit of the rules, codes and culture statement of the bank in order to induce the appropriate staff behaviour to produce the desired outcomes consistently over time.

It is not possible to achieve sound banking without all the three components, as they tend to support and reinforce each other. Quoting the famous words of Mencius, supplemented by a modern economics overlay, I would like to conclude today’s Conference with the following phrases:

徒善不足以為政
徒法不能以自行
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