Monsoon Paper Dragons

Transparency, Accountability, Risk, and Compliance in Banking Regulation and Practice

Shruti Kashyap
Abstact

This dissertation explores the overall research question of how transparency- and accountability-driven post-crisis financial regulations within the European Union (EU) have influenced risk control and compliance in banks. The dissertation consists of five substantive chapters: an introductory synthesis; a published law journal article; two published book chapters, one of which is an extensive literature review; and one working paper that has previously been presented at multiple international conferences and is currently under review with a European journal in the field of accounting. In answering the call of the main research question, the dissertation adopts an interdisciplinary analytical framework that combines perspectives from law and the social sciences in the context of empirical material from Scandinavia and the EU. The analysis within the four individual papers and the introductory synthesis chapter follow a qualitative research design. They provide several complementary theoretical and empirical contributions to current research, the most important of which are summarized as follows: Theoretically, an adapted framework that harnesses theories of regulation, institutional theory, principal–agent theory, and legal positivism is used to analyze and explain practice and regulatory developments in the Swedish and international banking sector over a pre- and post-2008 financial crisis period. Additionally, the concepts of transparency and accountability are explored over a similar period in the context of the regulation-practice nexus of banking in Sweden and the EU. Empirically, this work contributes to current understandings and analysis of specific EU and Swedish regulatory instruments, as well as their impact at the firm and intra-firm level. Moreover, the identified conceptual framework of transparency and accountability is applied at the level of markets and regulations, as well as at the intra-firm level by tracing the influence of post-crisis EU regulation on the risk-control and compliance function within a large listed bank in Sweden that has a strong European presence. Collectively, this analysis offers relevant insights into the tensions between the aims and understandings encompassed within prudential regulation on one hand and organizational understandings and approaches towards risk control and compliance on the other hand. Identifying that there are few, if any, studies that address the interplay between regulatory developments and their impact on the internal processes, management, and control of banks, this dissertation offers an analysis of how transparency and accountability can surface and be operationalized within the regulation-practice nexus of banking. Specifically, it illustrates how regulatory impact can be traced further along the dimensions of transparency and accountability at the inter- and intra-firm levels, as well as at the level of financial markets and regulatory instruments in banking.

Keywords: Accountability, Banking, Compliance, Financial Regulation, Risk Control, Transparency

Shruti Kashyap, Department of Business Studies, Box 513, Uppsala University, SE-75120 Uppsala, Sweden.

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Fifty-fifty.
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Without them, this dissertation would, quite simply, not be.
List of Papers

This thesis is based on the following papers, which are referred to in the text by their Roman numerals.


IV  Kashyap, S. and Iveroth, E. (2019). Transparency and Accountability Influences of Regulation on Risk Control: The Case of a Swedish Bank. Earlier versions were presented at the 10th European Network for Research in Organisational and Accounting Change (ENROAC) Conference, the 8th European Institute for Advanced Studies in Management (EIASM) Workshop on Accounting and Regulation, and the 25th Nordic Academy of Management Conference. Based on the received feedback, the article was revised and submitted to the Journal of Management and Governance.

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In 2005, freshly churned from the University of Maryland Baltimore County and optimistically enthusiastic about the wonderful world of finance, I embarked on what, as of today, has been an almost fifteen-year jaunt through the extremely convoluted, often confusing, yet strangely satisfying landscape of international financial regulation and practice. All those years ago, armed more with the unbridled confidence of youth than anything else, my first post-university job as a listed derivatives analyst at Morgan Stanley imbued me with both terror and exhilaration. It was still more than two years before the eruption of the global financial crisis, and the atmosphere on Wall Street was one of electricity and verve. Tensions ran high, demands ran higher, and for at least one newly minted analyst, the fast-paced glamor of exploring new horizons far outweighed the long hours and seemingly exponential pressures to deliver.

What I remember is that, at the time, regulatory reviews and required disclosures appeared to be little more than mundane matters – tasks to be respectfully observed and fulfilled, but hardly issues to feel excessively worried about. Position limits, disclosures, and market transparency, while high on the operational radar, presented much more of an issue with regard to trading efficiency, client satisfaction, and arbitrage opportunities rather than ethical concerns. Accountability seemed largely tied to efficiently maintaining transparent disclosures and documentation. It was achieved effectively if unremarkably through routine regulatory compliance and reporting. Knowing little if anything of the law behind the practice – and indeed, having far less of a grasp even of the practice than I believed I did at the time – it felt to me that as long as we, as individuals and organizations, tried to follow protocol and keep our noses clean, it was nigh impossible for us to catch a cold.

By the time the mortgage bubble burst and turbulence hit U.S. financial markets in 2007, I had added being a second-year law student in the Juris Doctor program at the University of Maryland to my list of responsibilities. By then, I had gained a passably rudimentary understanding of financial markets from the perspective of the regulators in addition to the regulated. From this new vantage point, transparency and accountability suddenly cast a much more ominous shadow over the risk realizations that were by then rapidly unfolding in banking practice. Not only were complex financial in-
Instruments themselves being discovered to lie markedly beyond the scope of extant regulatory instruments and authorities, but gaps in legislation as well as monitoring and enforcement shortcomings on the part of domestic regulators were increasingly highlighted in stark relief. Forget about keeping anyone’s nose clean, the entire investment banking sector appeared infected with a particularly virulent strain of risky and ethically questionable influenza!

As banks, consumers, and regulators struggled to cope with the burgeoning financial fallout, everyone seemed to be echoing the same questions surrounding two buzzwords: Transparency and Accountability. Where, clamored countless voices in policy and practice circles, was the transparency? Where was the accountability? And who shouldered the blame for the apparent lack of both in banking regulation and practice? That deficiencies in these two important qualities had led our markets to disaster was hardly questioned; rather, the focus seemed to be on where and how to apportion reproach, retribution, and reform.

By the end of 2008, the financial crisis had spread to European shores. Regulators on both sides of the Atlantic struggled to staunch the rapidly spreading contagion and liquidity shortages in the international banking arena. Again, conceptions of transparency and accountability were strongly implicated, both in relief efforts and emergent regulatory reform. Understandings of what these two terms entailed, however, remained fragmented. For naïve law students such as myself and, it seemed, even seasoned financial sector experts, the meaning and operationalization of these two concepts continued to pose a somewhat perplexing issue. My personal confusion in this regard stemmed from seemingly endless questions: What did it mean to refer to “transparency” and “accountability” in banking? Why, when nothing about the rationale behind banking practice and regulation had changed since at least the turn of the twentieth century, had we failed to achieve and maintain the requisite levels of these two concepts, whatever they meant, in banking structures and operations? Assuming that we had failed in this task, was this because we had learnt nothing from past crises? And if, arguably, we had learnt from the past, why did our reactions keep falling short? Maybe more importantly in the practical here-and-now, if we were, as it seemed from a cursory contemplation, terminally short-sighted in our response to each new financial crisis, did the reforms in the wake of this latest crisis even matter in the longer run?

Two years later, I left these conundrums behind – at least for a little while. Towards the end of 2010, I branched out from the U.S. financial sector and moved to Switzerland, where I found myself largely focused on international trade law and development policy work for a change. In this environment,
most of my dealings with financial sector issues arose in relation to the societal role and implications of banking: access to finance, market entry, competition, and both supply and demand-side technological impact considerations. Even in these areas, the underlying themes of transparency and accountability permeated through various discussions related to market actors and scrutinizers – primarily in the settings of multi-lateral and regional trade, national and supra-national policy making, and public-private partnerships.

In this new context, the conceptual underpinnings of transparency and accountability were rooted in principles of social justice and equitable economic applications that relied on dominant and largely neoclassical economic theories. At the same time, the permeability of the boundaries between the financial sector and real sector on one level, between banking and society on a second level, and between law, economics, and social development on a third level, seemed highlighted in the international trade and development arena to a degree that I had failed to see from within the investment banking sector a few years prior. This awareness lent a different flavor to the concepts of “transparency” and “accountability” as they arose in this new setting. Whilst available definitions of these two terms remained fragmented, I could now better see that the relational considerations they entailed encompassed the arguably direct consideration if not inclusion of a more diverse group of actors rather than only the owner-shareholder imperatives that largely drove private sector financial undertakings.

When I was offered the opportunity in 2012 to begin conducting PhD research at Uppsala University under a project that explored tensions and conflicts between organizational demands for uniformity and uniqueness in banking sector interactions, I was intrigued. Transparency and accountability in banking sector relationships appeared to be an important focus in the context of the project’s aim, and beginning a PhD study seemed a natural step to take in order to further my knowledge of these concepts as they played out at the intersection of regulation and practice – the “regulation-practice nexus of banking,” as it is referred to in this dissertation. In a way, the PhD project seemed the perfect way to come full circle; it offered a seemingly unique path towards combining perspectives from law and economics with organizational and accounting viewpoints. Moreover, Sweden, with its well-learnt lessons from the banking crisis of the early 1990’s, posed an almost perfect setting within which to launch new inquiries into how the banking sector was responding to ongoing regulatory reform following the most recent 2007 global financial crisis. And so, in the late summer of 2012, I packed my bags and embarked on my journey to exotic Sweden.

The project that I joined was formed under Professor Fredrik Nilsson and Assistant Professor Anna-Karin Stockenstrand at the Department of Busi-
ness Studies, Uppsala University. The work that we embarked on under that project set the foundation for some of us from the original team to later build an interconnected and multi-disciplinary research group that continues even now to focus on multifaceted issues of transparency and accountability, regulatory influence, and risk management in different contexts.

The PhD process underlying this manuscript has presented me with the challenging yet uniquely worthwhile task of exploring the concepts of transparency and accountability in a holistic manner that combines viewpoints from financial economics and law with accounting and organizational research perspectives. This has allowed me to better understand some of the complex and multi-level nuances of interactions and influences between financial regulation and practice. Whilst I cannot claim that this dissertation provides a complete or novel answer to any of the questions that drew me to this undertaking in the first place, I can attest that the work carried out during this PhD project comprises a sincere attempt to add meaningfully to ongoing discussions at the intersection of economics, law, and accounting in the context of prudential regulation and risk control in banking organizations and activities. Both the process and the outcome of this research endeavor serve to highlight some important threads in the intricacies and challenges that underlie questions of transparency and accountability in banking, and how these questions are addressed in research, regulation, and practice – something that I hope the reader will find easily accessible in what follows.

I am grateful to many colleagues and contributors for their guidance in helping me build these understandings along what has been a long and winding research journey. Without them, this dissertation would not have been possible. Any mistakes that remain are solely mine.
1. Introduction

“And the great Chinese dragon was therefore forever after confined in a Chinatown basement and ever since allowed out only for Chinese New Year’s parades and other Un-American demonstrations paternally watched-over by those benevolent men in blue who represent our more advanced civilization which has reached such a high state of democracy as to allow even a few barbarians to carry on their quaint native customs in our midst.”

- Lawrence Ferlinghetti
  “The Great Chinese Dragon” (1961)

The simile of corporations functioning as paper dragons in a parade has previously been put forth in research that addresses the legal shortcomings that allow individuals to escape accountability and liability for corporate wrongdoing (Nelson, 2017). In that context, the author begins by identifying that “instead of hollow procedural shells, modern corporations should be understood as paper dragons in a parade—costumes animated by agents who are the dancers under the fabric that make it move” (ibid, p. 872).

In the present context of transparency, accountability, and risk in banking regulation and practice, “monsoon paper dragons” is a term that vividly brings to my mind a depiction of how banks continue to navigate through the unabated monsoon of post-crisis regulatory reform that began in the wake of the 2007 global financial crisis.

Let me explain.

As a teenager living in Bangkok, one of the annual festivals that I looked forward to the most was the traditional East Asian Lunar New Year. With a large and influential Chinese-Thai population housed in its environs, early springtime in the bustling city was highlighted not only by the pleasant cool and dry season but also by joyful street parades to mark the beginning of the new lunar year. These parades were replete with dazzling lights and music, peddlers selling everything from trinkets to delicious roasted chestnuts, and above everything else, a cacophony of performers and bystanders cheering on the proceedings.
The indisputable highlight of these parades were the dragon dances – colorful and massive paper contraptions of green and red and gold, held aloft by countless human hands, carried along by countless human feet that deftly moved through the streets as the dragons danced in the air above, benevolently swaying past the cars and the buildings and the countless enchanted spectators along the sidelines. Delicate. Powerful. Breathtakingly magical. And, at the heart of it all, inescapably human.

Paper dragon dances are quite a sight to behold.

For the coordinators and performers in the Lunar New Year parades, there is always much to plan and consider. Alongside building the paper dragons and practicing the steps of the planned dance procession, an additional important factor that those overseeing and performing in the parade must think about is the weather. Paper dragons, you see, do not dance well in the rain. This is why it is a very good thing that the New Year festivities do not fall within the monsoon season, when torrential rainfall is a continuous daily occurrence. Even in the dry season however, tropical weather being what it is, rain is a possibility that dancers must contend with and buttress their dragons against. Paper dragons dancing in the rain will, at best, end up slightly bedraggled or, at worst, be damaged beyond repair. And damaged paper dragons can pose a danger to the dancers who maneuver them as well as to the hapless onlookers, who may be injured should the dragons falter and veer off course. In the monsoon, the sheer weight of endless torrential downpour ensures that paper dragons, even those shrouded within the most water-repellent protections, cannot dance without being crushed.

Monsoon paper dragons do not exist. At least, not in parades.

In banking, a different experience unfolds.

Much like paper dragons, legal corporate entities such as banks operate as distinct agents that are propelled along a rich landscape colored by social, political, and economic actors and institutions. The movement of these banks, these paper dragons, is achieved through the maneuverings of the various and mostly invisible individual actors concealed within the dragons’ skin. Under the clear blue skies of a deregulated or unregulated environment and robust market conditions, the paper dragons – banks – dance unfettered. Observers are aware that individual dancers exist underneath the dragon’s body, but these dancers and their actions remain invisible and, for the most part, uninteresting. Largely, the dragons remain opaque and bystanders remain safe and focused on the movements of the dragons and the spectacle of the dance itself.
When the weather shifts and a cyclical deluge hits, whether it is sudden or anticipated, whether it is because of increased regulatory demands or market distress or both, the paper dragons struggle. Their scales may begin to tear under the weight of the storm, and the dancers, even if they still cannot be clearly seen, are suddenly in stronger focus. Spectators, whether they are social, political, or economic agents themselves, become more keenly aware of not only the dragons’ movements but also the movements of the human actors ensconced within the dragons’ paper skin. How has the parade been organized to proceed in the rain? What are the dancers doing? Will the dancers be able to maneuver their dragons through the downpour, or will they falter? Are they following the appropriate steps and patterns to safely navigate their dragons in these inclement conditions? What if the dancers miscalculate or slip? What if the organizers made a mistake in their planning? What if the dragons crash and cause damage? What if the rain does not stop? Can the spectators, at least some of them, act? Should they act? And if so, how should they act?

In the regulation-practice nexus of banking, regulatory seasons follow a largely pro-cyclical pattern in relation to an economic and financial crisis. The dance is unending. Even in the monsoon, the paper dragons must dance. The dancers must move. Even as the rain continues on. And the spectators hold bated breaths, watching the rain and the dancers and the dragons, waiting to see what happens next.

This dissertation addresses the overall research question of how transparency- and accountability-driven post-crisis financial regulations within the European Union (EU) have influenced risk control and compliance in banking. Within this frame of inquiry, the manuscript as a whole considers the rationale behind the structure of banking and how this, together with the theoretical and conceptual underpinnings of transparency, accountability, and risk in banking, impacts organizational and regulatory understandings of and approaches to risk control. Empirically, this work traces the development and impact of pre- and post-crisis financial markets and regulation at national and supra-national levels and follows the influence of specific post-crisis regulatory instruments on the risk control and compliance function within a large listed bank in Sweden that has a strong international European presence. Through this varied approach, the work undertaken captures a multi-level perspective of the influence of regulation on banking operations and practice. These perspectives are outlined within a conceptual framework of transparency and accountability in the regulation-practice nexus of the financial sector. Collectively, this work thus offers a longitudinal view of how regulations influence risk control and compliance in the European banking sector.
In addition to this introductory synthesis chapter, four papers comprise this manuscript. Each of the four papers focuses on a discrete yet connectively complementary aspect of the main question under exploration – namely:

**How have transparency and accountability driven post-crisis financial regulations within the EU influenced risk control and compliance in banking?**

To this end, the individual papers focus on specific and complementary investigations within the empirical setting of the European financial sector, the Swedish banking sector, and a representative case study of a large listed bank in Sweden. The connections and synergy between these four individual investigations are highlighted and explored within this introductory synthesis chapter.

The remainder of this chapter is structured as follows:

**Section 1 (Introduction)** presents a brief overview of the following: the research questions that each of the four individual papers address (1.1); a brief background and overview of the four individual papers that comprise the dissertation (1.2); and finally, a short overview of the empirical and theoretical foundations of this thesis (1.3).

**Section 2 (Empirical Background and Theoretical Perspectives)** provides a more detailed exploration of the theoretical and empirical positioning of the dissertation as a whole. It begins with an empirical background to this undertaking (2.1). This is followed by an examination of the theoretical threads of legal positivism, the institutional perspective, economic rationales for regulation, and the principal–agent considerations that still dominate the development and implementation of financial regulation (2.2). These theoretical perspectives are then discussed in the context of transparency and accountability as relevant to the risk and governance considerations that influence regulatory approaches and how banks manage and control their risks (2.3).

**Section 3 (Methodological Approach)** explains the research process and methodology used in this dissertation. First, the methodological positioning of each of the four individual papers is provided (3.1). Next, the data collection procedures are outlined (3.2). This is followed by a description of the analytical approach and controls used (3.3).

**Section 4 (Summary and Concluding Reflections)** provides a summary presentation of the contributions of the four individual papers (4.1) and a synthesized analysis of the theoretical and empirical contributions in the
context of the overall research inquiry together with a few general ideas for future research (4.2).

1.1 Research Questions

This thesis consists of five components: An initial introductory synthesis, in Swedish colloquially termed a *kappa* (‘cloak’), and four individual papers. The research questions within these individual pieces of the dissertation are presented in Table 1 below.

<table>
<thead>
<tr>
<th>Thesis Components</th>
<th>Authors / Publication Date</th>
<th>Research Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Introductory Synthesis (the <em>kappa</em>)</td>
<td>Kashyap, S. (2020)</td>
<td>RQ1: How have transparency- and accountability-driven post-crisis financial regulations within the European Union (EU) influenced risk control and compliance in banking?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>RQ2: How do prudential and accounting regulations account for these risks?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>RQ3: What are the potential tensions between the aims and approach of prudential regulation, on the one hand, and how banks approach, take, and account for risk on the other hand?</td>
</tr>
</tbody>
</table>
RQ2: How can the concepts of transparency and accountability be understood in the regulation-practice nexus of banking?

5. Transparency and Accountability Influences of Regulation on Risk Control: The Case of a Swedish Bank Kashyap S. & Iveroth E. (2019) RQ1: How has post-crisis financial regulation influenced the risk-control and compliance function within a large listed bank in Sweden?
RQ2: What are the transparency and accountability implications of this regulatory impact on the structures, agent roles, and processes of the bank’s risk-control and compliance function?

1.2 The Four Papers

Four papers collectively form this compilation thesis, together with the extended introductory synthesis in the present chapter. This section presents a brief background and overview of these individual papers within the dissertation. It identifies how and why these four inquiries were undertaken, as well as what they contribute to the research inquiries described in the preceding section.

Whilst it is tempting to envision the PhD journey as a clear linear road, with the individual components of the dissertation rising up in full and mature bloom at well-spaced and regular intervals, the reality is that this is rarely, if ever, the case. The PhD path is winding and often convoluted, scattered with confusing crossroads, switchbacks, and daunting obstacles that even the most intrepid researcher will inevitably have to face and overcome. The dissertation components customarily emerge at random and sometimes inconvenient intervals, sometimes in parallel, and almost invariably in various stages of misshapen infancy, growth, decline, or in some cases, rebirth. All in all, the PhD process is messy, confusing, and sometimes, unpredictably long.
True to reality, each of the papers in this dissertation developed in its own way through the data collection, analysis, internal review, conference presentations, and peer-review process it was subjected to. These papers are interdependent in the context of the overall thesis but were written as stand-alone pieces that often overlapped in terms of when and how they were developed and written. As such, the four papers represent distinct yet intertwined steps along the intellectual journey of this PhD process. Below, I begin by describing the rationale behind each paper, followed by a summary of its most important contributions in relation to the overarching research inquire of this thesis.

**Paper I** is a law article that emerged through my participation as an expert-panel member at the 5th Center for European Company Law (CECL) Conference, held in Uppsala Sweden on the topic of “Banks in Europe: Regaining Trust and Securing Continuity.” It was published in the journal *European Company Law* in 2015.

My participation in the CECL Conference and the resultant journal article helped me to clarify for myself what I saw as the important links between prudential regulation, on the one hand, and accounting and risk-management practices in banking on the other. Whilst Papers II and III were already well underway at the time I wrote and submitted this article, Paper I nevertheless afforded me an important checkpoint at which I assessed what I considered to be the important gaps in the regulation-practice nexus of banking. This in turn aided my reflections on how I wanted to shape the in-depth study upon which Paper IV was based.

The methodological rigor of Paper I lies both in the strong foundation of legislative acts and policies that it explains as well as more dynamically in the feedback and expert level discussions following its inception and presentation at the 5th CECL conference in 2014. It is structured as an analytical narrative that explores the basic structure of banking activities and financial regulation and identifies the relationships between the two in terms of risk control and, in an indirect manner, transparency and accountability. The narrative is based on a qualitative and longitudinal description of legislative texts, policy documents, and academic research articles that address historical, pre-crisis, and post-crisis regulatory developments in relation to risk control (and, indirectly, transparency and accountability). The discussions and research position I adopted in this article were shaped both by direct research activities in relation to the article itself as well as knowledge (now largely tacit) that I gained over the years preceding the PhD process.

For the dissertation, Paper I directly addresses the relationship between prudential regulation and supervision, on the one hand, and accounting rules and
practices on the other. In the context of how banks function as financial and risk intermediaries, this article provides three important foundational contributions through its structure and discussion. First, it presents the basics of banking structure and risk in banking activities. These in turn serve to identify the important role and function that capital and liquidity play in banking operations, as well as how banks function as risk intermediaries. Second, it traces how these theoretical considerations of risk and resilience have translated into post-crisis EU banking regulation, most notably through the CRD IV Package which encodes the Basel III framework into EU financial regulation. Finally, it identifies some important potential tensions between accounting rules and reporting, on the one hand, and prudential regulatory supervision on the other. Specifically, it identifies the differing foundations between prudential regulation and accounting rules and practices as they relate to the banking sector. In terms of transparency and accountability, the paper highlights a strong potential tension between the aims and outcomes of prudential supervision versus accounting rules and practice, namely through the lack of transparency and accountability that accounting practices and disclosures may present in terms of prudential aims and oversight.

In terms of a more detailed discussion of the relevant threads in Paper I, the article begins by recognizing that the dominant regulatory approach towards the banking sector remains exemplified by the “universal” banking model, whereby banks face few restrictions on their allowable activities and thus can combine both investment and commercial activities. Even so, the basic definition of banks as credit institutions carries forward the fundamental notion of banks as financial intermediaries and, more implicitly, risk intermediaries – organizations with business models that use funds borrowed from depositors to make investments or loans on the organization’s own behalf. This dichotomy of highly liquid and potentially short-term funding versus longer-term and potentially lower liquidity investments gives rise to the important consideration of bank capital (related to solvency) and liquidity (related to viability) for both banks as well as regulatory authorities.

In terms of the role that risk plays in bank structure and operations, banks must contend with two factors: quantifiable probabilistic risks, such as debt default and investment returns, and also less quantifiable risks and uncertainties, such as systemic risk. Such factors may be exemplified by the risk of widespread financial or political crises in the bank’s operating environment, or even organization-specific links between the financial and real sectors of the economy in ways that are not always apparent in accounting documents or real-time operational outcomes.

In considering how banks and their regulators have broadly addressed the topic of risk and risk management following the crisis, the article important-
ly notes that accounting disclosures may not always provide accurate depictions of a bank’s risk exposures. Specifically, bank balance sheets and income statements do not necessarily present an accurate reflection of the institution’s underlying risk exposure and how the organization approaches the management and control of its risk. The reason for this is that accounting disclosures are necessarily retrospective, while the effects of risk exposures may be more prospective, in that they are often unseen until later on in time. For instance, loan-loss provisions and write-offs are an expression of risk activities which surface in the income statement. Yet, given the retroactive nature of financial disclosures and the time-lag between when the bank takes a risk and when the bank feels the effects of that risk, by the time these factors are actually reflected in the bank’s financial statements, the effects of the bank’s risk-taking may actually have been ongoing for some time. This highlights the need for adequate capital and liquidity buffers in banks and explains recent regulatory developments through Basel III and the CRD IV Package that address these areas specifically.

Importantly highlighting the links between organizational accounting and the role of regulation, the article also recognizes that accounting standards and banking regulation, whilst comprising two distinct areas of practice, are nonetheless inextricably linked. In order to fulfill their responsibilities, banking regulators rely heavily on the provision or acquisition of information regarding the financial condition of the institutions they monitor. For this, they have a strong dependence on accounting disclosures. Particularly in the context of prudential regulation, accounting information is imperative in risk-assessment and management activities from the perspective of regulators and banks. In this context, the principle of fair valuation plays an important role not only in assessments concerning capital and liquidity but also in determining how the risk exposures and vulnerabilities of financial organizations are presented.

In terms of specific regulations, the article focuses on prudential regulatory developments introduced in Basel III/CRD IV and highlights the role and importance of capital and liquidity controls in banking operations. In addition to providing a background to the theory and history underlying the Basel Committee and its historical iterations of issued guidelines, the article further focuses on specific introductions in the CRD IV Package, and highlights both the micro- and macro-prudential introductions of the Package. Collectively, these contributions highlight the need for more in-depth and empirical case-based research that focuses on considerations of transparency, accountability, and risk in the regulation-practice nexus of banking.

**Paper II** is a literature review of 146 articles, published in 18 top-ranked accounting journals during an eleven-year time period from 2002 through
2012. This paper was actually the first one that I started to work on in the research project that launched me along my PhD journey. It emerged from an early identification that there was, in addition to a lack of integration between law and accounting in banking literature, a marked lack of insight into how financial accounting and management-control practices functioned in the banking sector. Paper II represented a collaborative effort between the five authors in our original research group to explore this gap within the field of accounting. Work on Paper II commenced in August 2012, with its final publication as part of an edited volume in 2017. What initially spurred our endeavor was our curiosity regarding how top accounting journals addressed this important topic, particularly in light of the financial crisis and strong resulting regulatory response. Thus, we selected the reputable ABS journal list in order to identify the scope of our review. We limited ourselves to the top 18 journals in the list.

The methodological procedure underlying this review is explored in detail within the article itself. Briefly, beginning in August 2012, our group of five authors began the process of journal selection and scope. As one consideration amongst others, the scope of 11 years that covered pre- and post-financial crisis periods was deemed appropriate because it offered enough of a time period to trace regulatory implementation (pre-crisis) and development (post-crisis). The list of journals selected comprised the top 18 ABA journals in 2012. Articles were selected for inclusion based on key words that related back to their connection to the banking sector. The selected articles (146 in number) were then classified according to broad themes, which were then refined into six overarching themes and seventeen sub-themes within these six areas.

At a more general level, what this work offers to the thesis as a whole is a strong basis upon which the research gap and subsequent conceptual and empirical methodologies were undertaken. This was the first collaborative endeavor undertaken within the research project. From a practical perspective, it allowed for an important first step into understanding extant and relevant banking-related research within the field of accounting, in the context of a selection of top accounting journals. Whilst this literature review naturally was not all encompassing in regard to banking-related accounting publications, it offered a stable and clear picture into quantitative and qualitative trends in banking research in accounting literature at the time. This in turn allowed us as researchers to better grasp what current understandings were, how (if at all) those understandings were being criticized, what issues were currently identified in regard of banking-related research and practice within at least one respected portion of the field of accounting, and what some potential research avenues could be for us to build on as we began our collective work.
Theoretically, the literature review relies on the Nilsson and Stockenstrand (2015) framework, which identifies that external regulatory demands encourage harmonization across organizational approaches and disclosures while internal demands and needs within organizations necessitate unique and organization-specific approaches. This model largely motivated thematic classifications and analysis of the paper. The literature review identifies extant accounting research trends in relation to the banking sector and pinpoints both substantive and methodological gaps in current approaches. Specifically, our research efforts through the literature review showcased that although distinct facets of inquiry such as in the areas of financial accounting, management control, transparency, accountability, and comparability were covered by different articles, there were no studies that addressed the interplay among these areas. In particular, we did not find any articles that addressed how regulatory developments impacted the internal processes of banks, or how accounting and regulation affected how banks are controlled and managed (p. 52). Of methodological interest in this regard was the dearth of in-depth case studies that applied a holistic perspective towards studying these research gaps – an identification that was of direct relevance in shaping the approach of the pilot study covered in Paper III as well as the in-depth case study addressed through Paper IV.

Given the marked regulatory developments following the financial crisis and the high demand on banks to respond to these legal advances, the literature review thus served to identify an important research gap that shaped the focus of the dissertation. Additionally, it also served as methodological encouragement to engage in a pilot study as well as an in-depth case study of organizational response to regulation in the banking sector – the method of inquiry employed respectively in Papers III and IV.

A presentation of the Nilsson and Stockenstrand (2015) model and a summary of the relevant threads of Paper II are outlined below:

The Nilsson and Stockenstrand (2015) framework supports an empirical categorization of studies using a top-down as well as a bottom-up perspective of banks from regulation, to governance, to financial reporting, and to internal aspects of banks, such as management and task control. This framework allowed for the analysis of two opposing ideas: demands for uniformity, on one hand, and demands for uniqueness, on the other. Many of the papers focus on the effects of external demands for uniformity, often in connection with accountability, transparency, and comparability. However, links to internal differences and internal mechanisms of accounting and transparency were scarce.
In terms of an overview of the current state of banking research in the selected accounting journals and the corresponding research-gap identification, the literature review generally finds that the role of accounting in banks and financial institutions has previously been studied through the employment of varied perspectives, methods, and research disciplines. However, across this diverse literature, there are few studies that provide detailed empirical accounts of organizations’ internal processes against the background of external changes and demands. Similarly, knowledge of daily practices within banks is still lacking. Whilst some more recent work outside the scope of Paper I does indeed address this gap (see e.g., Kaplan and Mikes 2016, Giovannoni et al. 2016), much remains unknown about the inner workings and responses of banks to external demands, particularly in the context of regulatory compliance – an identification that allowed for a better tailoring of the approach taken in Paper IV.

In terms of the regulation-practice nexus in the banking sector, the literature review highlights some important points. The articles covered focused on a variety of areas related to financial and accounting regulation, accountability, and transparency. In this regard, the substantial links between regulation and the internal risk-control practices of banks were in strong and consistent focus. The link between external and internal control – that is, control exerted on the firm’s internal processes and actions due to external demands – is most apparent in the context of organizational change; more specifically, how control structures, be they related to management control, governance, or disclosures, respond to shifts in external demands.

In the context of management control and organizational change, the literature review underscores the importance of culture, organizational knowledge, and the importance of both structures and roles within the organization. Two important papers along this vein were Soin et al. (2002) and Helliar et al. (2002), both of which highlighted the importance of both institutional factors and technology in influencing organizational adaptation and response to external demands. From an institutional perspective, Soin et al. (2002) examined the implementation of an activity-based cost (ABC) system in a clearing department of a UK-based multinational bank. ABC introduced accounting into the management culture, and the lack of knowledge about the technical capabilities among accountants was significant in the case. In the early stages of the implementation, banks had a preference for older management technologies. When the change did take place, it was considered revolutionary, but there was a reluctance to employ the full strategic potential of the new approach. Helliar et al. (2002) also addressed the gap in

1 Specifically, the important themes that arose in the context of financial and accounting regulation were related to the standard-setting process, financial reporting and disclosures, and governance effects of regulation.
the use and outcomes of activity-based techniques through a longitudinal study of changes to profitability reporting in relation to cost allocation processes in a UK bank. Four external factors and two internal factors contributed to the shift in emphasis from ‘financial accounting and reporting’ in 1989 to ‘management accounting and management control’ in 1996. The four external influencing factors are particularly noteworthy: Change in banking technology, regulatory change, increasingly competitive global markets, and difficulty in attracting customers. Culture was again heavily implicated in the ultimate outcome of the implemented changes, with the success of activity-based techniques dependent on a number of factors such as education, communication and implementer support, and post-implementation use of the applications.

Manager experiences and individual views are heavily implicated in changes such as those listed above (Norris, 2002). What emerges as an important consideration is that management accounting change may result from either extra-organizational developments or the micro-processes that reproduce non-institutionalized routines. This highlights how change in management accounting can come from both outside and within the organization.

Regarding regulatory developments specifically, the literature review highlights the strongly interconnected nature of banking regulation and accounting standards. To illustrate, research by Kaplan (2011) finds a strong interconnection between the mechanisms of banking regulation and accounting regulation. This supports the work undertaken in Paper I. It highlights a need for balance between prudential regulation and accounting rules, and also identifies that mismatches between the two may result in unintended consequences. Work by Barth and Landsman (2010) further highlights the objectives-based distinction between reporting based on accounting standards versus prudential banking regulation. Whilst prudential regulation is concerned with macro- and micro-prudential issues that relate to systemic stability and contagion avoidance, accounting standards are more directly focused on investor needs and capital-market considerations. Nonetheless, at least in the name of efficiency, it is useful for accounting standards and bank regulation to find some common ground and work together to resolve their concerns.

Regarding links between accounting and banking crises, another article in the review, Kothari and Lester (2012), links the crisis at least partly to management incentives and poor risk management through accounting rules within banks. The link between accounting and banking crises is also explored in the context of the Japanese banking crisis by Sawabe (2002), who shows that accounting principles embedded in regulatory change can contribute to crisis when the regulation lacks consolidation and adequate regulatory oversight. In their case study of a Turkish bank, Omurgonulsen and
Omurgonulsen (2009) raise an interesting point on the ‘creative’ and arguably unethical accounting practices that have precipitated accounting scandals that also impact and, in their case, implicate the banking sector. They note that transparency, auditor independence, and corporate governance at the firm/bank level all have an impact on the reliability of accounting representations and signaling accuracy in times of financial crisis. However, what they term to be “widespread myopia” at the individual (and perhaps firm) level often prevents observers from accurately appraising events.

The review identifies that a scantily explored area in extant literature concerns how regulatory changes impact private firm decision-making and organizational change. In an experimental setting using a sample of privately held banks, Hodder et al. (2003) find that when regulation allows for changes in organizational form, tax and accounting considerations strongly impact the firm’s strategy regarding the use of this option. In choosing to change their form, banks consider benefits and costs, which in turn may be impacted by jurisdictional contexts. For example, in a US context, these gains may be impacted by state (local) tax regimes that counteract federal benefits.

Tying these developments to firm-level and intra-firm responses, the literature review identifies some strong links to governance and risk-control approaches of banks. One article that addresses these issues is Magnan and Markarian (2011), who hold that accounting impacts governance processes in both banks and financial markets. The governance failures that came to light in the crisis originated from bad loans issued by banks. The issue was exacerbated by internal oversight failures by boards and non-aligned compensation schemes, and external oversight failures by rating agencies and regulators and through accounting shortcomings. Two interesting points are that inadequate regulation may have spurred higher levels of risk-taking by banks, and that a lack of alignment between manager incentives and overall firm risk management may have led to principal–agent issues and governance weakness. Post-crisis regulatory developments have sought to address these issues, and they form an important part of this thesis work. In the context of risk management in the Swedish banking sector, Wahlström (2009) engages in a qualitative analysis of the four main banks in Sweden. He identifies that risk-management regulations such as Basel II might be well established in practice, especially in larger banks with centralized structures. As Basel II promotes a more centralized system of management, opposition to its implementation is more likely in decentralized systems where employees face a post-implementation loss of decision-making power and autonomy. This suggests a certain degree of reluctance to adapt to new forms of regulation when there is a control-structure change involved.

Collectively, the literature review provided a necessary research foundation for the dissertation. It extended the writings of Paper I into a more granular
exploration of the links between prudential regulation and accounting rules, as tied to risk control. Additionally, using a framework that allowed for the exploration of multiple relationships and perspectives, the literature review highlighted the lack of coherence in understandings of transparency and accountability within extant research. In addition to the threads identified above, this paper highlighted the more general need for deeper qualitative inquiry into the inner workings of banks, thus setting the stage for Paper III and perhaps more importantly, Paper IV.

**Paper III** is a book chapter that was published in the same edited volume as the literature review. Work on this paper began in 2013, with a focus towards building an understanding of an accountability and transparency framework as applicable in the regulation-practice nexus of banking. To this end, during the drafting process, I relied primarily on an analysis of literature and policy materials in order to trace both conceptual developments and the evolution of regulation and market activities. Based on the discovery that there was a current dearth of qualitative case-based research into this area, I undertook a pilot study (2013-2014) that explored regulator and bank perspectives towards transparency, accountability, and risk through five exploratory interviews with representatives from three Swedish banks and two Swedish industry associations (namely, the Swedish Bankers Association and the Swedish Securities Market Dealers Association). This pilot study also comprised a part of the empirical foundation for Paper IV.

Paper III serves as the first explicit elucidation of the overall theoretical framework used in this dissertation. It importantly recognizes both the agency and institutional considerations that influence the operationalization of accountability and transparency in banking sector interactions. Adopting a longitudinal view of EU financial sector developments, it traces regulatory instruments and financial market changes to identify how transparency and accountability considerations and impacts have emerged in the regulation-practice interface of banking both before and after the 2008 financial crisis. It further presents a framework for theoretical operationalization of transparency and accountability at the inter- and intra-organizational level – a framework that is then operationalized in Paper IV.

The process of building up the conceptual framework was highly interdisciplinary in nature, with a strong reliance on insights from streams of literature within public policy and governance. At the same time, the article also provided another historically longitudinal and legally relevant piece in the empirical puzzle of financial regulation and its development in the EU. In this paper, a more specific focus on transparency and accountability developments in financial regulation was honed within the broader pattern of regulatory developments from the 1980’s until 2016. Namely, a marked shift was
identified from pre-crisis regulatory focus on market efficiency and competition concerns to post-crisis prudential concerns, with a corresponding increase in general focus on transparency and accountability. As the paper identified, however, understanding what was meant by transparency and accountability was not a clear-cut issue, and in fact, higher levels of both concepts did not necessarily translate into uniformly positive impacts on all stakeholders.

In more specific terms, from a theoretical perspective, Paper III outlines how transparency and accountability are conceptually understood in organizational and inter-organizational contexts, and it provides a framework for how these concepts may emerge in both regulation and banking practice. Second, it provides an account of the historical development of banking regulation in the EU and in particular focuses on the first and second iterations of the Markets in Financial Instruments Directive as a case example to trace how regulations account for considerations of transparency and accountability.

The theoretical framework of transparency and accountability outlined in Paper III is explored in further detail in Section 2.2.2 of this chapter. In the context of accounting research, transparency and accountability discussions form an important part of the link between regulation and accounting (Humphrey et al. 2009, Magnan and Markarian, 2011). This, together with policy documents that highlighted the importance of transparency and accountability in the post-crisis regulation practice nexus of banking (Liikanen 2012), formed the basis for beginning to build an understanding of these concepts. Ultimately, in addition to accounting research (Roberts 2009), it was research from political science and governance (Hood 2006; Heald 2006; Meijer 2013) that proved to be most illuminating in building understandings of these concepts.

Using literature from accounting and governance streams of literature, Paper III recognizes the concept of accountability as a relational and reflexive connection between those who demand accounts and those who provide those accounts. It defines accountability as “a relational construct between a provider of information (the entity that gives an account) to a recipient of that information (the entity to which the account is provided)” that is in some sense “a formal and unavoidable duty” (p. 109). Under this umbrella, transparency is presented as a means by which accountability may be achieved, and a tool that offers some degree of variance or flexibility in how an obligation of accountability is met (ibid). In this sense, the paper highlights that transparency is both a relational and informational concept, and entails “the provision of an account that offers into some underlying phenomenon or process” (ibid).
Importantly, Paper III utilizes a transparency framework based on governance literature (Heald 2006, Meijer 2013). This framework identifies two axes across which transparency may operate, namely: vertical transparency and horizontal transparency. Additionally, it identifies three sets of dichotomies under which transparency may be classified: Transparency may measure events or processes, in real time or retrospectively, and may either be effective or nominal.

From a theoretical perspective, Paper III sets up the conceptual framework of transparency and accountability that forms the approach for the in-depth case study upon which Paper IV is based. In this regard, institutional and agency considerations are implicitly and importantly recognized. As such, both serve to form the theoretical basis of the case-study design.

In relation to regulation, Paper III importantly highlights that research and empirical experience both indicate the rather unexplored and delicate nature of transparency as a tool of accountability, particularly as harnessed within the regulatory toolkit. The understanding that emerges highlights that regulatory implementation and impact are subject to concurrent technical, political, and cultural dimensions. Resultant new practices are absorbed and eventually institutionalized into ongoing interactions within and amongst organizations (Lounsbury 2008, Fiss 2008). In regard of transparency and accountability, the paper identifies how the focus on both concepts has increased in post-crisis EU financial regulation. At the same time, it opens the question of whether the envisioned regulatory goals are being effectively and beneficially achieved.

Paper IV focuses on an in-depth case study of Banque de Montagne, a pseudonym used here for a large listed bank in Sweden, which has a strong international market presence. The case study covers a period of one year and 8 months, from October 2015 through June 2017. It investigates the impact of regulatory developments on organizational response in the context of risk-based compliance and control. It incorporates and builds on the theoretical framework of accountability relationships and transparency conditions. This framework, first presented in Paper III, attempts to capture theory in action within the case bank.

The case study follows the structural and process-based changes in the organization following the implementation of a specific post-crisis regulatory instrument, GL44, which was translated into Regulation FFFS 2014:1 in the Swedish setting. This regulation required the structural and substantive separation of operational risk and compliance functions across the Three Lines of Defense (3LoD) model within the bank. Annual reports covering a time period of 25 years, from 1992 through 2017 were used as background research.
to formulate the data collection strategy as well as during the initial analysis phase of the case study. Internal documents, reports, observations, and interviews conducted within the compliance organization of the case bank between 2015 and 2017 were used to track the organizational effect of regulation on the compliance and risk-control structures and processes.

The research identifies the relevant changes to transparency and accountability mechanisms across the three lines of defense within the organization. The operationalization of these concepts through risk-control mechanisms is an important consideration for both banks and regulators who rely on the three-lines-of-defense model as an industry-wide adoption for effective risk control. The background of this paper is based on two sets of conceptual developments that link banking regulation with practice:

1. The understanding of the dynamic relational concepts of accountability and transparency as they emerge in intra- and inter-organizational interactions within the financial sector. Accountability and transparency considerations have direct implications on risk control within banks and also between banks and regulators. For banks, these concepts play into the design and function of effective and (regulatory) compliant systems and processes of risk-control activity. For regulators, these implications are in turn directly tied to the aims of prudential regulation. How FFSS 2014:1 has impacted accountability and transparency within the risk-control process thus has important implications for banks seeking to efficiently control their risks and for regulators seeking the furtherance of prudential regulatory aims. The concepts of transparency and accountability are understood the same way as they are in Paper III.

2. The introduction and assimilation of the 3LoD model of organizational control that has largely set the current industry and regulatory standard within the banking sector. How transparency and accountability considerations are operationalized and effectuated within the 3LoD model again has important implications for both banks and regulators as outlined in the paper. In the corporate governance context of the 3LoD, the concepts of accountability and transparency are reflected through the activities and systems of reporting, decision-making, and roles or responsibilities of specific actors and functions within the organization (Davies and Hopt 2013; Arwinge and Olve 2017). Who is responsible for what, how these responsibilities are fulfilled, and how effectively the fulfillment processes and outcomes are communicated vertically (and where appropriate, horizontally) within the organization form the basis of transparency and accountability channels within the organization as well as between the organization and external parties, including regulators. Uniformity in in-
tra-organizational understandings and communication form the basis of effective control across all dimensions of corporate activity, including in the context of risk control. Here, it is perhaps useful to note that risk-control activities and the effective communication of these activities, processes, and outcomes depend in large part not only on individual understandings and actions, but also on a harmonized organizational understanding and communication of different risks and uncertainties as they relate to the organization through its contemplated and realized choices and actions.

What emerges in the findings was that both technology and the experience held by actors played an important role in building understandings and approaches towards risk recognition and control within the compliance organization. These risk understandings themselves, as reflected across dimensions of transparency and accountability, were visible across organizational structures, processes, and roles.

The findings indicate an increased proliferation of accountability structures and processes at both vertical and horizontal levels within the organization and between the compliance organization and regulators. The transparency impact was more difficult to assess. Whilst process and event transparency increased in form at intra- and inter-organizational levels of interaction, these were accompanied by identified elements of nominal as well as effective transparency. In particular, the role of technological systems in achieving transparency was highlighted, with the recognition that technological systems are accompanied by the increased risk of nominal transparency – that is, ineffective information overload that could be the result of either an overly sensitive system design or input errors by system users.

At the intra-organizational level, the findings indicated that effective transparency decreased due to inefficient translations between actors and systems, thus leading to a potential increase in risk exposures, while accountability channels at vertical and horizontal levels increased across the dimensions of structures, processes, and actors.

At the inter-organizational level between the bank and regulators, process transparency increased, with increased direct interactions between the independent compliance organization and the regulators. However, event transparency remained sub-optimal according to internal respondents. The reason for this could be traced to the still-ongoing development of information and risk-control channels within the compliance organization as well as an ongoing effort to cement the role and scope of the compliance function as a whole. In the absence of concrete stability in both these regards, it was felt that the transparency of accounts provided to regulators was still lacking.
Between the bank and regulators, outward and inward accountability mechanisms both increased, in the wake of FFFS 2014:1. Interestingly, regulatory accountability to the bank also increased, largely through the regulatory clarifications (transparency) offered through such interactions, or at least a mutual sharing of areas and points of continued challenge for the bank. At the same time, the liability of the bank (the risk of incurring formal sanctions for failing to meet regulatory demand) did not decrease.

Theoretically, in addition to extending understandings of the intra-organizational regulation-influenced dynamics of transparency and accountability in risk control and compliance, the study also highlighted broader areas of conceptual tension that arose within the governance and control structures in response to regulatory demands and regulatory implementation. Namely, an implicit tension could be identified between strategic aims of the organization and the inherent shareholder primacy upon which extant governance and control systems were built. Within the compliance function particularly, the profit-centric shareholder-primacy model of operations was far from apparent. Instead, regulatory interests (representative arguably of broader societal interests) were in heightened focus, even at the expense of profits in at least the short run.

1.3 Empirics and Theory: A Brief Overview

The intersection between regulation and practice in the banking sector – the “regulation-practice nexus” of banking as it is referred to in this dissertation – rests on a multidisciplinary conglomeration of theories and professional foundations, not the least of which are the fields of economics, law, and accounting. Whilst this multifaceted foundation has previously been explored in varied research endeavors (see e.g. White 1994; Eisenberg and Noe 2001; Summer 2003; Jesus and Gabriel 2006; Barth et al. 2008; Ashby 2011), the need for more research integration between these different perspectives remains urgent (Goodhart 2006; Reinhart and Rogoff 2009; Rajan 2010; Heremans and Bosquet 2011) as well as in policymaking, practice, and regulatory circles (see e.g. Liikangen 2012; Gulija 2019). An integrated perspective of the empirics and theory relevant to the inquiry of this work is briefly outlined below.

1.3.1 Empirical Selections

The primary empirical setting of this study is the European banking sector, with a focus on emergent post-crisis regulations and the response of the large financial institutions tasked with meeting heightened post-crisis regulatory compliance requirements. This focus is explored through a multi-level in-
quency that considers the aims and links between prudential regulation and how banks account for risks (Paper I), the extant knowledge and gaps regarding the banking sector in the field of accounting (Paper II), the development of how transparency and accountability may be understood as they surface in risk-focused financial regulation and financial market activities (Paper III), and finally, how post-crisis financial regulation impacts the structures, processes, and actor-based function of risk control within the organizational setting of a Swedish listed bank with an international European presence (Paper IV).

Since the creation of the European Union, financial regulations in Europe have been introduced systematically and with greater centralization in the context of a large, increasingly integrated, supra-national economy. The binding regulatory instruments that have emerged in consequence follow a democratic rulemaking process, and closely adhere to the principles espoused by the primary international banking sector’s standard setting body – the Basel Committee of Banking Supervision (BCBS). What the EU has adopted in terms of post-crisis financial regulatory measures is being translated in an increasingly harmonized form across EU Member States, including Sweden. Post-crisis EU financial regulation also shares, at least in principle, many similarities with concurrent reform measures that are ongoing in non-EU jurisdictions, such as the Dodd-Frank Act in the United States. In a very practical sense, the EU thus represents a microcosm of integration within the broader harmonization and interlinkages of the international financial sector. Additionally, and in a very practical sense, given the interconnections between financial sectors across different jurisdictions, EU regulatory developments are of undeniable relevance and impact for any non-EU bank that conducts business with EU entities or holds a presence within EU jurisdictions. Hence, the empirical focus of this work on Sweden and the EU is of potential relevance to financial sector researchers, regulators, policymakers, and practitioners across both European and non-European jurisdictional settings.

The work undertaken in this dissertation focuses on primarily EU financial sector developments, regulation and practice in the Swedish banking sector, and an in-depth exploration of regulatory influences on organizational compliance responses within a large and internationalized listed bank in Sweden. Empirically, the representative case selection of Sweden was motivated by two factors: First, Sweden has historically adopted EU financial sector regulations, directives and guidelines without high degrees of deviation (Taylor and Fleming 2000; Hellman 2011). Second, where Sweden has deviated from EU financial regulations (for example, in the context of capital and liquidity controls), Swedish regulatory requirements may actually be stricter than their EU-level equivalents (Swedish Financial Supervisory Authority
2019). Thus, findings in the Swedish context lend themselves well to establishing the effectiveness of EU regulations as floor-level approaches and constitute a representative example of the influence of EU regulation on national responses in regulation and practice.

The selection of a listed bank in Sweden for the in-depth case study (Paper IV) was likewise motivated by the relatively similar empirical considerations of organizational structure and regulatory response that apply to all listed entities within the Swedish banking sector. Swedish listed banks in turn share several commonalities with similarly large, complex, and internationalized financial organizations within the increasingly harmonized regulatory setting of the EU financial sector. Findings from the in-depth case study conducted within a listed bank in Sweden thus lend themselves well to generalizable understandings that may apply to other financial organizations of similar size and complexity within Sweden and the EU.

1.3.2 Theoretical Foundations

One lesson for academia from the 2008 financial crisis was that there remains a very real and important need for more interdisciplinary research in areas of practice that are of societal importance, no matter how specialized or complex those areas may seem (Rajan 2011). This is particularly relevant in the context of risk control and compliance in banking. Understandings of and interactions between risk control and compliance are built on the relationship between risk management in banking practice and the core function of banks as risk intermediaries in the broader economy. This context forms an integral and intricate part of the regulation-practice nexus in banking, and is of relevance to research, policy, and practice in multiple areas of expertise that span not only the social sciences, but also legal studies. In order to better understand these nuances, this synthesis chapter thus harnesses and combines theoretical perspectives from law as well as the social sciences.

In the context of this dissertation, the ‘social science’ component includes three distinct theoretical areas: First, understandings of institutionalism, rooted in sociology and widely used in management and organization studies; second, principal–agent considerations that continue to dominate corporate governance and aspects of management control such as remuneration structures within organizations; and third, the economic and political rationales that underlie financial regulation. From legal theory, the perspective of legal positivism contributes a further lens through which a more holistic understanding of the regulation-practice nexus of banking may be augmented.
As is further motivated in Section 2 of this introductory chapter, principal–agent theory plays a strong role in both the formulation of banking regulation and the practical structures of banking operations. However, in order to understand the links between regulation and practice as they arise in organizational and field-level developments over time, the lenses of institutional theory, economic and political theories of regulation, and the “legal theory” perspective of legal positivism provide three important complementary perspectives through which the impact and efficacy and reflexive influence of both banking regulation and banking practice may be understood. In the context of the latter two papers in this dissertation especially, these theories together with contributions from political science and governance allow for a more holistic exploration of the concepts of transparency and accountability as they surface in regulatory and market developments and regulatory influence on intra-organizational mechanisms.

The integration of social science and legal perspectives benefits the research inquiry by allowing for a more holistic exploration of how regulation and risk control are linked in banking structures and practice. In this regard, it is important to note that the practical links between regulation and practice in the banking sector are of particular importance given the integral role of banks not only as financial intermediaries that facilitate real sector economic growth, but also their role as risk intermediaries in both the real and financial sectors of the economy. Stable banking systems are an important component of well-functioning financial systems, with banking inefficiencies and breakdowns often translating into negative impacts on the real sector of the economy. The resultant disruption of economic growth and potential precipitation of banking and financial crises have far-reaching implications (Barth et. al, 2001; Admati and Hellwig 2013). These linkages are oftentimes theoretically complex with correspondingly intricate empirical implications. Thus, the importance of a holistic understanding of such links and interactions cannot be overstated.
2. Empirical Background and Theoretical Underpinnings

Section 2 of this chapter provides a more detailed explanation of the empirical and theoretical positioning of the dissertation as a whole. It begins with an empirical background to this undertaking (2.1). This background outlines the links between banks, society, and the real economic sector, the role of regulation and supervision in the financial sector, and how these linkages and regulation are intertwined in the context of crises and pro-cyclical regulation.

After this, an overview is presented of the theoretical threads of legal positivism, the institutional perspective, economic rationales for regulation, and the principal–agent considerations that underlie the regulation-practice nexus of banking (2.2). These theoretical perspectives are then discussed in the context of transparency and accountability as relevant to the risk and governance considerations that influence regulatory approaches and how banks manage and control their risks (2.3).

2.1 Empirical Background

This section provides an overview of the empirical setting within which the dissertation work was undertaken. It begins with a brief explanation of the links between the financial and real sectors of the economy, and the role of banks in society.² Next, it provides an overview of the links between crises,

² The traditional distinction between the financial sector and the real sector of the economy lies in the difference between the financial market, on the one hand, and the more industrial market of goods and services, on the other. From an economic perspective, the former is more related to capital markets, debt and other asset-based contractual instruments, currency exchange rates, and interest rates whilst the latter concerns traditional industries of production and macroeconomic growth indicators, including industry growth, profit, and production, and consumption considerations and impacts. The financial and real sectors of the economy are inexorably linked in the context of growth as well as crisis, as is well recognized by historical as well as current research (Boyd and Smith 1996; Bezemer and Hudson 2016; Borio et al. 2016). Given the important risk and financial intermediation function that the financial sector has typically provided in the real economy (Boyd and Smith 1996) and given the high level of interdependence as well as influence that financial sector developments and impacts have on the real sector of the economy, the boundary between these sectors can arguably be under-
regulation, and banking practice in the financial sector. Here, the broader macroeconomic links are brought into focus for the important reason that these links, while highly relevant to the creation of external shocks as well as direct banking activities and risk exposures, are integral to understandings of risk creation and control in banking but are largely excluded from the explicit discussions of the individual papers. After this, the role of regulation and supervision in the financial sector is outlined, and the unique risk-control structure of banks is explained in light of different stakeholder interests and influences.

This section collectively highlights the important market dynamics between the financial sector and the real sector of the economy as well as their links to the role of regulatory supervision in risk monitoring within the banking sector. As a whole, the economic and risk monitoring considerations are important in the context of understanding the relation between the individual papers of this dissertation. As these links are only implicitly discussed in the papers themselves, I take the opportunity to focus more on them in this chapter, as follows.

2.1.1 Banks, the real economy, and society

Banks, which comprise important actors in the financial sector of the economy, serve the important and arguably indispensable roles of risk and financial intermediation in real economy (Boyd and Smith 1996; Davis 2010; Borio et al. 2016; Ray and Das 2017). Moreover, the institution of banking is in some sense ingrained into societal fabric and has existed in some form for centuries (Capie 1995; Ugolini 2017). That there are linkages of great magnitude between the financial and real sectors of the economy as well as the financial sector and societal well-being cannot be denied (Rajan 2011; Diamond et al. 2017). Similarly, the historically important role of banks in society continues on today (Admati and Hellwig 2013; Rajan 2019).

In terms of banking structure, the commercial component of banking, which remains an important part of universal banking activities in general, is set apart from organizations in the real economy through the rather unusual maturity mismatch between bank assets (usually long term loans) and liabilities (deposits that are, at least theoretically, callable at will). Through their deposit taking and lending activities, banks function as risk intermediaries and capital providers in the real sector of the economy. Although this rendered as highly permeable – particularly in the context of regulation and supervision as investigated and illustrated in this dissertation.

Through their payment processing and clearing activities, banks also function as largely indispensable nodes in payment networks, although one may question how indispensable this role truly is. A debate on this issue has been taken up in both policy and practice circles, and
ders their role important, it also leaves banks arguably more vulnerable to market-confidence fluctuations, liquidity shocks, and reserve-capital considerations than firms in other industries. Given the importance of their economic function, bank failure often has repercussions and implications that reach much further than the failure of other types of firms.

In line with the above, there is a rich body of economic research on the channels through which financial sector and real sector developments are linked both positively and negatively. For example, Greenwood and Jovanovic 1990, who adopt positive views towards how financial sector developments promote efficient risk-sharing in the real sector; Aghion et al. 2005, on the positive impacts of financial sector evolutions on reduce agency costs and increase innovation across the economy as a whole; and Greenwood et al. 2010, who identify links between financial sector development and efficient resource allocation in the real sector. At the same time, parallel research also highlights that banking crises are uniquely capable of disrupting credit channels and exacerbating economic contractions (Mitchener 2005). Thus, increased levels of systemic risk introduced through financial sector activities may have significant negative impacts on the real sector as well (Allen and Carletti 2006; Gennaioli et al. 2012).

As with many practices and infrastructures that are institutionalized into societal life, these links, whether positive or negative, often go unnoticed during periods of stability and growth and are only highlighted in stark relief during breakdowns or periods of crisis (Eisenstadt 1964(a); Eisenstadt 1964(b); Star 1999). Certainly, the chronic pro-cyclicality of financial regulation in relation to economic boom and bust cycles – more markedly, the reactionary nature of financial regulatory developments in relation to economic crises – can at least partially be explained by such myopia (McDonnell 2013). Since the early 1900’s, multiple financial breakdowns and crises have underscored the links between the financial and real sectors as mentioned in the paragraphs above. These crises have also emphasized the important role of regulation in the financial sector, particularly the banking sector – a sphere of interaction that this work refers to as the “regulation-practice nexus” of banking (Paper III).

Financial crises of modern times, beginning with the Great Depression of the 1930’s, progressing with various national and international crises such as the Latin American Debt Crisis of the 1970’s, the U.S. Savings and Loans Crisis that lasted from the mid-1980’s well into the middle of the 1990’s, the Finnish and Swedish banking crises in the early 1990’s, the 1997 Asian Financial

is evidenced in recent EU regulatory developments such as the revised Payment Services Directive (PSD2).
Crisis, and leading up to the continuing aftermath of the most recent 2008 Global Financial Crisis, have invariably drawn attention to both the shortcomings of and continued reliance on the banking system by the real sector of the economy and society at large. With the most recent 2008 financial crisis, what governments, regulators, and banks themselves were forced to recognize were the international interlinkages and dependencies between financial sectors and actors in an increasingly integrated global financial marketplace. This often-opaque interconnectivity was boosted by technological advances in both product and service capacities since the 1970’s (Scarborough and Lannon 1988; Pennings and Harianto 1992; Banner 1997; Humphrey and Pulley 1997). It was also exacerbated by the lack of appropriate accountability infrastructures and transparency mechanisms between regulators and banks and, to some extent, between banks and depositors/investors (Caprio 1998; Vishwanath and Kaufmann 2001; Liikkanen 2012).

In regard of the role that banks play in society, banks are hugely important as risk and financial intermediaries in both an economic and a social context. In research, the role of bank intermediation is well recognized and established (e.g. White 1998; Allen and Gale 2000; Allen and Santomero 2001; Demirguc-Kunt et al. 2011). What is also recognized within research is that as economies develop and grow, the relationship between the real and financial sector, particularly the relationship between banking and society, can change. White (1998) for example identifies that historically, even in the face of heightened competition and regulation, banks have traditionally retained their importance as financial intermediaries. Extending this, Demirguc-Kunt et al. (2001, 2011) importantly identify that as economies develop, both the banking sector and securities markets remain important for economic growth.

Interestingly and with direct relevance for banking policy, regulation, and supervision, Demirguc-Kunt et al. (2011) find that as economic growth occurs over time, traditional banking services become less directly important for future marginal increases in economic growth, while securities-market developments become more directly important for the same. Although the research does not identify this as an infinitely linear trend, it is nonetheless an important indication that financial regulation and supervision in a regulatory environment that allows for universal banking – that is, the allowance of a single organization to engage in both commercial and investment banking activities – must adequately and appropriately encompass both a market and a firm-level focus in addressing not only commercial banking considerations but also investment banking activities that are directly tied to capital and derivatives markets. In other words, how banks conduct their business is just as important as how the financial markets themselves function and change.
In addition to prudential regulation aimed at strengthening systemic stability, banking regulation and supervision are also important in mitigating moral hazard and asymmetric information problems within the financial sector (Mitchener 2005). For financial regulators and supervisors, market entry, market conduct, and market exit considerations for the banking sector are therefore just as important as deposit insurance, capital and liquidity considerations, and allowable investment activities (for example, proprietary trading) in different financial markets. Here, the importance of designing an adequate regulatory framework cannot be stressed enough, given that if there are shortcomings in the applicable conduct and monitoring mechanisms, even strong compliance by entities within the financial sector may not be enough to stave off negative risk realizations and their resulting repercussions on an organizational as well as systemic level (Demirgüç-Kunt and Detragiache 2011).

One challenge in regard to the above is directly related to transparency and accountability—namely, the tradeoff between transparency in rules and accountability enforcement versus supervisory discretion that connotes a more opaque approach toward dealing with specific situations and organizations. Whilst the former approach can be argued to be more ‘fair,’ it is important to consider that where contagion risk is high and when industry or public panic may exacerbate liquidity distress, public interest and systemic stability may be better served by reaching resolutions ‘behind closed doors,’ so to speak. Through more opaque channels, regulators, impacted banks, and the banking industry as a whole may be better able to ensure the stability and continued vitality of the financial sector in a way that is not achievable through more transparent approaches. A good example of this is the 2007 bailout of Northern Rock in the United Kingdom – a situation that occurred in mid-September 2007, was publicly announced on the news shortly thereafter, and that then resulted in public panic and “the first run on a British bank since 1866” (BBC 2017). In terms of capital market impacts, Northern Rock shares dropped in value by more than 30% after the announcement. The bank itself was nationalized in 2008, and this new incarnation, with bad assets segregated into a separate (unsold) corporate entity, was purchased by

4 The approach taken by the UK government towards addressing the Northern Rock situation by separating the original organization into two, one which housed performing assets and the other which consolidated high-risk and non-performing illiquid assets is also known as the ‘good bank-bad bank’ approach. Conceptually, this split of organizational holdings into two independent new entities allows the ‘good bank’ to deleverage its balance sheet and prevent contamination of strategic and performing assets by the risky assets housed in the ‘bad bank.’ Conversely, the ‘bad bank’ focuses on salvaging what is possible from the high-risk ‘bad’ products that it holds. In terms of counterparty and market confidence, this split also helps build external certainty about the solvency, viability, and performance capacity of the ‘good bank.’ In practice, the approach is a complex affair, which must consider government support, the state-of-play within the financial sector as a whole, and also how the decision will impact
Virgin Money as publicly announced on January 1, 2012 (UKFI 2012). After an unsuccessful lawsuit and appeal, shareholders of the original firm are still fighting to recover any portion of the loss they incurred. Nonetheless, as the Higher Court and Court of Appeals judgments held, a higher interest in the public good was maintained by the decision to repay taxpayers via proxy of the government rather than individual shareholders who were, in essence, diversified owners of the failed bank (Gray 2009).

In parallel with the above, the link between banks and society at large is relevantly captured by three recognitions:

First and foremost, ordinary laypeople within society often either do not understand or else remain unconcerned with the risks that occur in banking and the financial sector, unless those risks are realized, and they are directly impacted (Söderberg and Wester 2012).

Secondly and equally importantly, even after a given set of risk has been realized and disaster or crisis strikes, non-expert members of society may lack the adequate information or understanding required to appropriately respond to such distress (ibid). In the financial sector, such risks exist with regard to situations of liquidity distress that banks may face, where at least historically, customer panic has resulted in bank runs that push the affected institutions into non-viable situations. Paper I generally provides a more detailed theoretical explanation of how capital and liquidity are linked to bank solvency and liability, and numerous articles identify the role of customer panic in the bank runs that occurred and in some ways exacerbated the impact of prior crises, most notably the Great Depression in the 1930’s (e.g. Jacklin and Bhattacharya 1988; Chen and Hasan 2006; Iyer and Puri 2012).

Finally, the important role that public and investor trust plays in maintaining stability at the organizational and market levels in the financial sector, particularly during times of regulatory intervention or market distress cannot be discounted (Schinasi 2004, Gray 2009, Han and Melecky 2013). Söderberg and Wester (2012) highlight this at the individual level, pointing out that whilst individual behavior traced in a sample of 1,017 laypeople in the wake of the 2007 crisis depended on individual circumstance and expectations

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5 There are several news articles that cover these developments as well as the continuing shareholder bid for a recovery on their ownership interests. Hodgson (2017) and Fantano (2017) respectively provide succinct news coverage on these aspects. Additionally, a good legal overview and examination of the High Court and Court of Appeal judgments is Gray (2009).
regarding transparency (those who acted rashly in their financial decision-making in the aftermath of the crisis seemed to be more impoverished and thus have less capital to lose, were less educated, and believed that it was important to keep updated on financial issues), trust in the political and economic institutions as well as the financial sector organizations themselves could also have an important bearing on how individuals behave during and after financial crises. Notably, the researchers find that “belonging to an ethnic group with an assumed high level of trust in Nordic official institutions and their ability to handle a crisis of large proportions, could also indicate a lower risk perception and, therefore, a lower likeliness of act when faced with a financial crisis” (p. 798).

Sheehan (2003) similarly addresses the issue of trust as vested by individuals in institutions and organizations of banking and money (currency). Using the empirical context of China, Sheehan defines a financial crisis as “a suspension of impersonal trust” (p. 5) – an occurrence marked by rising levels of distrust exhibited by laypeople or society towards not only banks themselves, but also regulators and currency itself. What Sheehan identifies as an important facet of the socio-economic-political landscape of banking is that when societal confidence and trust are low, often the political and economic components and actors must work together to bolster the legitimacy and trustworthiness of the financial sector in the eyes of the public.

In considering the public reaction to the 2007 financial crisis, similar to the Great Depression of the 1930’s, the 2007 crisis resulted in its own form of risk-triggered customer panic and loss of trust. Notably the impact of the 2007 financial crisis was characterized by the liquidity distress of numerous banks such as IndyMac Bank in the United States and Northern Rock in the United Kingdom, amongst others. For most of these banks, the modern-day equivalent of a bank run was affected by institutional investors and investment counterparties. The result was an immediate and direct liquidity freeze for the affected banks, with serious concurrent repercussions in the form of market contagion effects (Shin 2009; Iyer and Puri 2012). Focusing on the EU more specifically, the regulatory response following the crisis focused heavily on addressing the liquidity distress in the European financial sector, with significant government and central bank involvement at national levels (Liikanen 2012). Importantly and in line with Sheeran (2003), the regulatory

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6 This tension between trust and regulatory control, particularly in the context of transparency and accountability, is also reflected in Paper II (p. 35-36, citing Humphrey et al. (2009) and Malsch and Gendron (2009), amongst others). In that extensive literature review, one particular example of what emerged was the question of how or even whether it was possible for trust to truly and adequately be established through disclosure (transparency) and audit (accountability). Whilst that line of inquiry is not directly pursued within this dissertation, I strongly feel that it is a promising avenue for future exploration in the field.
(political) and industry (economic) focus in the years following the crisis has also included significant steps to build public trust and confidence in the financial sector generally and banks more specifically.

2.1.2 Banking regulation and supervision

For banking regulators and supervisors, the importance of the banking function as well as the peculiar vulnerability of the extant banking business model (Paper I; *supra* pp. 38-39) mean than the banking sector is the focus of both heavy regulation and supervision. Formal legislative and regulatory instruments together with supervisory structures and authorities collectively govern the financial sector in terms of capital markets as well as market actors markets.

The regulatory approach in the financial sector is driven by different and sometimes competing considerations. Banking regulation and supervision shoulders the unenviable responsibility of mitigating prudential, moral hazard, and information-asymmetry-instigated risks and misbehavior in the financial sector at the market level as well as at the level of market actors, while at the same time maintaining investor and public trust and confidence in the financial system. The vulnerabilities of the banking sector also make it important for regulators, in balancing competing and often varied stakeholder interests, to consider fluctuating needs and impacts of market confidence and informational transparency in order to ensure the efficient functioning of markets and the fulfillment of normatively desirable social outcomes. The need for regulation is thus important and also arguably often acute. Understanding this, the regulation of the financial sector and, more specifically, the banking sector, has unsurprisingly been high on the regulatory agenda since the turn of the last century at a minimum.

In functional terms, regulation may be understood as exercising market entry, conduct, and exit (resolution) controls on market actors as well as the financial products and services traded in financial markets. Regulatory focus is equally concerned with consumer protection through deposit insurance, maintaining fair and functioning markets that dissuade financial organizations from behaving in predatory or unscrupulous activities, and ensuring resilience at organizational as well as systemic levels through capital and liquidity controls. Thus, in terms of specific areas of regulatory focus, market access, market competition, investor/consumer protection, and micro- as well as macro-systemic soundness and stability are of high importance on the regulatory agenda. To a perhaps lesser (though now growing) extent, an increasing recognition of the perils of potential misalignments between actor incentives and normative regulatory aims has also led to strengthened focus on corporate governance controls within the financial sector (see e.g., BIS 2015).
When market failures occur, regulatory gaps and corresponding regulatory failures are highlighted, with regulatory reform then resulting. Markets then continue to evolve, and new failures may be created in areas either missed by previous regulatory reform or else in newly created markets outside the scope of extant regulation. In this manner, financial regulation\(^7\) and financial crises are inexorably linked in a reflexive cycle of development.

An illustration of the latitude of activities conducted by financial regulators and supervisors, collectively grouped as ‘regulatory agents,’ may be depicted as follows:

![Figure 1: The Latitude of Regulatory Agents in the Financial Sector](image)

\(\text{Source: Author}\)

2.1.3 The European Context: Pre- and Post-crisis Regulatory Developments

The integration of Europe’s fragmented financial markets into an efficient and competitive single market officially entered the European Union (EU) agenda in the early 1990’s, beginning with the 1993 Investment Services Directive (ISD). Since then, financial regulations in Europe have been introduced systematically and with greater supra-national centralization in the context of a single EU financial market. Following the 2008 global financial crisis and its repercussions within the EU, this trend increased further. After the 2008 financial crisis, the historical focus of EU regulators on market and firm-level activity in financial markets has notably shifted from market effi-

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\(\text{\textsuperscript{7}}\) Given the integral role of banks in financial sector operations, it is difficult to separate ‘financial regulation’ from ‘banking regulation,’ considering that most if not all financial regulations are inexorably linked with the banking sector, and vice versa. Thus, it is relevant to note that in the context of this dissertation, financial sector regulation is considered specifically with regard to its influence on banks.
ciency concerns to risk-based market integrity and firm resilience considerations (see Paper III for a more detailed exploration of this development).

Regarding prudential risk recognition and regulation in banking, an important historic international development was the establishment of the Basel Committee of Banking Supervision in 1974 by the Central Banks of the G10 in response to severe international currency and banking market disturbances. The aim of the Basel Committee was and is to enhance financial stability by improving the quality of banking supervision internationally. As the primary global standard setter for international cooperation and formulation of prudential regulation, the Committee has, through the issuance of the Basel Accords (Basel I, Basel II, and following the 2008 financial crisis, Basel III), provided important capital and liquidity guidelines for banks. Additionally, the definitions of risk included in the Basel Accords have successively evolved to include more complex considerations of factors that move beyond capital and market risk to now include the more idiosyncratic risks that face both the system as well as individual banks. These risk recognitions have served, together with other regulatory instruments in domestic and international spheres, to shape not only the capital and liquidity approaches that banks must adhere to in order to (at least theoretically) improve their resilience to external and internal shocks, but also the understanding of the role that risk control plays in the broader governance and control systems of banks and banking activities.

In tandem with the above, accounting also plays an important role (explored in more detail in Paper I). External environmental impacts on the financial reality of banks are reflected on bank balance sheets, albeit with a time lag. The relationship between banking activity, economic and societal links, and regulatory influences all have an impact on industry and organizational trends towards broad accounting responses through leveraging or deleveraging decisions, compensation and reward systems, and human resource considerations, amongst other control factors (e.g. Claessens 2017).

A November 2015 report to G20 leaders from the Basel Committee on Banking Supervision (BCBS) highlights that post-crisis regulatory reform through Basel III builds on the gaps and weaknesses of Basel II, and also takes into account newly realized market vulnerabilities that emerged in the context of the 2007/2008 global financial crisis (BIS 2015). In addition to amending the definition and increasing the quality of bank capital as compared to Basel II levels, the report also recognizes risks that remained unrealized until the 2007/2008 crisis, namely the inadequacy of extant capital and liquidity controls, excessive leverage, and opaque understandings of actual risk exposures at both organizational and systemic levels. It identifies that a new framework of banking regulation has to not only ensure minimum
standards of resilience, but also reduce the impact on the financial system in the event that failure occurs (p.2-3).

Whilst it is of course arguable that the warning signals should have been apparent to regulators, the fact remains that pre-crisis regulation was simply not well-equipped or flexible enough to adequately address the myriad convoluted factors that ultimately led to the global crisis itself. Regulatory reform is ongoing and will presumably fill many existing gaps in many important ways (Omarova 2017; Constâncio et al. 2019). For example, in recognition of the need for better risk controls and protections at both market and actor levels, the European Commission (EC) has pursued numerous post-crisis initiatives in a bid to create a safer single market for financial services through the establishment of a single rulebook and ultimately, a banking union that will provide the EU financial market with stronger prudential controls for banks, improved depositor/investor protections, and uniform rules for the management and (potential) dissolution of failing banks. Such a banking union rests on three pillars:

1. A single supervisory mechanism (SSM) for banks and other financial actors;
2. A single resolution mechanism (SRM); and
3. An EU-wide European Deposit Insurance Scheme (EDIS).

Thus, far, the first two pillars of this banking union – the SSM and SRM – have been established, with active efforts ongoing since 2015 to establish the last pillar, EDIS, as well. In conjunction with the structural and procedural establishments of the SSM and SRM, the EC has, together with the European Banking Authority (EBA), built up a Single Rulebook that aims to provide a single set of harmonized prudential rules that apply uniformly to the banking sectors within the 28 EU countries.

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8 The SSM became fully operational in November 2014; the SRM came into operation on January 1, 2016. The SSM was established by the Council Regulation (EU) No 1024/2013 of October 15, 2013, which relegated responsibility for specific tasks concerning the prudential supervision of credit institutions on to the European Central Bank. The SRM was established by Regulation (EU) No 806/2014 of the European Parliament and of the Council of July 15, 2014, and establishes uniform rules and procedures for the resolution of credit institutions within the EU.

9 The Single Rulebook still does, however, assure a degree of national flexibility in the activation of macro-prudential tools – a factor important to maintaining systemic stability, given that credit and economic cycles often vary across different EU jurisdictions. For the same reason, the Single Rulebook also ensures that Member States retain the ability to set higher capital requirements in certain contexts (usually to avoid the negative implications of domestic market bubbles), such that these requirements apply not only to domestic banks but also to other banks that do business in that Member State. Certain requirements in specific regulatory instruments, such as the countercyclical buffer that is a part of the CRD IV Package, are also subject to national differences in implementation given that each Member State is responsible for adjusting the level of its countercyclical buffer to its economic situation and to protect its economy/banking sector from any other structural variables that can pose a threat to financial
The Single Rulebook, which first began to formally take shape in 2009, was a direct response to the accountability and transparency shortcomings that the financial crisis highlighted. For the EC and other administrative bodies within the EU, ‘accountability’ translated into the ability of the relevant institutions to provide their citizens/constituents with an explanation or justification for their actions, whilst concurrently accepting responsibility for those actions. Here, the links between accountability and transparency can easily be understood in the context of administrative law or administrative rulemaking – namely, the existence of clear accountability structures and relationships is crucial in order to ensure the transparency and legitimacy of legislative and supervisory rulemaking and decision-making. Indeed, it is the explicit existence of such accountability relationships that guarantees a certain degree of democratic control that is expected in the EU and other Western democracies.

For banks, ‘accountability’ similarly translates into the ability of the relevant banking organizations to provide the same account and assumption of responsibility to their stakeholders – not only regulators but also depositors and investors. In the context of the relationship between banks and their stakeholders, accountability relationships in particular were determined to have been negatively impacted by the lack of transparency at all levels – regulatory, market, and firm levels – prior to the crisis (Liikanen 2012). The lack of transparency at the level of the firm not only made effective supervision an impossibility, but it also reduced depositor and investor trust in the firms as well as the overall financial system. Similarly, opacity in regulatory requirements in different Member States (MS) contributed significantly to the systemic financial instability of the EU financial market leading up to the 2008 crisis. In order to address these shortcomings, the Directives and Regulations that form the Single Rulebook seek to ensure that the financial situation of credit institutions are more transparent and comparable across the EU for scrutinizers who may be regulators or supervisory authorities, investors, or deposit-holders.

Today, the Single Rulebook comprises the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV) that collectively form the CRD IV Package which translates the new Basel Framework into legally binding instruments; the Bank Recovery and Resolution Directive (BRRD); the Deposit Guarantee Schemes Directive (DGSD); the Payment Services Directive (PSD2); the Mortgage Credit Directive (MCD); and the corresponding technical standards developed by the EBA and adopted by the stability. Lastly, domestic banking supervisors retain the ability to impose additional requirements on specific banks following the Supervisory Review Process (SREP), under Pillar 2 of the new Basel Framework as adapted into the Single Rulebook.
European Commission through Regulatory and Implementing Technical Standards (RTS and ITS). Additionally, the Single Rulebook also includes the EBA Guidelines and related Q&A’s on these guidelines.

For the independent EU financial regulatory agencies established in the wake of the 2008 crisis and under the Banking Union (see Paper III for a more detailed presentation of these), accountability takes the shape of administrative accountability rather than relational accountability. That is, rather that accountability to specific parties with whom the regulators interact, accountability applies in terms of democratic rulemaking and execution through the establishment, scope, and authority of administrative regulatory agencies. Administrative accountability comprises an indelible facet of the democratic process and is, as such, a foundational facet of modern western democratic societies. Under such accountability, regulatory agencies must be able to demonstrate that they have exercised their authority and discretion in the public interest.

Under the new structure of financial regulation in the EU, key responsibilities have been transferred from the national to the supra-national level, under the authority of independent European agencies. Administrative accountability through the rulemaking process, public comment periods, and the ultimate administrative control of the European Parliament is hence essential to ensure that powers and responsibilities given to the ECB and independent agencies are exercised in the public interest, and in proper accordance with EU law. This system of administrative accountability is crucial for the transparency and legitimacy of supervisory and resolution decisions and guarantees a certain degree of democratic control. In a very practical sense, the EU thus represents a microcosm within the broader harmonization and interlinkages of the international financial sector.

2.1.4 Risk and Regulation in Banking

Let us begin with some definitions relating to risk. Perhaps the most simplistic and encompassing definition of ‘risk’ is what has been issued by the International Organization for Standardization through its updated international risk management standard ISO 31000:2018. Under this standard, risk is defined as the effect of uncertainty on achieving some objective, with the understanding that:

1. An effect of uncertainty simply means a deviation, either positive (creating an opportunity) or negative (creating a threat), from the expected path towards the objective in question; and
2. Risk itself can be expressed in terms of the existence of risk sources that can either alone or in combination with other factors give rise to
risk events and consequences according to some likelihood of the risk event, or consequence being realized. (ISO 31000:2018 §3.1)

Here, what is important to understand is that ‘likelihood’ is defined in a much broader sense than mathematical probability; it covers the chance of some risk event or consequence happening, whether the definition, measurement, and determination of that event or consequence depends on subjective or objective perceptions and qualitative or quantitative assessments (ISO 31000:2018 §3.7). ‘Risk management’ in turn refers to the coordinated set of systems, processes, and roles within an organization that are aimed at addressing and controlling risks (ISO 31000:2018 §3.2), with ‘control’ being further defined as measures that aim to (but may not always have the intended or assumed effect to) maintain or modify risks such as through structures, systems, processes, and practices within the organization (ISO 31000:2018 §3.8). Additionally, in terms of risk recognition and classification as either an opportunity or a threat, how firms identify and respond to risks is closely tied to strategic approaches. All firms, including banks, make different strategic bets in terms of how business activities, expansion decisions, and so on are decided and undertaken. Thus, if we consider, as a hypothetical example, expansion strategies of Swedish banks in Baltic markets, how different risk sources in such trajectories fit in with individual bank strategies may affect whether the identified risks of expansion are classified as opportunities to be seized or threats to be avoided. Consequently, not all banks may decide to expand into Baltic markets, and even for those banks that do expand, they may not engage in expansion in the same way.

As discussed in the preceding sections, risk is an important and unavoidable component of banking structures and activities. Society today can well be characterized as a “risk society” (Beck 1992) where individuals, firms, and markets are subject to distinct and important but often imperceptible risks due to activities and new technological innovations. Risk understandings, including in the financial sector, have increasingly become more holistic (Mikes 2009). The risks in the financial sector can well be characterized in this holistic way, as evidenced by the increasingly wider risk considerations included in the evolving iterations of the Basel Accords issued by the Basel Committee of Banking Supervision from the 1980’s until the present time (see Paper I and Paper III).

By this point in the text the reader should have some insight into the general nature of risks inherent in banking and the financial sector, and how ordinary non-experts, laypeople, and society at large may not be in the best position to directly monitor and control these risks. The risk-monitoring and mitigation function of prudential regulation is thus very important in the regulation-practice nexus of banking.
Risk governance in banking is often discussed using the terms information asymmetry and moral hazard. Corporate governance policy and practice in turn invariably fall under the dominant influence of principal-agent considerations, wherein these two concepts play an important role. In the context of this thesis, it is of particular interest how these concepts depend on the knowledge actors possess, or believe they have, about the characteristics and situation of relevant parties to market transactions. This is an important component of why accountability and transparency are vital issues. Access to valid information will determine awareness of risks and how they are shared. Transparency in this regard affects how risks are identified and communicated, and this in turn is linked to accountability through organizational roles and duties, control practices, and how some information is mandatorily provided to investors/ the public, or at least made available to auditors or regulatory agencies. This general framework also relates to other industries, but has proved particularly sensitive for the financial sector.

Additionally, for regulators, the iatrogenic effects of regulatory and supervisory measures are also important if complex to consider. Hood (2002) discusses these effects as new risks introduced as unintended side effects of risk management or mitigation. That is to say, by focusing on reducing risks in one area, regulators and market participants may inadvertently introduce new risks in another area. In banking, one clear and common conceptual area where this is seen is the balance between consumer protection and moral hazard. Practically speaking, deposit insurance, which has been a mainstay of financial regulation since the Great Depression and forms an important component of the EU regulations currently in place, provides guaranteed insurance to individual customers that allows them to recoup any deposits lost to bank failure (up to a ceiling amount). Whilst this reduces systemic risks tied to a loss in customer/ consumer confidence, it concurrently introduces the risk of moral hazard to banks whose deposits are subject to this insurance. That is to say, knowing that customers are confident in depositing funds thanks to deposit insurance, and knowing that their own accountability is diminished – that they are not responsible for the eventual payouts required in the event of a bank failure – some banks may, due to unscrupulous leaders or agents, veer towards suspiciously risky investments that put their liquidity (deposits) at risk. Moral hazard concerns could in turn be addressed

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10 It is assumed that the reader possesses knowledge of these terms. However, for a basic explanation of the terms ‘information asymmetry’ and ‘moral hazard,’ as well as how they are related to adverse selection in the context of financial intermediation, the interested reader may wish to refer to Van Damme (1994) and Krishnaswami et al. (1999).

11 Originating from literature in the field of medicine and healthcare, ‘iatrogenic risk’ is a term that derives from the concept of ‘iatrogenesis’ – that is, the countervailing negative impacts or side effects, either foreseen or unforeseen, of a treatment or cure (Weiner 1998). When, in the course of trying to mitigate or address a given risk, some other risk is increased or newly created, this increased or created risk is termed the iatrogenic risk that results from risk control or management (ibid; Hood 2002).
by, for example, heightened market entry and market conduct controls, which could themselves give rise to new iatrogenic risks, and so on.

Bank ownership and control is another area of direct relevance to the relationship between risk and regulation. In the context of the banking sector, the specificities of the banking regulatory environment and the particularities of banking business models have their own implications for the relationship between bank ownership (shareholder interests), control (management), and performance (capital market effects). Risk plays an important role in these considerations, bearing in mind (as stated earlier in this chapter) that banks importantly function not only as financial intermediaries but also as risk and information intermediaries within the broader economy (see e.g., Pi and Timme 1993; Prowse 1997; Iannotta et al. 2007).

Under the traditional bank business model, risk assessment and risk-based decision-making functions warrant slightly different understandings of information asymmetry and moral hazard that do not apply to other industries (see e.g., Esty 1997). To illustrate: from an ownership and control perspective, in addition to shareholders, other relevant stakeholders who may impact the risk-taking activities of banks include bank creditors, borrowers, bank depositors (debtors), and bank regulators. Thus, in addition to the traditional information asymmetry issue between owners and managers, the banking sector faces additional information asymmetry issues in at least three other important relationships:

1. Between bank owners, bank managers, and regulators;
2. Between depositors, banks as independent entities, and regulators; and
3. Between borrowers, bank managers, and regulators.

Llewelyn (2001) provides a particularly insightful overview of the unique risk governance considerations in banks, drawing particular attention to the role of regulators. In addition to the role of regulation itself, supervisory monitoring means that regulatory supervisors in some sense take on the monitoring role of shareholders, depositors, and other stakeholders, in addition to the more general market integrity and firm resilience considerations mentioned in the previous section. Given differences in stakeholder motivations and capacities, the regulatory monitoring is not a substitute for monitoring by other stakeholders but may nonetheless impact the incentive of other stakeholders to engage in effective monitoring. Additionally, the fiduciary relationship between banks and their customers gives rise to a second set of agency issues and professional conduct considerations that are rather unique to the banking sector (pp. 27-28).

Although the banking sector is subject to its own peculiarities in information asymmetry and agency conflict considerations as briefly provided above, the
general ownership and control structures are no different for banks than for firms in other industries. In addition to publicly held and privately held ownership, a firm’s (or bank’s) ownership structure can be defined across two other dimensions:

(1) Ownership concentration; and

(2) Owner characteristics.

Quite simplistically, concentrated ownership exists where majority equity holdings are limited to a few owners while dispersed ownership is where firm equity is shared amongst many owners. Owner characteristics are tied to the nature of the owners themselves (e.g. private sector firms, government owners, or individuals), and define differences in ownership that may exist even between firms with similar ownership concentrations.

In the European banking sector, multiple forms of ownership structures exist, including privately owned stock banks, mutual banks, and government-owned banks. While banks with different ownership structures and concentrations exist in the same regulatory environment and largely function in the same way (i.e., under similar business models), asset composition, funding structures, and bank performance may all be impacted by these structural differences. U.S.-based research where similar ownership structures exist has found correlations between bank risk taking and the comparative power of shareholders within the bank’s governance structure, with bank risk generally being higher where the bank has large owners with substantial cash flow rights (Laeven and Levine 2009). Likewise, the relationship between bank risk and bank regulations has also been found to be dependent on bank ownership structure, with the marginal effect of regulation on bank risk varying according to bank ownership and concentration levels. More specifically, regulatory measures such as deposit insurance are associated with increased bank risk only when the bank has a large shareholder with enough power to act on the moral hazard incentives provided by such insurance. Similarly, in regard to capital regulations, bank owners have incentive to compensate for stringent capital restrictions through increased risk taking only where ownership is heavily concentrated but not where ownership is more widely dispersed (ibid).

Adopting the perspective of regulators, it is important to note that legal expectations of bank prudence may sometimes be slightly at odds with what would be expected under traditional financial economic views. Although more economics-based industry standards of investment practice generally prevail in practice, regulatory norms often list towards high levels of conservatism with at least a theoretical inclination towards promoting the
preservation of principal\textsuperscript{12} even in the face of lower returns. Regulatory developments are indicative of this tendency. In particular regard of post-crisis regulations, both the normative and the practical risk-based considerations of regulators are highly evident.

Under the dominant market-failures-based approach to regulation, regulatory measures may serve different purposes (Stiglitz 2010). These include the mitigation of what may broadly be termed as negative externality effects through, for example, market competition/antitrust measures, investor/consumer protection schemes such as deposit insurance, and varied information disclosure requirements aimed at both certifying soundness (instilling market confidence) and mitigating moral hazard concerns. Additionally, given that markets and investors do not always behave rationally, regulation may be necessary to also prevent or prescribe industry or organizational measures that are necessary for the maintenance of systemic stability and soundness. For example, bank bailouts and lender of last resort functions were, in a very real sense, unavoidable courses of action for Central Banks during the most recent financial crisis; however, more stringent liquidity and capital constraints on banks may well have served to avoid such inevitabilities and indeed are in strong focus through ongoing banking regulatory reform. Lastly, even when markets may be efficient, there is no guarantee that the resulting outcome will be equitable to all stakeholders, thus giving rise to a need for regulation to provide mechanisms through which distributive justice (equitable outcomes) may be achieved.

In the context of current regulatory reform, the furtherance of this last regulatory aim can be seen in the strengthening of various accountability mechanisms (for example, in the U.S., this can be seen through increased personal liability of Chief Compliance Officers through more stringent interpretations of Rule 206 (4)-7 of the 1940 Investment Advisor Act). Even so, it is important to remember that what extant legal and political institutions deem to be in the public interest may not satisfy all relevant actors in the economic and social spheres. Recall in this regard the case of Northern Rock and the lawsuit brought by shareholders in an attempt to mitigate the losses they suffered. As Gray (2009) outlines, the Higher Court decision, upheld by the Court of Appeals, was a true test and analysis of the government’s lender of last resort function and what it meant to uphold the public good. In the case against Northern Rock, the courts deemed it unjustifiable as being in the interests of the public to compensate owners (shareholders) before the taxpayer funds expended on solving the debacle had been refunded to whatever extent was possible. Understanding that it was the government that would be repaid rather than the taxpayers directly, it is markedly unsurprising that

\textsuperscript{12} ‘Principal’ here is in the financial accounting sense, referring to the underlying value of the asset-side holdings of the firm.
the shareholders (who were probably taxpayers themselves) were decidedly unhappy about this outcome.

From a regulation and practice perspective, an additional consideration for regulators at least is that certain regulatory instruments that may be in the best interests of certain bank stakeholders may inadvertently serve to exacerbate risk-taking behavior by other actors. For example, as mentioned, deposit insurance that serves to protect the interests of depositors may serve to increase managerial incentive for morally hazardous risk-taking, given the loss buffer against deposit accounts that such insurance provides. Moreover, in deciding the regulatory strategy and toolkit to employ, regulators must also decide on the appropriate strategy for market discipline that should be undertaken.

Lastly, regulators serve a vital function in the supervisory risk monitoring of banks. Although as mentioned already in this section, the monitoring role of regulators is quite different from that of other stakeholders. A brief explanation of the differences may serve to highlight the importance of regulators as risk monitors. If one contrasts the risk-monitoring incentives of regulators from those of shareholders, depositors, and creditors in different situations, some interesting thoughts emerge.

In all situations, whether the bank is healthy or facing a situation of low capital or liquidity, regulatory aims arguably always seek to minimize risk and keep financial stability first and foremost on the list of priorities. Depending on the applicable legal regime, different stakeholders such as shareholders and depositors may be protected to different levels. For example, under changing EU banking law, shareholder responsibility to bear bank losses has heightened while deposit insurance has increased. In all instances, the regulators seek to minimize tail risk from a systemic perspective. The same cannot be said of other stakeholders who may be in a position to serve as risk monitors.

For bank funders/creditors, one must consider that it is the bank that must make payments to these debtholders. As long as the bank is able to make payments on its debt obligations, debtholders probably have little incentive to engage in risk monitoring activities. When a bank faces a situation of low capital but is not yet insolvent, assuming no information asymmetry between the bank and its debtholders, bank debtholders may serve as good risk monitors and enforcers. Debtholder interests are aligned with the bank’s own interest in maintaining going concern, protecting capital, and (for the debtholders at least) continuing interest payments on outstanding loans. However, if the bank reaches insolvency, the subordination of debt and the creditor protection regime in place will determine how effective different classes of creditors will be in monitoring a bank’s risk activities. Whilst se-
cured and prioritized debtholders (e.g. secured funders) may still continue to serve as effective risk monitors, subordinated debtholders who face losing all payouts may fall prey to moral hazard and be willing to allow the bank to engage in high risk activities (they seek to gain if the bank experiences a positive windfall from such activities, but do not run any risk of losing more than they have already lost).

Shareholders, too, are incentivized to engage in monitoring and may enforce control and organizational change through voting mechanisms. Shareholder monitoring power is largely dependent on the corporate governance regime in place and may vary across different jurisdictional settings. When capital is adequate, shareholders can encourage banks to engage in healthy risk-management activities – an effect that would arguably be bolstered through the implementation of strong market discipline mechanisms by regulators. However, when capital is low or the bank is insolvent, then shareholders may be more likely to encourage high-risk activities than regulators, largely due to moral-hazard triggers.

A third category of stakeholders, depositors/customers (or more broadly, liquidity providers) can influence banks through the withdrawal of deposits/customer account funds. Today, with the common establishment of deposit insurance, the risk of such an occurrence is very low even in times of distress. Nonetheless, as evidenced in the 2008 crisis, banks are still vulnerable to liquidity freezes through a different sort of ‘bank run’ where liquidity providers in the realms of institutional investment and the inter-bank loan market may behave in a similar manner to disillusioned and nervous depositors (Liikanen 2012).

Where the bank is healthy, its competitiveness will largely determine depositor/customer/other liquidity support – an effect that is strengthened by robust market discipline mechanisms (Pillar 3 of the Basel Framework, see Paper I and Paper III for a more detailed discussion). In both low capital and liquidity scenarios, a loss of market confidence can (theoretically) trigger rapid withdrawal of funds (or refusal to provide needed funds), leading to liquidity distress for the bank. This risk is mitigated by the existence of deposit insurance schemes, which function as public safety nets, but also theoretically serve to reduce incentives for depositors or retail customers’ interest in taking on the costs of monitoring risk activities by banks. As risk monitors, large depositors/liquidity providers may be more interested in exerting control over bank behavior than small depositors. In some ways, this mirrors the interests of equity holders as well, with large shareholders and institutional investors perhaps more interested and able to exert control over bank risk activities. Even for these stakeholders however, high monitoring costs may provide an incentive for these stakeholders to lobby for ‘competent’ regulation that encompasses their own best interests. This is supported by
strong empirical evidence of financial sector lobbying interests and activities in the United States and, increasingly, in Europe as well. At a more theoretical level, in markets or industries that face reputational risks, there is often a movement towards the formation of alliances for self-regulation in order to ensure organizational legitimacy and market stability. The historical regulatory developments of US financial markets, which have largely been self-regulatory through the formation and industry standard controls of exchanges, are one example of this.

In building on the above through some empirical findings, it is interesting to note that ownership and control structures of banks and their link to risk and performance present some additional important points for regulatory consideration. For example, pre-crisis investigation into 81 large banks from 15 European countries over the 1999–2004 period showed that state-owned banks are on average less profitable and riskier than other banks, and that the banking activity of public banks indicates a larger share of their funding coming from the wholesale interbank and capital markets, higher liquidity and lower investments in loans (Iannotta et al. 2007). This represents a different kind of financial intermediation model – something that is consistent with the presence of government guarantees for such banks that allow them to escape the negative capital market consequences of poorer asset quality and less profitable intermediation activity. Conversely, mutual banks and private banks benefit from stronger customer relationships and correspondingly higher loan quality and lower risk. If market discipline and risk monitoring are truly high on the regulatory agenda, then it would behoove regulators to be aware of the potential negative consequences for explicit guarantee protections for public banks and correct for such mechanisms. Additionally, as is being seen in current regulatory reform, a strengthening of the market discipline framework through increased market disclosures would at least theoretically increase the risk monitoring incentives for other bank stakeholders/market participants.

In terms of ownership types/the nature of owners, earlier studies (e.g. Saunders et al. 1990) have found some support for the idea that higher levels of manager owners of banks lead to lower incentives for risk taking than do higher levels of outside shareholder ownership where type-1 agency conflicts (infra fn.18) are increased. This indicates that even within one monitoring class (e.g. shareholders/owners), differences in owner characteristics and the basic issues raised by a separation of ownership and control remain important for regulators to be aware of.

Finally, adopting a somewhat internal view of bank activities, early research considering the perspective of board functions and monitoring activities by management raises some interesting implications regarding the monitoring and control effectiveness of the Board. Pi and Timme (1993) for example
find a strong indication that internal monitoring processes may not be as effective as theory would imply in instances where the CEO is also Board Chairman. For jurisdictions that allow this dual role, this implication is particularly important. From a regulatory perspective, changes to structural governance and control mechanisms (for example, as seen in GL 44 and explored in more detail in Paper IV) represent a heightened awareness of the importance of internal monitoring and control and a renewed regulatory focus in this area.

2.1.5 Risk, Technology, and Regulation in Banking

What importantly lies at the foundation of banking and financial crises as well as the responses they evoke is the mismanagement and lack of control over downside or tail-risks that affect individual market actors and the financial system as a whole. Here, possibly the most complicating factor in the modern financial marketplace is the high degree of technological reliance in both inter-organizational and intra-organizational contexts. In a commercial banking context for example, credit risk is determined by an almost automated procedure that relies on significantly digitalized analyses of individual/counterparty creditworthiness. Similarly, in an investment banking context, not only are banks’ own investment portfolio risk-management strategies often reliant on highly complex computations that lie well outside the realm of non-computerized capacity, but the capital market activities of banks are almost entirely reliant on electronic platforms and often complex algorithmic trading strategies that are only achievable through the use of computers.

The organizational and systemic opacities and risk-control difficulties that have emerged through technological reliance are indisputable, but the link to regulation is less clear. Regulatory cycles, including the most recent regulatory response in the wake of the 2008 financial crisis, have emerged not in response to new technologies but rather in response to the severe tail-risk realizations and contagion effects that are realized during crashes and crises. As American legal historian Stuart Banner states, “If new technology doesn't cause new securities regulation, what does? In a nutshell, crashes.” (Banner 1997, p. 850). Banner subsequently notes that although this is not a universal rule, it is a strong pattern – “There have been sharp price declines without subsequent regulation, and of course there has been regulation without immediately preceding price declines. But most of the major instances of new securities regulation in the past three hundred years of English and American history have come right after crashes” (ibid).

With regard to risk and technology, another factor of importance in financial markets is innovation. In prior research, financial innovation has broadly been defined as the creation and dissemination of new financial instruments,
technologies, institutions, and markets (Tufano 2003; Kim et al. 2013). Such innovation has traditionally served the beneficial function of helping to address and mitigate inefficiencies in risk shifting within financial markets, information asymmetry issues, and payment system facilitation (Niehans 1983; Tufano 2003), while at the same time introducing new risks into the financial system, such as the opacity, increased contagion dangers, and false risk mitigation introduced by the innovative financial instruments largely held responsible for the 2007 global financial crisis (Krugman 2007; Achariya and Richardson 2009; Ashcraft et al. 2011; Kamin and DeMarco 2012). Additionally, with regard to public confidence and consumer protection in the regulation-practice interface of banking, technology has posed additional challenges for banks and regulators alike. For example, what both banks and financial regulators have had to address in the past (and have by and large successfully addressed) are the risks introduced along with the benefits of innovations such as credit cards. Whilst credit cards undoubtedly fostered economic growth, they also came with their own sets of risks such as, for example, credit card fraud and the resulting personal fund losses to individuals (Liebermann and Stashevsky 2002).

In any industry where technological innovation plays a role in product or service advancement, the role of regulation remains threefold: First, regulation seeks to mitigate the instances and severity of damages or injury resulting from new innovations; second, regulators must be able to provide a channel for restitution to injured parties where injuries do occur; and finally, regulators must balance safety and stability interests with promoting and incentivizing innovation within markets (Hubbard 2014, p.1811). With regards to banking, where there invariably always exists a high degree of regulatory interest for the purpose of maintaining systemic stability and ensuring the soundness of market actors (banks), the interplay between innovation and regulatory oversight has not always been either clear or smooth (see e.g. Berger et al. 1996; Berger 2003; Calomiris 2009), with the concern of new risks and effective risk mitigation remaining high on the regulatory agenda over the past decades (Furst et al. 1998). Regulation by its very nature of being a public, deliberative, and inclusive process necessarily cannot include encompassing considerations of cutting-edge emerging technologies and technological innovations. Thus, there is always a degree of unknown risk when regulations are designed and implemented. Regulators may choose to address these unknown risks by implementing broader principles-based standards rather than very narrow and detailed rules; nonetheless, legal frameworks generally consist of a mix of narrow rules and broader principles that invariably leave the regulation-practice interface open to the introduction of new risks through market developments that are not captured by extant regulatory oversight and enforcement.
Today, technology plays an integral and inseparable role in banking activities in markets as well as within banks themselves. As Paper IV identifies, technology is a central facet of the risk control and compliance system in Banque de Montagne – a reality that is shared by other banks in Sweden as well as foreign jurisdictions. In regard of technology, risk, and regulation, banks today face multiple challenges. In one respect, banks must balance regulatory compliance with market, industry, and strategy-driven firm-specific needs for innovation. In another respect, banks face the challenge of integrating and in a theoretical sense, institutionalizing risk control and compliance into their technological structures, systems, processes, and roles, while at the same time integrating and institutionalizing technology itself into their risk-control and compliance structures, systems, processes, and roles. In yet another respect, banks face market competition and stakeholder-based factors that they must contend with in the process of engaging in innovation of new products and services to meet organizational aims. The role of technology in risk control in these respects has been highlighted not only by policy guidelines (see e.g. Akhtar 1983; BIS 2011) but also, in the EU context, through post-crisis regulation that recognizes the need for continued innovation in financial markets alongside a need to level the playing field for banks and other market participants. This is the developmental contrast that Paper III highlights, between market efficiency and prudential interests. It is reflected most notably, for example, in Directive (EU) 2015/2366 which is better known as the Second Payment Services Directive (PSD2), in force from January 2016, and applicable from January 2018. PSD2 sets the foundation for a better-integrated electronic payments market within the EU financial sector, taking into account financial innovations and developments in electronic payment systems and services. Through a focus on cybersecurity and customer protection requirements, informational transparency towards end users, and equalizing measures that allow new market entrants to compete alongside established incumbent banks within the financial sector, the Directive seeks to expand the EU market for payment services while at the same time achieving greater market efficiency, provider transparency, consumer choice, and consumer trust in the EU financial services market. Whilst the structure and aims of the Directive and its supporting instruments (e.g. Regulation (EU) 2015/751, which caps interchange transaction fees between banks in an effort to reduce merchant costs for credit- and debit-card transactions) are arguably as encompassing as they can be, there is nonetheless an awareness in regulatory as well as practice circles that new risks as well as arbitrage opportunities may well arise in consequence of such regulation as well as ongoing financial innovation developments within financial markets.
2.1.6 Compliance in Banking

According to the Merriam-Webster dictionary, to ‘comply’ with something means “to conform, submit, or adapt (as to a regulation or another’s wishes) as required or requested.” Whilst regulatory compliance is apparently part and parcel of the mainstream understanding of what it means to ‘comply’ in a general sense, what is more interesting and also relevant to compliance from an actor perspective at both organizational and individual levels is that even under this general definition, there is an implicit understanding that not all compliance is legally obligated; rather, organizations’ or individuals’ conformance, submission, or adaptation, to use the dictionary definitional terms, may either be required under some legal or contractual obligation, or else motivated by some personal or organizational desire to fulfill a request that has been issued by some other party.

According to the ISO through its guidelines on standards for compliance management systems, ‘compliance’ requires that an organization fulfill all the compliance obligations that it is either required to fulfill or has voluntarily committed itself to fulfill (ISO 19600:2014, §§3.1—3.19). Under this definition, in addition to regulations, compliance can also be understood in regard to industry standards, the organization’s own standards and procedures, as well as different stakeholder demands or requests of the organization. Further, the intra-organizational structural, system, process, and actor-based dimensions of compliance are all highlighted through the recognition that an organization can sustain compliance by embedding it into organizational culture and practices and by fostering compliance-oriented employee behavior and attitudes.

In terms of banking more specifically, the Basel Committee on Banking Supervision (BCBS), even in its pre-global financial crisis 2005 guidelines on Compliance and the Compliance Function in Banks (BIS 2005), identifies that whilst compliance risk may be tied to regulatory violations and legal sanctions in addition to financial and reputational losses, compliance itself relates not only to legislations and regulations, but also to market conventions, industry-driven best practices and standards, and the banks’ own internal rules and codes of conduct. What is also highlighted in this document is the understanding that compliance as a practice and a function of banks may well go beyond legal requirements to include standards of integrity and ethics in banking (ibid, p.7), and that compliance depends not only on internal control systems, corporate governance, and sound risk management practices, but also on the organizational culture which, while rooted in the intra-organizational conduct of all actors within the bank, is ultimately the responsibility of the Board of Directors and Executive Management.13

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13 As the introduction of the publication points out, “Compliance starts at the top. It will be most effective in a corporate culture that emphasizes standards of honesty and integrity and in
In terms of compliance within organizations, the BCBS importantly recognizes that banks may have different organizational structures and requirements, which may necessitate differences in how their individual compliance function is organized. Nonetheless, a uniform requirement for all compliance functions is that they should be independent and well provided with necessary resources. Regardless of how the compliance function is organized within a bank, it should be independent but subject to review periodically by internal audit, have a clearly specified scope of authority and responsibilities, and be issued sufficient resources to carry out its function (ibid).

In addition to being linked to risk, regulation, and broader stakeholder interests and demands, these layperson, general industry-standard, and banking sector-specific understandings of compliance all highlight that compliance is not strictly based on law, but also in some sense on industry and broader societal understandings as well as the concept of ethical conduct (as understood in relation to rules and best practices). In relation to risk and business strategy, it is particularly important to note that the BCBS guidelines in particular highlight the role of compliance within the broader context of organizational culture and practice, thus at least theoretically tying compliance as a function to both board and management activities as well as business unit activities. It is this encompassing structure and function of compliance within the organization that is further explored in Paper IV of this dissertation.

As such, what the above draws attention to is that whilst regulatory compliance may be something that is mandated under applicable law or industry rules, in the context of the compliance function within organizations, it is often interests and motivations other than regulatory requirements that also serve to influence how the organization chooses to comply with even mandated requirements. In extant policy guidelines, regulatory rules, as well as organizational approaches, there is an almost paradoxical development that surfaces in consequence – namely, a potential tension between regulatory goals and organizational goals, which may surface through organizational challenges to align business strategies and risk appetite to regulatory aims in practical terms. To illustrate, in the Paper IV case study of Banque de Montagne, the role of compliance as an independent function operated almost as an extension of regulatory reach into the organization. At the same time, there was a strong organizational focus, including within the compliance organization itself, on institutionalizing compliance practices into organizational culture. In this regard, the recognition of compliance as more than which the board of directors and senior management lead by example. It concerns everyone within the bank and should be viewed as an integral part of the bank’s business activities. A bank should hold itself to high standards when carrying on business, and at all times strive to observe the spirit as well as the letter of the law. Failure to consider the impact of its actions on its shareholders, customers, employees and the markets may result in significant adverse publicity and reputational damage, even if no law has been broken” (BIS 2005, p.7, §2).
mere regulatory demand was strongly apparent, with the bank recognizing that compliance meant following organizationally driven internal rules and controls that were tied not only to regulatory requirements but also strategy, competition, and stakeholder interests.

2.2 Theoretical Perspectives

In this section, the multi-disciplinary theoretical foundations of this dissertation are outlined and presented. This interdisciplinary approach is indirectly supported in research in individual fields (Tinker 1984; Kashyap et al. 2008; Bamberger 2009; Hanson et al. 2011) as well as within the individual papers within this manuscript.

As economist Raghuram Rajan pointed out in an article addressing the reasons why economists might have missed the warning signs of the 2008 financial crisis, the most likely explanation was not hubris but rather the high and narrow degree of specialization that economists generally adhere to within their sub-disciplines (Rajan 2011). Although the lack of warnings from academia is debatable considering the volume of literature published after each financial and banking crisis of history and the clear recognition of the both the links and the cyclical nature of regulation and crises, the fact remains that academics, practitioners, and regulators all repeated the same patterns of behavior regardless of what they did or did not realize. Even if the ‘why’ of this reality is perhaps hard to identify and harder still to pin down in concrete terms, a greater multi-level degree of integration between disciplines that seeks to illuminate at least some aspects of these complex linkages would not, at this point in time, be amiss.

To begin with, let me identify what I mean in this dissertation by ‘theory,’ ‘theoretical frameworks,’ and ‘theoretical lenses.’ This is not a particularly straightforward task, given that although established theories such as institutional theory and principal–agent theory are well accepted in the social sciences, defining what constitutes either novel theory-building or a meaningful contribution to established perspectives is difficult to articulate in a uniformly understood fashion.

A good starting point is a 1995 article titled “What Theory is Not,” by Robert Sutton and Barry Staw. That article holds that neither references, nor data, nor mere operationalization of variables or constructs, nor diagrams nor hypotheses by themselves can constitute theory. Theory building and testing are difficult and complex endeavors in organization and management studies, as the authors put it. Within the field, there exists a marked “lack of agreement about whether a model and a theory can be distinguished, whether
A typology is properly labeled a theory or not, whether the strength of a theory depends on how interesting it is, and whether falsifiability is a prerequisite for the very existence of a theory” (p.371).

In complementary contrast to Sutton and Staw (1995), Weick (1995) presents an engaging response that echoes the need for stronger theory building in organization and management studies, but at the same time makes the important point that whilst theory may exhibit well-defined relationships and explanations, theorizing, understood as the process by which theory is created, is much messier though no less important. A significant and illuminating excerpt from the article is what Weick states regarding the difficulty that researchers face in identifying theory. According to Weick, “this difficulty arises because theory work can take a variety of forms, because theory itself is a continuum, and because most verbally expressed theory leaves tacit some key portions of the originating insight. These considerations suggest that it is tough to judge whether something is a theory or not when only the product itself is examined. What one needs to know, instead, is more about the context in which the product lives. This is the process of theorizing,” (p. 387).

In relation to the drafting as well as the publication process of the individual papers within this dissertation, it is this concept of theorizing that has proved most useful to keep in mind. As Weick (1995) further expands on page 389, theorizing – the process of building theory – involves “activities like abstracting, generalizing, relating, selecting, explaining, synthesizing, and idealizing,” which result in the formulation of exactly the kinds of things Sutton and Staw (1995) say are not theory – “reference lists, data, lists of variables, diagrams, and lists of hypotheses.” These artefacts, according to Weick, “have vestiges of theory but are not themselves theories. Then again, few things are full-fledged theories. The key lies in the context—what came before, what comes next?” (p.389). In other words, the process by which theory is derived is perhaps just as important as the resultant theory. And for this, the research context matters.

Gioia and Pitre (1990) identify theory as “any coherent description or explanation of observed or experienced phenomena” (p. 587), and theory building as simply “the process or cycle by which such representations are generated, tested, and refined” (ibid). In later work, Corley and Gioia (2011) add to the above by concurrently acknowledging that there is no uniform definition of theory within organization and management studies, and harnessing a simple definition for their paper, namely that “theory is a statement of concepts and their interrelationships that shows how and/or why a phenomenon occurs” (ibid, p. 12). The authors further add that within the research community of organization and management studies, theoretical contribution may be meas-
ured as that which “provides original insight into a phenomenon by advancing knowledge in a way that is deemed to have utility or usefulness for some purpose” (ibid, p. 15). Whilst differing from the 1990 definitions somewhat, the 2011 definitions also encompass both a descriptive and an explanatory value to theory and the process of theorizing.

Theories are often assessed in the context of their usefulness through explanatory and predictive potential (Malmi and Granlund 2009). In arguably applied fields such as organization and management studies, accounting, and also law, such considerations of explanatory and predictive capacity confuse the issue of what constitutes a theory. The reason for this is that in the applied setting, the question of “what came before, what comes next” (Weick 1995, p. 389) is often dictated by empirical phenomena that occur outside the controlled research or laboratory setting. Defining theory in the applied context is thus complicated by the fact that effective theories, that is, theories that actually work in practice and accurately reflect reality (Gioia and Pitre 1990, Corley and Gioia 2011), may not derive strictly from narrow empirical testing aimed at definitively confirming or falsifying the proposed theory in question.

In applied disciplines, particularly in interdisciplinary work, the messiness of social reality – for example, the cultures, power dynamics, resource distributions, and actor motivations that are under study – present an extremely complex and challenging phenomenon (or collection of phenomena) to try and capture theoretically. In consequence, what are often accepted as theoretical frameworks can depart from the established aegis of formal theory to include theoretical frameworks that are more rooted in practice or external phenomena. Some examples of such frameworks include the Balanced Scorecard in management accounting (Kaplan and Norton 1992), the Nilsson and Stockenstrand (2015) framework that drives paper II of this dissertation, and the Three Lines of Defense model that forms a part of the theoretical basis for Paper IV.

So, where does all of this leave us?

Quite simply, this dissertation adopts the view that theory constitutes a coherent presentation or explanation of how or why a phenomenon occurs. In terms of theoretical perspective, this collective work relies on both established theories, namely the four theoretical strands addressed in Section 2.2.1 below. These theoretical perspectives, which also arise in the individual papers to different degrees, are used as lenses in the sense that they are used to try and understand the why and how of the empirical phenomena described in Section 2.1 that sets the background for this dissertation. Additionally,
multiple theoretical frameworks are used in the four individual papers, as provided below.

The three frameworks of direct relevance are the Nilsson-Stockenstrand model that forms the basis of Paper II, the transparency and accountability framework that is built into Paper III and extended in Paper IV, and the Three Lines of Defense model used in Paper IV. Finally, recalling that the overall research question of this dissertation aims to explore how transparency- and accountability-driven post-crisis financial regulations within the EU have influenced risk control and compliance in banking, the theorizing undertaken in this synthesis chapter expresses emergent understandings in the context of a transparency and accountability framework as presented in Section 2.2.2.

The theoretical lenses selected in this synthesis chapter are, in order of presentation below:

1. The economic and political theoretical rationales that underline regulation;
2. Principal–Agent theory;
3. Legal positivism; and
4. Institutional theory.

The views presented below are not intended to be comprehensive treatises on the theories they outline. Rather, they highlight the relevant applicability of the four selected theoretical perspectives to the endeavors undertaken in this dissertation.

2.2.1 Theoretical Lenses
This section first provides some rationales and challenges for banking regulation that are rooted in economic and political theories of regulation and build on the previous section to contribute to a more holistic understanding of the banking regulation-practice nexus. Next, the basic precepts of the

14 Paper I, which is a largely empirical exploration of risk understandings and operationalization in prudential regulation versus banking-sector accounting rules and practices, implicitly relies on the theories outlined in this theoretical section, but does not present an explicit framework in the same manner as the other three papers.

15 Here, it must be noted that a distinction is often made between the terms ‘legislation’ (the creation of legal instruments through legislative bodies, whereby regulatory oversight and rulemaking are often allocated to lower level institutions, independent agencies, or officials) and ‘regulation’ the use of legislative authority to exert supervisory, monitoring, and decision-making control over the regulated industries). As the distinction between the two is not especially important in the context of this discussion, the two terms are not distinguished from each other unless specifically noted in the text.
principal–agent perspective that continue to dominate financial regulatory efforts are outlined. After this, a brief overview of the legal positivist positioning of this work is provided. This is then tied to perspectives from institutional theory that allow for a translation of these complex relationships into the setting of the firm. Finally, in Section 2.2.2, these discussions are presented in the context of the multi-level transparency and accountability considerations that are harnessed within the research approach of this dissertation.

The selection of theoretical lenses was fueled by two important considerations: First, the regulation-practice nexus of banking is complex for reasons rooted in multiple fields and multiple theories, all of which play out to varying degrees in actual practice. Second, one important personal aim in this interdisciplinary endeavor is to break down some of the walls that exist between fields in the area of banking sector research. Without economic and legal understandings, organizational and management understandings will never be complete, and vice versa. Regardless of the area of expertise held by the reader, I assume that the informed reader holds some interest if not prior insight in banking research. It is my hope that a perusal of this dissertation will provide a more complete picture of the field, with highlighted threads that will be of some use to synergies in research and practice regardless of the field the reader is most comfortable working in. For this, an explanation of the theoretical underpinnings of empirical developments is just as important as the identification of the developments themselves. Thus, whilst the individual papers of the dissertation are much narrower in their focus, this chapter seeks to provide an insight into at least some of the theoretical links as relevant to the context of this work.

2.2.1.1 The Rationale Behind Banking Regulation

Although the need for regulatory oversight in the financial sector is, at least in the context of post-crisis response, relatively unquestioned, there is no consensus on the best way to approach banking regulation (Williamson 1987; Dewatripont and Tirole 1994; Llewellyn 1999; Hendrickson and Nichols 2001). In general, theories of regulation cover two distinct areas of economic regulation – structural regulation and conduct regulation (Kay and Vickers 1990). Structural regulations concern market entry and exit, as well as professional requirements and license regulations. Collectively these regulations ensure the integrity of the market structure. Conduct regulations are used to regulate the market activity or behavior of market participants through conduct requirements such as regulation of allowable activities,
mandated disclosures on products and services offered, on quality standards, and similar controls.\textsuperscript{16}

Different perspectives exist on why banks are heavily regulated, ranging from depositor and consumer protection, to industry protection and in some sense, regulatory collusion or capture by regulated industries (Hauswald and Senbet 1999; Hendrickson 2001). Even accepting that regulation may have multiple aims, as a practical matter, regulatory instruments may, in isolation and the aggregate, promote certain aims at the cost of others. For example, as has been mentioned at earlier points in this chapter, in the context of risk, deposit insurance measures aimed at promoting consumer confidence and thus systemic safety and soundness may serve to increase the risk of moral hazard in banking activities. This in turn contributes to a greater likelihood that banks may engage in or mismanage riskier investments, thus negatively impacting organizational and ultimately systemic risk exposures. The rationale behind regulation and how different regulations fit together are thus important considerations for regulators and practitioners, as well as researchers.

In this dissertation, two rationales for banking regulation are considered, as both have an important role to play in the transparency and accountability considerations that arise in the regulation-practice nexus of banking. The first of these is an economic perspective of regulation, and the second of these is a political perspective of regulation. These are outlined as below.

\textit{The Economic rationale of regulation}

Prior to the 1970’s, the prevalent economic perspectives on the regulation of markets and actors rested on the perception that regulation was based on public interest – that it was necessary in order to address and correct market failures and functioned, primarily, to advance the public interest. Stigler (1971) introduced a more economics-based view of regulation that considered regulation to be similar to any other product in a marketplace. Under this economic theory of regulation, if there were effective demands for and supplies of regulation, the result would be some equilibrium level of regulation in the given market. Unlike other products however, the production of regulation is also dependent on the political process that defines the regulatory ‘market.’ As long as political considerations are taken into account, the standard tools of economic analysis, under Stigler’s view, would function to provide useful answers to the questions of why regulation exists in markets, what forms it takes, and what its optimal amounts might be (ibid; Carrigan and Coglianese 2016).

\textsuperscript{16} Theories of regulation also cover the area of social regulation, which encompasses issues relating to health and safety standards, environmental regulations, and in the context especially of the financial sector/banking sector, consumer-protection regulations (See e.g. Posner 1974, Ostrom et al. 1994).
On the demand side of regulation under this economic view, firms or industries could desire and benefit from regulations through reduced competition, the assurance of market share, or other “political rents” (McChesney 1997). The cost to obtain these rents would have to be paid as incentives to the regulators themselves in order to incentivize favorable regulation. Although the term “regulatory capture” was not used in Stigler’s original theory, the costs of such rents (through lobbying efforts, campaign contributions in some jurisdictions, or market distortions) share commonalities with later emergences of this term in public choice theory (see e.g. Bhagwati 1982: McChesney 1997). Here, whilst agency considerations were not directly considered, they were implicitly included for example in the hypothesis that firms or industries would benefit at the expense of consumers or the public (Stigler 1971).

Intra-industry conflicts may also exist, for example in the banking sector where small commercial banks arguably do not have either the capacity or the motivation to hold the same interests as large banks that combine commercial and investment activities. Small banks and large banks may thus have different drives to seek different political rents from regulators. In this regard, regulation emerges as a process of exchange and competitive lobbying, whereby individual firms may belong to groups within an industry and seek to use political pressure to achieve their own goals (Becker 1983). As Hendrickson (2001) identifies, “it is the competition between the interest groups that determine the political outcome, be it regulation, tax policy, or subsidy policy” (p.852).

The Political rationale of regulation

In political theory, the most relevant view of regulation theory for this dissertation is the well-established position of public-choice theory, which is, succinctly, the opposite side of the coin to the economic rationale discussed in the preceding section. Under public-choice theory, laws and regulations are products traded in a political marketplace. Understandings of how regulatory outcomes emerge rest on economic underpinnings of market supply and demand as well as agency drivers such as welfare maximization. In this case, the welfare sought to be maximized is often that of political decision-makers themselves, and often functions to the detriment of the public (McChesney 1997).

Under this view, whilst public interest is not rejected outright, attention is given to the assumption that lawmakers and bureaucrats, driven by their own agency interests, work to design relevant industry laws to benefit various interest groups. These interest groups have their own fortunes dependent upon a favorable legal and regulatory environment, and the regulators in turn have their interests such as incumbency and informational dependency as-
sured by the financial and political support of these groups (Posner 1974; Den Hertog 2010). In a very unambiguous identification of ‘regulatory capture,’ what the financial sector in particular is susceptible to is a ‘revolving door’ whereby regulators today may be industry employees tomorrow. The prospect or desire of private sector jobs or benefits may, in a practical sense, align the interests of individual regulators (or individuals within regulatory agencies) with regulated industries in a manner that is at odds with both regulatory aims and public interest (Zheng 2014).

In the ways outlined above, there is a recognition that the basic economic assumptions of public interest theory – first, that economic markets will operate very inefficiently or inequitably but for formal government regulation; and second, that such regulation is cost free – are incorrect. Indeed, empirically speaking, both the United States (with its long and fragmented history of industry self-regulation in the financial sector) and Sweden (with its moderate to low levels of legal protections for investors and owners but extremely robust financial markets)\(^{17}\) are clear contra-indicatory examples of these assumptions in the context of financial markets.

**Bringing it together: Economic interests and the public good**

In applying the above to the historically procyclical nature of financial regulation cycles in relation to financial crises, the following observations are of theoretical and, ultimately, empirical relevance:

First, even economic theories that recognize and account for the shortcomings of public interest theories fall short on two points: That the political process is oftentimes independent of the regulatory process, at least in theory if not in practice. Thus, for example, governmental interests in micro- and macro-prudential regulation in the financial sector are in some sense independent of the legislators and regulatory decision-makers who may be serving in office during any given term. This begs the question of whether regulation should be designed with more positive (effects-based) or normative (ideal outcome based) underpinnings dominating the substance if not the process of regulation; and additionally, that even though principles of equity and justice may be reduced to economic efficiency through extant dominant theories of regulation, it is undeniable that the public interest, in a more normative capacity, appears to enter both political and regulatory agendas with great force in the wake of scandal and crisis.

As earlier research in law and economics has pointed out (McDonnell 2013), there is a tendency towards regulatory overreaction in opposite directions during both boom and bust economic periods. After crises (during bust periods), public outrage at exposed scandals and shortcomings fuels politicians

\(^{17}\) Staffsudd (2006), LaPorta et al. (1997, 1998)
and regulators alike (who are probably also impacted by the agency and capture considerations identified in this section) to address the suddenly salient and identifiable risk factors responsible for the crisis in a swift and strongly reactionary manner. Unless this response is delayed, the impacted financial institutions run the iatrogenic risk of experiencing a delayed recovery by having to contend with additional burdens at a time where their reserves and resilience are already stretched thin (ibid). At the same time, as the economy progresses into the inevitable subsequent boom period, interests fueling regulatory capture change again, and regulators arguably have a higher interest in feeding industry interests rather than public outcry (Tinker 1974; McDonnell 2013). The public itself, at this stage, with no negative impacts felt from the financial sector, may neither understand nor care enough to try to influence regulatory rulemaking one way or the other (Söderberg and Wester 2012).

Additionally, and very importantly in the context of the financial sector, booms may be accompanied with (if not precipitated by) significant technological progress (McDonnell 2013). As happened during the 1980’s and 1990’s when financial markets concocted a variety of new financial products tied to mortgage securitizations, much of financial innovation simply lies outside the scope of regulatory oversight – at least, at the initial stage before a problem occurs. Today, the same phenomenon is observable with the various fintech products and services that are being developed, although regulators are arguably trying to stay abreast if not ahead of the game through ongoing regulatory developments (such as PSD2 in the EU).

Secondly, regulators themselves are subject to various heuristically driven errors and biases that could lead to less than optimal decision-making. In the financial markets, particularly in relation to banks, regulators are highly dependent on information provided by the market participants (banks) themselves (see Paper I). Thus, it is entirely likely that regulators themselves may have a distorted perception of risks in the regulated markets. Here, too, technological progress plays a role, as regulators are likely to always be a few steps behind industry in understanding ongoing market change (McDonnell 2013). Thus, a lack of understanding, and a lack of transparency regarding relevant or necessary information, may well interfere with and hinder regulatory adaptations to market and institutional changes in the field.

2.2.1.2 The Principal–Agent Perspective

Although other theories have risen in prominence within both organizational and regulatory frameworks over the past several years, principal–agent theory remains the central driver of both legal and organizational developments, particularly in the context of banking sector discussions as related to governance and financial accounting issues. Indeed, agency theory has been domi-
nant in shaping our extant understandings of the financial sector and many of the key regulations that impact this sphere.

Principal–Agent considerations can be traced as far back as 1776 when Adam Smith, in his seminal work titled *An Inquiry into the Nature and Causes of the Wealth of Nations*, first identified the issues that could arise when those who managed corporate activity were not in fact the owners of the funds they were in charge of managing. In the context of joint stock companies, he identified that the directors of these companies, “being the managers rather of other people’s money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance” (Smith 1937, p. 700).

More than a century later, Berle and Means (1932), in *The Modern Corporation and Private Property*, explained the same issue. As markets develop, ownership and control of corporations is more likely to separate. This is evident in US and UK (common law) markets, where in particular the protection of minority shareholders has encouraged greater diversified holdings in corporations. As La Porta et al. (1999) identify, however, this is not the norm. Whilst diversified holdings are common in common law countries, in much of the world, the dominant corporate control structure remains as family-owned firms or firms with largely concentrated ownership. Such ownership and control structures give rise to different sets of issues, and thus require different regulatory controls.

In 1976, Jensen and Meckling published their seminal paper, “Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure,” in which they combine agency theory with theories of property rights and finance. Adopting a positivist approach and viewing the firm as a legal fiction that serves to operate as a nexus for contractual interactions and relationships between individuals, Jensen and Meckling theoretically open the ‘black box’ of the firm in an attempt to focus on the behavioral implications of the property rights contractually specified between firm owners and firm managers (Jensen and Meckling 1976, p.305). The key assumption that their paper launches from is that the normative issues of how to structure contractual relationships between principals and agents are already solved, and that some equilibrium-contracting form between the parties has been reached. The paper thus addresses the incentives and factors that the principals and agents each face in establishing this equilibrium, including how agency costs may be understood in relation to external debt and equity claims on the firm. This paper in particular serves as the launching point for the sections below.

*Principal–agent considerations between owners and managers*

The basic foundation of principal–agent theory rests on the idea of a separation between ownership and control (Jensen and Meckling 1976; Fama and
Jensen 1983a; Fama and Jensen 1983b). In any instance where the owner or principal does not control that which is owned, and must rely on a contracted agent to carry out actions on his/her behalf, a principal–agent relationship may be said to exist. On a broader theoretical level, a principal–agent relationship may exist in any context wherein two or more parties must cooperate or engage in a contract with each other for some purpose (usually understood as the furtherance of the interests held by at least one of the parties).

Consider a case where there are two parties, both with their own individual goals. These two parties may enter into a contract with each other whereby one party would function as the effective agent to fulfill some duty on behalf of the other party (the principal). In the context of firms, such a relationship exists where owners of the firm contract out their monitoring and control duties to agents, understood as the board of directors and management. These agents are responsible for acting on the behalf of the owners, towards the furtherance of the owners’ goals. In such a principal–agent relationship, there are two basic agency issues that may arise (Eisenhardt 1989, p.58-60):18

1) **Conflict in goals**: Here, the principal and the agent may have goals that conflict with each other, and the principal is limited by either inherent or economic capacity to oversee the actions of the agent;

2) **Conflict in approach**: This is essentially a risk-sharing problem. The principal and agent may share a common goal but may differ in their risk appetites and approach towards risk. How the agent is predisposed to act may not be in line with how the principal would like the agent to act, even though they both are objectively in pursuit of the same goal.

Both issues are in fact very likely to prevail simultaneously for the simple reason that most agents will differ in some important respects from their principals. Common reasons for employing an agent include that s/he possesses knowledge the principal lacks, can be present while the principal is absent (and consequently acquire real-time and detailed knowledge about conditions), and has personal interests and motivations for performing the required services while the principal wants to use her or his skills and time for other occupations. All lead to a division of labor that is beneficial not only for the principal but arguably for society in general (Jensen 2010). Nonetheless, they also lead to a strong likelihood for divergent goals and approaches. The contribution of principal–agent theory is to improve our understanding of how these can be harmonized, or may lead to more-or-less beneficial effects for both principals and agents. In this context, risk man-

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18 These issues may also arise in different contexts, such as the commonly understood ‘types’ of agency conflict – ‘type 1’ being between owners and managers, and ‘type 2’ being between majority and minority owners.
agement, corporate governance, and compliance all largely go towards building a better alignment between the goals and approaches of principals and agents.

The issues or misalignments highlighted by the above may be exacerbated by the issue of ‘information asymmetry’, whereby the principal is assumed to have a disadvantage as s/he has less information regarding the agent’s actions than the agent has. Any resultant costs incurred as a result of misalignment, malfeasance, or mistake on the part of agents is called ‘agency costs.’

In the absence of agency problems or agency costs (or in a reality where a happy equilibrium could be assumed into existence), corporate governance or indeed regulation itself would not really be needed in the context of principal–agent considerations. The reason for this is that without agency costs or with the establishment of equilibrium between principals and agents, all individuals associated with an organization could theoretically be instructed to maximize profit or net market value or to minimize costs, with all the appropriate incentive structures and contracts already assumed in place, and all monitoring and bonding costs (as well as residual loss) already accounted for. Individuals would theoretically be prepared to carry out their contractual instructions since they are assured that the contracts under which they are operating are welfare optimal for themselves (see generally Jensen and Meckling, 1976). Thus, they would not care per se about the outcome of the organization’s activities. Those activities in turn would theoretically benefit society as a whole through the kind of ‘enlightened agency perspective’ presented in, for example, Jensen (2010). Arguably, no governance structure would be required to resolve disagreements either within the firm or between firms, since there theoretically would be none. The above describes the situation assumed to hold in the idealized standard neoclassical theory of the firm, which heavily informs the market view of the firm as a ‘black box’ as well as the positivist agency view that opens up the black box but assumes contractual equilibrium between principals and agents at an intra- and inter-firm level (Jensen and Meckling, 1976).

In the reality of our world, this is never the case.

Under agency theory as it functions practically, corporate governance mechanisms were largely left to industry self-regulation but have come into increased regulatory focus following the financial crisis. These mechanisms, particularly the board of directors, are an important part of monitoring to make sure that agency problems are identified and mitigated. The costs associated with pursuing this assurance are called monitoring costs, bonding costs, and an inevitable degree of residual loss (Schneider 1987, Smith 1989). These costs may be understood as follows.
Monitoring costs are the economic costs associated with making the agent aware of the fact that the principal or some other enforcing force acting on behalf of the principal is monitoring agent activity. In terms of corporate structure, the Board of Directors serves an important monitoring function. Internal and external audit functions serve as another important monitoring mechanism. These mechanisms may be understood as mandatory monitoring mechanisms, in that there is really no choice involved, as these requirements are in large part regulated either through legal supervision or else through industry standards. However, monitoring costs may also be voluntary, such as informal/discretionary communication and reporting within the company, voluntary accounting disclosures, and the like.

Bonding costs may be understood as the costs of promoting agent commitment towards principal goals – how can we make the agent act more like the principal, or more in line with the principal’s goals? Both compensation incentives and corporate funding debt structures can function as bonding mechanisms. In terms of risk control, increasing personal liability for risk failures at the Board and management levels may similarly harmonize risk incentives between owners (through regulators) and managers. Recall the discussion of regulators as risk monitors, however, and recognize that whilst regulators in principle represent societal interests, including the interests of owners, at times, pure ownership interests (shareholder primacy) may conflict with the more systemic and broader public good motivations of regulatory mechanisms.\(^{19}\)

Even with optimal monitoring and bonding activities, there will invariably be a degree of divergence between the agent’s decisions and actions, and the optimal welfare outcome for the principal. The monetary equivalent of the loss in the principal’s welfare due to such divergence is counted as residual loss.

For banks and banking regulation, the role of capital and liquidity buffers, and the role of resolution mechanisms are essentially failure mechanisms that come into play only if agency controls do not adequately avoid failure outcomes. Extant financial regulation is heavily based on the principal–agent model. As such, most if not all elements of corporate governance codes and, increasingly regulatory instruments, rely heavily on principal–agent considerations at a foundational theoretical level. Two examples in practice can

\(^{19}\) To complicate matters further, “public good” motivations of regulators themselves may, in turn, be reduced or made redundant by self-interest influences through regulatory capture, as discussed in the section preceding this one. Analyzing the regulatory aims and potential regulatory impacts of specific regulatory instruments is therefore sometimes a case-by-case analysis where the history of each regulation and the ongoing market and governance influences must be considered.
clearly be seen, for example, in remuneration structures and in liability controls.

Principal–agent considerations for regulatory actors and instruments
At a broader level, the relationship between regulators and the regulated entities tasked with accountability and transparency by regulations may be understood to exhibit certain characteristics of the principal–agent interactions and issues outlined in this section. For example, in the law and finance literature, it is well recognized that regulatory approaches

Equally importantly, regulators themselves may be seen as agents of society who are tasked with promoting societal welfare through legal rulemaking and regulatory monitoring, oversight, and enforcement responsibilities. Thus, conflicts of interest between not only regulated entities and regulators, but also regulators and society must be considered in matters of accountability and transparency within the regulation-practice nexus of banking.

This last point – potential agency conflicts between society and regulators – is not addressed in any of the individual papers of this dissertation. However, the discussion in this chapter would be incomplete without acknowledging that these conflicts do exist, and that administrative accountability structures that exist in the rulemaking process are largely derived from an effort to mitigate these potential conflicts. In the context of regulatory interactions with the political sphere, one potentially negative response to the financial crisis has been a somewhat diminished focus on the regulatory independence of financial supervisors and heightened accountability of financial regulators to the political sphere (Helleiner and Pagliari 2011; McDonnell 2013; Romano 2014). This development is empirically reflected through budgetary reliance of independent agencies on government funding and regulatory developments in, for example, the Dodd-Frank Act that establish the Secretary of the Treasury as the chair of the new Financial Stability Oversight Council, which coordinates federal financial rulemaking (McDonnell 2013, p. 1635).

2.2.1.3 Legal positivism: Linking economic interests, legal infrastructure, and social reality
Shifting the focus to the legal sphere, the first recognition should be that as a field, law consists of a complex matrix of social and political institutions that overlaps with but nonetheless remains distinct from the social sphere (see e.g. Somers 1993; Latour 2010). Even within the sphere of law, legal theories and practice diverge not only across legal areas but also across jurisdic-

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tions, which has, as addressed in the principal–agent discussions earlier (su-
pra Section 2.2.1.2), significant implications for financial and real sector
economic developments.

Understanding the legal perspective in the context of this dissertation is im-
portant because by its very nature, the regulation-practice nexus of banking
relies just as much on legal frameworks as it does on principles more rooted
in the social sciences. Although social science theories undoubtedly allow
for an understanding of the interplay between regulations and practice, ex-
cluding legal theory from consideration necessarily means that this under-
standing is incomplete. Exploring the legal perspective thus allows for a
more holistic understanding of the interactions between law, politics, eco-
nomics, and societal considerations that collectively form the regulation-
practice nexus of concern.

In the 2010 English translation of Bruno Latour’s La Fabrique du Droit
(2002), titled The Making of Law: An Ethnography of the Conseil d’Etat, it
is what Latour ends his work with that I would like to quote here at the start
of this section:

“Yes, law is formal, but its reality is indeed to precede any enunciator, any
speaking human, for whom it accompanies all the overwhelming disen-
gagements, all the fabulous fictions, all the audacious organizations, with
work that, as far as possible, is not overwhelming, fabulous, or audacious,
and that reconnects, preserves, links up, assigns, retraces. To celebrate it,
there is no point in playing the great organs of nature, religion, the State.
Law already has enough totality attached to it for us to not add all these dead
weights that, in any case, make an awful noise. No, law’s music is more
discreet. Without it, we wouldn’t be human; without it, we would have lost
the trace of what we had said… We would be unable to find the trace of our
actions. There would be no accountability.” (Latour 2010, p. 277)

In this 2010 publication, Latour undertakes a study of the process by which
legal decision-making is undertaken, rejecting both the perspective that law
exists as a purely tautological field as well as the idea that social science
studies of law capture an accurate picture of its reality. In deconstructing law
into its networks and translations and interactions and recordings that link
one action in time to another, Latour simultaneously recognizes the superfi-
ciality and meaninglessness that law can be reduced to in the social context,
while at the same time recognizing the value and meaning that it lends to the
fabric of the social (see e.g. Latour 2010, pp. 256–266). The position he de-
scribes is a version of the position adopted in this dissertation – namely,
legal positivism (Hart 1994; Latour 2010).
In relation to financial-sector law and regulation in particular, the relationship between legal formulation and its effect in practice (enforcement, if you will) is an important one. Whilst the substantive content of regulation depends largely on narrower economic principles and codes of behavior (for example, shareholder primacy in corporate governance), the legal theory discussed in the present section dictates the formulation of the legal system underlying the financial sector. This system is, ultimately, what provides the institutional stability required for the robust development and continuance of healthy financial markets (La Porta et al. 1998). The value of the legal positivist stance here is its focus on clarity and legal certainty in both form and effect – that is, how lawmaking bodies and legal instruments are created and organized within the legal framework, as well as how the influence of these actors and instruments is achieved in the context of rulemaking, implementation, monitoring, and enforcement (Hart, 1994). Across both national and international dimensions of financial law, these two aspects of legal structure and effect are high on both the regulatory and practice agendas, as evidenced by developments and independent authorities created through the extant administrative process as well as the substantive content of post-crisis regulatory instruments. The concurrent fragmentation and harmonization within the sphere of international financial regulation are thus best understood through this positivist lens.

Under the legal positivist tradition, the law as we know it exists because we, as human beings, created the legal systems that apply to our societies. As put forth by Hart (1994, pp.91-110), legal rules may be understood as generally arising from ‘secondary rules’ under a structure of ‘primary’ and ‘secondary’ rules. Primary rules, which comprise restrictions or obligations on behavior, may in their simplest form be understood as rules that control those actions that human beings may be tempted to engage in but which, unchecked, would deter the possibility of the existence of a group of human beings in close and continuous proximity with each other (i.e., the existence of a society). In other words, primary rules may not be formal legal rules, but are nonetheless perhaps even more powerful informal societal influences that dictate what is allowable and what isn’t. Such rules, often unofficial and enforced through group culture (for example, rules of etiquette and other social conduct) must, as groups increase in complexity and size, necessarily depend on secondary rules that serve to clarify and formulate a formal system of societal conduct.

The raison d'être of secondary rules invariably stem from the shortcomings of primary rules – namely, uncertainty outside of an established scope.21

21 What happens when a situation or action occurs that gives rise to doubts on the meaning or applicability of a primary rule? What are the texts, or who are the individuals, who can settle these doubts, and what procedures should they follow to do so?
static applicability;\textsuperscript{22} and inefficiency in design and application\textsuperscript{23}. These defects can be solved through the introduction of secondary rules that aid in the development of what can be understood as a legal system founded on the primary rules that drive a given society.

In a most basic sense, legal positivism addresses how we may establish and maintain social order; how socially acceptable behaviors are encouraged, socially unacceptable behaviors deterred, and conflicts between the actors/inhabitants within a given community addressed and resolved (ibid). Where legal systems exist, they do so in relation to some form of socio-political system with its related norms of legitimacy and power dynamics. Regardless of the state of legal systems in society, all societies have some approach towards achieving these three goals, which can perhaps be summarily expressed as:

1. Behavioral encouragement;
2. Behavioral deterrence; and
3. Conflict resolution.

This thesis follows a positivist view of law that is strongly rooted in social constructivism (Hart \textsuperscript{1994}; Green \textsuperscript{2008}; Latour \textsuperscript{2010}). As related to the inquiry of this dissertation, the positivist view has direct bearing on understandings of accountability as addressed especially in Paper III and with relation to morality. In terms of theory, this section also links directly with institutional theory in understanding how regulation functions as an institutional force, which has a bearing (sometimes more implicitly than others) on all four papers within this collective work.

In its most traditional form, legal positivism holds a strict separation between the existence of law and morals, maintaining that “the existence of law is one thing; its merit and demerit another. Whether it be or not be is one

\textsuperscript{22} Primary rules allow for a slow process of change, similar to what is exemplified within perspectives of institutional theory. Such change may consist of behaviors shifting over time from optional to habitual to eventually obligatory; or, conversely, of negative behaviors (deviations) shifting from being strictly addressed to being tolerated and eventually ignored either by design or accident. However, secondary rules are required to address new or shifting circumstances that may require action or reaction within a much shorter period of time. With particular relevance to contractual obligations, property rights, and the transfer of assets as they arise in the regulation-practice nexus of banking, secondary rules, through extant and applicable legal frameworks, facilitate the creation, adjustment, execution, and enforcement of actions within accountability frameworks as discussed in this dissertation.

\textsuperscript{23} What happens when conflicts or disputes arise between members of society? Leaving the identification and resolution of disputes to ‘society at large’ may lead to inefficiencies as well as undesirable escalations (such as family vendettas, for example). Using secondary rules to establish a well-functioning system of laws, administrative agencies, judicial authorities, etc. is thus important to the effective and efficient functioning of a societal system.
inquiry; whether it be or not be conformable to an assumed standard, is a different inquiry” (Austin, 1995 p. 157). Under this traditional view, law functions as a coercive force, hierarchical and derivative from a sovereign source that is itself independent from any influence.24

Such an imperative theory of law does not consider the moral base and merits of the sovereign source issuing legal commands, thus espousing a strict separation between law and morals in form. Legal commands themselves may be considered monistic (having singular form, namely a unidirectional issuance of obligations on subjects of the sovereign, with ultimate legal authority resting in the sovereign from whence they originate). A legal system under the traditional positivist perspective is also a reductivist system, in that its normative components (the concepts of sovereignty, obligations, etc.) comprise a closed system of understanding and applicability, founded on power relations, directive commands/coercion, and obedience accompanying descending hierarchical levels.

As such, the above is the basic notion of law as a coercive force that is reflected in some extant social science perceptions, including the economic theories of regulation discussed earlier and some (but not all) elements of the institutional perspective that follows this section. However, as Latour (2010) implicitly provides, reductionism in this manner fails to capture much of the social process that defines the evolution and development of the legal systems that in turn exert influence on institutions and societal actors. Indeed, certain institutional perspectives adhere to a similar viewpoint, whereby the role of culture and the influence of coercive pressure may operate through societal forces that are distinct from the law or the sovereign (see e.g. Engwall 2017).

In legal theory, modern interpretations of legal positivism mostly retain the basic notion that legal systems (based on secondary rules) are imbedded in broader socio-political systems (a mix of primary and secondary rules). Such

24 Under the traditional positivist view, limits on a legal system may still exist in the form of self-limited legislative authority as a decision of the sovereign or societal limits imposed by public opinion. A legal system may also rely on non-legal materials (including systemic provisions such as definitions and clarifications of terminology) that do not function as imperatives. These materials, and limits, whether internally created or adopted from external fields are not a part of law, even though they may be necessary for the functioning of a legal system. In contrast, modern interpretations of legal positivism, including the stance adopted in this thesis, recognize that there are non-legal materials, including self-regulation through professional codes, industry standards, praxis, and other factors including, not inconsequentially, judicial discretion, that have a direct bearing on legal analysis, particularly where the legal rules or the wording of legal rules no longer have a clear or determinable application to the issue or case being addressed (Hart 1994, p. 124–136). Thus, the distinction between the legal sphere and the social (or societal) are permeable, and in some sense, the two spheres are intertwined to the extent where a distinction may not always matter (at least, in the context of judicial determination).
interpretations have largely let go of the notion that law is ultimately imperative in nature. Whilst sanction, enforcement, and power relationships remain an important facet of modern legal positivism, this is accompanied by a greater recognition of the complex relationships and power dynamics within society that may influence both the formation and execution of laws and legal systems themselves (Hart 1994). This shift can be seen through a renewed focus on the public good in recent financial regulatory developments at political and policy levels, in regulatory instruments themselves, and in judicial decisions as pertaining to accountability considerations in the financial sector. It is also an evolution that brings into question the relationship between law and morality – something that is perhaps of particular interest in the context of accountability considerations within this current work.

In relation to accountability within the regulation-practice nexus of banking, the first consideration on morality relates closely to the impact of regulations on practice in the context of ‘moral’ accountability in monitoring and supervision as well as in regulatory discipline on regulated entities. In some sense, this ‘moral’ perspective straddles the boundary between accountability and legal liability. An actor may be able to fulfill its accountability responsibilities without being legally liable for any shortcomings or detrimental results; conversely, liability regimes that are in place do ensure accountability in some sense, but may also hold actors culpable even if they are not directly responsible or accountable for the events or outcomes for which they are being held liable.

With the introduction of more individual or personal liability into corporate governance and financial regulation, this flavor of ‘moral accountability’ through legal liability has, in some sense, been strengthened. Even so, the question remains of whether accountability translates directly to liability, and if so, how. There is still a certain essence of economic reductionism in financial oversight that is quite different from, for example, the penalties that accompany morally reprehensible crimes of serious impact in areas such as criminal law. Indeed, one of the continuing tensions regarding accountability (especially moral accountability) through legal culpability is the difficulty in criminally prosecuting individuals who have been accused of wrongdoing in the course of their duties within the corporate form (Nelson 2017). Two examples to illustrate opposite sides of the spectrum this tension creates are as follows:

First, in both common and civil law jurisdictions, what is apparent is the considerable difficulty in holding individuals criminally liable for corporate wrongdoing, even when it is clear that corporate wrongdoing has occurred. In the US common law context for example, two key traders who were largely “responsible” for the failure of Bear Stearns in 2008 were acquitted.
of any criminal wrongdoing by New York courts in 2009 (McCool and Erman 2009). Similarly, in the civil law jurisdiction of Sweden, in the case of the 2010 failure, license revocation, and subsequent liquidation of the Swedish bank HQ, there was no doubt that the bank had engaged in questionable practices. Even so, in 2016, the Stockholm District Court cleared the bank’s board members, CEO, and auditor of any criminal wrongdoing (Hartmann et al. 2018, citing Stockholm District Court, 2016). Additionally, in 2017, the civil suit for damages claimed against the former board members, executives, and auditors of HQ was also ruled in favor of the defendants even though the court found HQ to have been in non-compliance with the applicable accounting rules (in this case, IAS 39) to the tune of miscalculating HQ’s trading portfolio valuation and thus misrepresenting its financial statements in the amount of almost SEK 500 million. The court’s reasoning was that even though HQ bank and actors within the bank had failed to responsibly measure and account for their portfolio valuation and connected risk exposure, this failure was not the proximate cause of the plaintiffs’ loss (Hartmann et al. 2018, citing Stockholm district Court 2017).

Second, in relation to regulatory rules themselves, there is growing concern within the compliance industry that personal liability controls on compliance officers in some jurisdictions unfairly increase individual penalties in a manner that is out of accordance with any reasonable expectation of accountability. This is the other side of the spectrum: legal liability and punishment where no reasonable expectation of accountability can give rise to such punitive reprimand. At this end of the spectrum, the earlier discussions on principal–agent perspectives may help the reader to understand that such regulation, if misaligned with socio-economic conditions impacting firm and individual behavior, could theoretically serve to introduce iatrogenic risks as firms seek to comply and individual actors responsible for the compliance function contend with the shifting agency obligations of their contracts with these firms.

As examples, consider two rules under which the Securities and Exchange Commission (SEC), the main financial regulatory agency in the United States, can bring individual civil and (through cooperation with the Department of Justice) criminal charges against individuals – namely, Chief Compliance Officers (CCO’s) – in the US financial sector: Section 15(b)(4)(e) of the Securities and Exchange Act of 1934 (Exchange Act), and Rule 206(4)-7 of the Investment Advisers Act of 1940 (Advisers Act) (Ceresney 2015).

Section 15(b)(4)(e) of the Exchange Act largely mirrors Section 203(e)(6) of the Investment Advisers Act of 1940 and is targeted at addressing internal control failures in the context of supervision. Both allow for individual CCO liability should the CCO fail, either deliberately or through negligence, to
supervise adequate compliance by the financial organization with regard to the covered external financial regulations.\textsuperscript{25} Similarly, Rule 206(4)-7 of the Advisers Act is an anti-fraud provision that requires appointed Chief Compliance Officers (CCOs) to oversee the adoption and implementation of firm policies and procedures aimed at preventing fraudulent, deceptive, or manipulative business practices. Under this rule, personal liability for CCOs through enforcement actions by the Securities and Exchange Commission (SEC) is heightened, as CCOs can be and have been held liable for incurred damages that result not only from deliberate actions but also from potential negligence (Golumbic 2017, p. 66; Temkin and Atlas 2017). Over the past decade, such liability has indeed been enforced against individual CCOs through cases such as \textit{In re SFX Financial Advisory Management Enterprises, Inc. and Eugene Mason}\textsuperscript{26} and BlackRock Advisors, LLC,\textsuperscript{27} albeit through settlement and not successful criminal prosecution.

Perhaps unsurprisingly then, compliance professionals in the US financial sector have spoken out vehemently about their concerns regarding enforcement of these rules (DiPietro 2015). What is interesting and also directly relevant to a non-coercive positivistic view of the legal sphere is that in this example, the SEC has publicly responded with reassurances, a willingness to engage with the compliance profession to address the issue, and also a recognition that even within the SEC’s own ranks there is significant disagreement on whether such enforcements are in line with regulatory intent (c.f Cerseney 2015; Gallagher 2015; Aguilar 2015; Pierce 2018).

What the above illustrates is a conceptual understanding in positive law that recognizes the substance and applicability of law as being in a constant evolution regarding what constitutes an open texture of the law and what comprises its settled core, in other words, what is open for interpretation in the law, and what has already been established to an uncontestable or accepted degree such that it is not open for interpretation. In legal philosophy, these terms are often used to illustrate and explore the relationship between the formal components of law – the structural and substantive (constitutional,

\textsuperscript{25} It should be noted here, however, that both the applicable Sections of the Exchange Act and the Advisers Act allow for affirmative defenses on part of the COO with almost identical language, namely that (1) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect insofar as practicable, any such violation by such other person; and (2) the responsible person, i.e., the CCO, has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with (Advisers Act § 203(e)(6); Exchange Act §15(b)(4)(E)).


statutory, and legislative) basis of law – and the judicial execution of that law through the courts (Waismann 1945; Hart 1994; Schauer 2019).

In both common and civil law jurisdictions, it is ultimately the judiciary that is responsible for establishing, through their decisions, what the law is – or at least, what the law’s practical application is. Here, the positivist stance adopted is that in order to advance the aim and values within the settled core of the law, a certain degree of open texture is inevitable, considering that both courts and social actors may suffer from factual ignorance and the law itself may not have perfect predictability in its application. The concepts of ‘settled core’ and ‘open texture’ thus arguably provide the necessary epistemological framework for discussing and interpreting legal texts and regulatory impact – in this case, in the context of transparency and accountability in the regulation-practice nexus of banking.

In legally oriented discussions, particularly in the context of overlapping national and supranational legal influences in the financial sector, the conceptualization of law as comprised of a settled core and areas of open texture is an important one as illustrated through the examples in this section. Importantly, it is these concepts in practice, as they are understood and as they are negotiated, that shape both extant legal understandings as well as how these understandings relate to the permissible and actualized behavior of regulated market participants. In an integrated social science discussion such as this dissertation, these understandings remain important, as they allow for a better understanding both of how laws are translated into organizational practice and also how organizational risk control and compliance play out in the regulation-practice interface of banking.

2.2.1.4 Institutional Theory

Whilst the above sections identify some important influences on regulatory discourses and to some extent organizational practice, in this study there are also strong elements of institutional theory that bind together the above field-level understandings with the practical impact of regulation on organizational behavior. This section covers these links through a discussion that generally outlines the relevant developments in institutional theory and then builds on the institutional understandings that feed into understandings of the inter- and intra-organizational interactions of regulation and risk control that this dissertation addresses.

Institutional theory is a well-established lens in social science research (Hughes 1936, 1939; Parsons 1951; Selznick 1957, 1996) through which the behavior of organizational actors and their relationship with the environmental contexts in which they operate may be understood (Meyer and Rowan 1977; Zucker 1977, 1983; DiMaggio and Powell 1983; DiMaggio and Pow-
ell 1991; Williamson 2000). This can be understood by accepting the assumption that in modern societies, formal organizational structures and processes emerge from and exist within strong and often multifaceted institutional contexts. One important facet of institutional theory in its more modern or ‘neo-institutional’ form has thus been its use as an explanatory lens through which organizational similarities within a given field (the concept of ‘isomorphism’) and overall field stability may be understood through the tendency of black-boxed firms to conform to rules, expectations, and beliefs in their institutional environments in a bid for legitimacy (Meyer and Rowan 1977; DiMaggio and Powell 1983; Ledford et al. 1989). The breadth and versatility of institutional theory, as recognized by explicit research efforts that began in the 1990’s (Suddaby 2010), has strengthened over the past few decades and has identified the institutional perspective as both useful and appropriate in building understandings of the sometimes highly specific behavior and change processes that impact organizations and the fields within which they exist (see e.g. Greenwood and Hinings 1996).

Although it often carries the reputation of being a macro-level theory that focuses on field-level analysis rather than opening the ‘black box’ of firm behavior (DiMaggio and Powell 1983; Oliver 1991; Coase 1998), DiMaggio and Powell (1991) identify that institutional theory encompasses a variety of viewpoints which diverge greatly on levels of analysis, how much importance is assigned to normative versus more individually cognitive elements of institutions and institutionalization, and how institutions themselves are diffused through society (p.1). Scapens (2006) reiterates this diversity of perspectives, identifying three distinct strands of institutional theory, namely: New institutional economics (NIE) that “uses economic reasoning to explain diversity in forms of institutional arrangements” (Scapens 2006, p. 11); New institutional sociology (NIS) that “seeks to explain why organizations in particular fields appear to be similar” (ibid, p. 12); and Old institutional economics (OIE) that is used to “understand what shapes management accounting practices in individual organizations” (ibid, p. 14).

In this section, a brief discussion of two facets of institutional theory will be presented. First, a general perspective is presented of institutional theory as a multi-level lens through which the practical action perspective of organizational behavior may be understood in the context of institutions and society. Next, an actor-focused view of institutional theory, whereby the links between economic theories and the broader focus of institutional theory are identified in the context of regulation and ‘actors’ – that is, individuals and firms as collective organizations.
In modern societies, formal organizational structures and processes emerge from and exist within strong and often multifaceted institutional contexts. One important facet of institutional theory in its more modern or ‘neo-institutional’ form has thus been its use as an explanatory lens through which organizational similarities within a given field (the concept of ‘isomorphism’) and overall field stability may be understood through the tendency of black-boxed firms to conform to rules, expectations, and beliefs in their institutional environments in a bid for legitimacy (Meyer and Rowan 1977; DiMaggio and Powell 1983; Ledford et al. 1989).

At its core, institutional arguments recognize the existence of and interconnection between structures, processes, and actors, albeit with traditional analytical focus on institutions as ‘higher order’ factors that, on their own merit and without the added force of extra-institutional influence, operate as a distinct *sine qua non* in constituting or constraining the behavior of actors (Jepperson 1991; Clemens and Cook 1999; Suddaby 2010). Institutions themselves may be defined to include formal and informal structures, procedures, routines, norms, conventions, specific values, rules, beliefs, action templates rooted in moral beliefs, or systems of signification that comprise the often taken-for-granted assumptions of the social and cultural force of the environment within which organizations operate. The consideration of these allows for an understanding of decision-making and emergent structures based on factors other than the efficiency and strict rationality espoused under more purely neoclassical economic views. With the pragmatist position taken in this dissertation, they may be considered equally or even more relevant explanations for observed behavior than *homo economicus* calculations.

An institutional perspective highlights facets of social behavior and process that are repeated enough to characterize a particular society or field (Jepperson 1991). As such, in the context of this dissertation, this perspective provides one frame through which the formulation, maintenance, implementation, and effect of legal structures such as banking laws and regulations are explored in a more nuanced yet holistic manner. This is reflected in an indirect capacity within Paper I, where field homogenization is an implicit assumption and is recognized through the acceptance of both accounting and prudential measures as they exist within the field of banking. It is also evident in Papers III and IV, where law and culture exhibit separation only with a high degree of permeability across their border.

In a broader sense, recall the distinction between the primary rules and secondary rules of society identified within legal positivism (*supra* pp. 78–81). One way of considering institutional settings in the context of law and socie-
to consider institutional influences or pressures (DiMaggio and Powell 1983) in the context of primary and secondary rules. These pressures, which may be classified as coercive, normative, or mimetic in their influence on the behavior of organizations and other actors, are ultimately rooted in the cultural factors and influences – the primary rules – that bind a society or field together.

‘Coercive isomorphism’ is either formal or informal pressure that a firm faces from other organizations upon which it is dependent in some fashion. These pressures may include political and social forces as well as organizations or entities that possess resources to which the firm requires or desires access. Coercive isomorphism is most commonly captured by the legal structure and environment in which the firm operates. In responding to the influence of coercive pressures, firms are usually driven by the quest for legitimacy. As firms mature, they thus seek and eventually reflect the dominant institutions of legitimacy as established by dominant government and societal forces.

‘Normative isomorphism’ is a pressure towards organizational homogeneity as shaped by the concept of professionalization – all practitioners of a given profession tend to follow the established norms of that profession, and function as an isomorphic force to disseminate those norms through their practice. Following the precept set forth by Dimaggio and Powell (1983), Chin and Mishra (2013) define this pressure as “the collective struggles of the members of an occupation to define the conditions and method of their work so that there is a clear established cognitive base and legitimation for occupational autonomy” (p. 291). Here again, legitimacy is a driving factor.

‘Mimetic isomorphism’ is the result of environmental uncertainty. Faced with external uncertainty, firms are likely to model their behavior on more experienced, more influential, or more successful firms in the same field. Mimetic isomorphism may thus be understood as industry best practices or benchmarking, where firms deal with environmental uncertainty by following what is perceived to be successful or least risky behavior as established by other similar firms that face the same set of environmental conditions.

At the most basic level, a strong link between institutionalism and what drives the rules of society – the culture, the routines and rituals that bind, and the structures and processes that build on these binding factors in a manner that allows for societal evolution – link institutionalism with legal positivism. In the institutional context, however, there is still, as stated earlier in this thesis, a tendency to view law (regulation) as a more monistic and unidirectional force under the older Austinian view rooted in the principle of the Sovereign. The necessary recognition of permeability between legal infrastructures and society is missed in this view of law or regulation as a coer-
cive force. At a theoretical level, the social nature of the legal regime loses its richness and gains a much more two-dimensional quality in its perceived application to actors within institutional fields.

Although I highlight the link with the legal/regulatory influence here, the same holds true of what are identified as the other two varieties of isomorphic pressures as well. What this strongly implies for macro-level considerations under the established ‘neo-institutional’ approach is that institutions and institutionalization are likely to occur in independence of agency, power, and technological or environmental uncertainty considerations. The latter two may explain the diffusion of organizational forms (Friedland and Alford 1991), and the former two may indicate an ability to enforce new patterns within an organizational field. However, on the whole, the approach indicates a certain independence of institutions from organizations or indeed, from organizational fields. Moreover, the permeability between society and actorhood is lost – the idea is discounted that agency is influenced by institutions just as institutions are influenced over time by agency (ibid; Hirschman 1986).

As the macro-level focus of the theory is on understanding field-level developments and inter-organizational homogeneity, the above is in one sense unsurprising. The explicit theoretical focus of the macro-level institutional perspective is in understanding the emergence of homogenization within the field as organizations seek to establish their legitimacy. Yet, a certain level of interdisciplinarity may not fall amiss in the more practical considerations of what is being institutionalized, and how, in terms of substantive effect, this will impact not only the actors but also the field itself. Within the context of this dissertation, the concepts of risk, transparency, and accountability are all in some sense dependent on the institutional context within which they arise. At the same time, the agency and power considerations implicit in these concepts cannot be dismissed and are arguably themselves reflexively interactive with their institutional settings.

Institutions and Actors: Introspective Institutionalism

‘Institutionalism’ is a term that is difficult to define. By proxy, so are ‘institutions’ and the process of institutionalization.’ As institutional theorists themselves have acknowledged, it is perhaps easier to say what institutional theory as a whole is not rather than what it exactly is (DiMaggio and Powell 1991, p.1). And yet, when one speaks of the ‘institution’ of banking, or the ‘institution’ of Western democracy, or indeed the ‘institution’ of education, the educated listener is likely to have an intuitive understanding of at least the broad connotations of what is meant by the speaker.
What institutional perspectives unfailingly address in some way is always the interaction between the social, political, and economic spheres of our collective reality. In other words, the social reality that, according to extant and dominant sociological thought, is in some sense irrevocably connected to the “agentic, purposive, and bounded human actors” (Meyer 2010, p. 2) that comprise it. In this sense, institutionalism is related to the individual human as well as to more ‘black-boxed’ collections of individuals (such as firms and other levels of organizations). More introspectively, if we are to speak of values and principles in addition to explicit practices, then institutionalism is connected perhaps more to inherent human nature as it arises within a collective and cohesive society. No matter how one views it, institutionalism is inseparable from not only actorhood but also personhood – what it means to be a person, what it means to be (or not be) a part of a given society.

Earlier in this chapter, the section on legal positivism identified that in relation to society and actors, all societies contain some approach towards achieving the encouragement of desirable behavior, the discouragement of socially undesirable behavior, and some form of conflict resolution for when disputes arise between societal actors (supra p.79). In the context of actorhood, this perspective of legal positivism, which understands the division between law and society as a permeable one situated within a complex social fabric of economic and political actor-based systems of varied power dynamics and norms of legitimacy (ibid). This is directly tied to the perspectives of intuitionalism presented below.

One avenue of providing a multi-level perspective of institutionalism in the context of economics was presented through the approach of New Institutional Economics (North 1990, Williamson 1998). Under the framework of this approach, Williamson 1998 provided for four levels of social analysis: In descending order, the first level is that of norms, customs, mores, traditions, and so on. This is what is again understood in legal positivism as the primary rules of society – the often unspoken, unwritten customs and practices that are slow to change. Identified by North (1990) as “informal constraints,” these social rules are largely what Scott (2008) has termed the cultural-cognitive element, as provided in the paragraphs below. The second level is what Williamson terms to be the “institutional environment” (Williamson 1998, p. 27). These are the “rules of the game,” as established by the interaction and interdependence between primary and secondary rules under legal positivism – what are the rules and procedures of the broader applicable legal infrastructure within which actors must conduct themselves? Here, the import of constructed values and norms on objective economic reality is important. As in level 1, the process of change is slow; yet, as Williamson identifies, there is the potential for sharp changes to the established “rules of
the game,” usually through some event that sparks massive discontent like a financial crisis is apt to do. The third level concerns governance structures and applications of transaction cost economics that link how legislative, judicial, or industry-led models interact and influence how organizations conduct their activities. As Williamson (1998) frames it, “taking the rules of the game at Level 2 as shift parameters, Level 3 deals with the play of the game” (p. 29). Finally, the fourth level focuses on a very neoclassical economics/principal-agent-based analysis of how organizational and intranorganizational activities occur. The timeframe of these adjustments is more or less continuous as organizations respond to internal and external influences; however, the resource and risk based considerations that drive activity on this level (and in turn influence the higher levels over time) arguably fail to capture the level-1 influences that drive level-4 decision-making at both individual person and individual actor levels.

This missing link between level 1 and level 4 – or between theory and action – has been addressed by what I call more introspectively oriented institutional research. Scott (1995, 2005, 2008) for example introduced and elaborated on the field-level concepts of isomorphic pressures through the more actor-oriented concepts of regulative, normative, and cultural-cognitive elements of institutional orders. This analytic strategy addresses the ‘why’ behind institutionalism outcomes in a way that the macro-level focus of traditional neo-institutionalism and the multi-level focus of institutional economics do not.

The concepts provided by Scott provide a bridge between legal theory and the social inclusion of culturally based notions into the regulation-practice nexus. It is not, then, simply that the legitimacy or power of the State as an actor dictates that organizations behave in a certain way or follow certain rules; these rules themselves contain a social element shaped by all constituents of a given society. The shape given to these rules consists of institutionally contingent considerations of both positive elements and normative elements. At the same time, the inclusion of these concepts in explaining organizational behavior aid in illustrating how and why individual actors may depart from the tenets of positively based rational behavior or even bounded rationality to behave in a more idiosyncratically normatively motivated manner. This focus serves to explain organizational or intra-

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28 Regulative elements emphasize rule-setting, monitoring, and sanctioning activities. Normative elements “introduce a prescriptive, evaluative, and obligatory dimension into social life” – a sort of institutionally or socially driven morality, if you will (Scott 2008: 54). Cultural-cognitive elements highlight the “shared conceptions that constitute the nature of social reality and the frames though which meaning is made” (Scott 2008: 57).

29 The maximization of economic benefits, and resource-based social justice, for example.

30 Moral aspects of behavior and what is normatively understood to be just and equitable, for example.
organizational divergence in behavior within a field. It also provides some insight into how self-determined decision-making under idiosyncratically bounded rationality may reflexively reduce the homogeneity within a given field – even if such internal diversity is not readily apparent in a cross-sectional or even longitudinal field level (Barley and Tolbert, 1997; Scott, 2008; Suddaby, 2010).

Regulative, normative, and cultural-cognitive elements may vary substantially in the type of institutional order they support. Thus, motives for compliance, the bases of structural order, and the underlying logics of processes, actions or mechanisms harnessed at the organizational (firm) or intra-organizational (intra-firm) level may differ. Similarly, the legitimacy gained through each element may be derived on different grounds – whilst some effects may be legally sanctioned, others may be primarily morally dictated, and yet others may somehow rest in the support of the extant culture within which they occur (Scott 2008: 51). Now, this is not to say that all elements cannot play a role; however, it is ultimately the motivation for action or behavior that matters under this view of institutionalism – is an actor behaving or complying merely to avoid punishment? Does the actor feel morally obligated to act – even, perhaps, under threat of punishment for the action? Does the actor engage in some behavior or response because it is inconceivable to act in any other manner? This is the more introspective, micro-focused side of institutional theory. The stability of action and the institution itself is not questioned; however, the deeper foundation of institutional forms is illuminated through an inquiry into the deeper influence of institutional elements on actorhood itself.

Institutional Settings: Power, Uncertainty, and Institutional Differences

Tying together the multi-level focus on fields and actorhood that institutionalism can harness, this section seeks to provide a context for how considerations of power dynamics, environmental uncertainties, and basic underlying institutional differences impacting actorhood may influence the structures, processes, and boundaries of empirical developments in the regulation-practice nexus.

The permeability between society and institutions is being increasingly recognized in institutional research (e.g. Engwall 2014; Engwall 2017). To some extent, this recognition addresses what Friedland and Alford (1991) identify as a shortcoming in the neo-institutional perspective of earlier decades – the assumption of a clear delineation between institutions, on the one hand, and conceptions of agency interests and power, on the other. These assumptions are tied to the idea of organizational field boundaries, and the more recent efforts along the vein of Scott (1995, 2008) that seek to identify not only what such boundaries are, but through what mechanisms and why
actors within those fields follow or diverge from the established patterns within those boundaries. Building in one sense on the multi-level focus of institutional economic theory, this introspective turn also considers that agency interests and drivers are not independent of institutions but may be institutionally shaped themselves. Of course, concepts such as risk, uncertainty, accountability, transparency, power, and even agency can be conceptualized ‘independently’ in theory, but in practice, their analytic potential depends heavily upon the institutional setting within which they are formed and within which they apply.

To illustrate, consider the difference in underlying principles of the Anglo-American approach to corporate governance and financial regulation as opposed to more continental approaches to the same (LaPorta et al, 1998). As Friedland and Alford (1991) perhaps rightly identify in the context of cultural links in this regard, it could very well be that differences between the social history of the United States and the European Union explain at least some of the structural differences in the present modes of authority and social control between the two settings.31 The authors identify that whilst the U.S. approach government/regulatory control as a means to establish ‘freedom from’ some constraint, the European perspective is more rooted in viewing government/regulation as providing an enabling ‘freedom to’ engage in some activity or field (p.246). Tying this to the institutional economic perspective and applying these principles specifically to the international financial/banking sector, this view could serve to explain structural field level differences at levels 2 and 3 (Williamson 1998; infra, p. 73-74) between different institutional settings; however, it also highlights that there is an inexplicable homogenization between institutional settings at level 4 (practical action and behavior). This is where introspective institutionalism affords a capacity to enrich our understandings – especially in relation to risk control and compliance at level 4. This is further explored in Section 2.2.2 below.

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31 The authors state: “The persistent tendency for Americans to construct decentralized state structures, to separate government powers, to prevent the emergence of national banks, and to foster market regulation aimed at avoiding market concentration derives in part from a culturally contingent concept of power, embedded in a notion of liberty derived from the original settlers’ experience of a highly intrusive, regulative English state” (Friedland and Alford 1991, p. 246). Arguably, the history of World War II and the subsequent efforts on part of European countries to assure regional integration in a bid for long-term political stability are rather the opposite of such an undesired intrusion, and have consequently led to slightly different conclusions regarding the nature of centralized authority and its influences on actor agency.
2.2.2 Transparency, accountability, risk, and compliance in the banking regulation-practice nexus

In understanding transparency, accountability, and risk in the context of regulation-practice nexus of banking, the four areas of theoretical discussion outlined above all play a role. What has been presented so far are the threads from regulatory rationales, the principal–agent perspective, legal positivism, and institutional theory. How they link to transparency, accountability, and risk has been identified in the running course of those discussions. The patterns that emerge are of relevance to understanding intra-organizational as well as inter-organizational perspectives explored in this dissertation.

In this section, the theorization process and presentation of the basic framework of transparency and accountability as they apply in the banking regulation-practice nexus is outlined. The framework is based on the approach and discussions contained in Papers III and IV. In this section, the framework is synthesized with the theoretical discussions presented earlier in this section.

2.2.2.1 Transparency and Accountability: Building Understandings

The process of theorization behind this framework began with extensive literature-based desk research as a fairly common-sense inquiry that ultimately centered on five key questions:

(1) What do the terms transparency and accountability mean?
(2) Why are these concepts desirable in the financial sector?
(3) By what means can transparency and accountability be established or improved in this context?
(4) Who are the actors involved in establishing (or benefitting from) transparency and accountability in the financial sector?
(5) What are the roles and relationships between these actors, and how is that relevant to transparency and accountability in the financial sector?

2.2.2.2 Tenets of Accountability

Focusing first on accountability, these are the threads that emerged:

Accountability is a relational, multi-directional, and information-based concept. Multiple scholars have touched upon important theoretical insights into the nature of accountability whilst simultaneously acknowledging its inherent elusiveness (Sinclair 1995; Mulgan 2000; Shearer 2002; Mansbridge 2009; Messner 2009). Nonetheless, accountability as a general concept may be said to encompass two important factors: First, accountability establishes a reflexive connection between actors, namely between those who demand accounts and those who provide the accounts. Second, it entails a ‘holding to account’ – a right on part of the entity demanding the account, and an obliga-
tion and potential consequence on the account provider (Roberts and Scapens 1985, p. 448–450). Such a holding to account may exist either at an intra-firm level (for example, through budgets) or at an inter-firm or even more aggregate level, such as through firm disclosures to different stakeholders. In the regulation-practice nexus of banking, accountability between regulators and banks is a relationship that extends in both directions. Whilst banks are accountable to regulators for compliance with regulations, regulators are accountable to banks for providing clarity in regulatory enforcement as well as fair and appropriate monitoring.

**Power and scope are important factors in establishing and enforcing accountability in a relational context.** Roberts and Scapens (1985) also draw attention to the power relationships inherent in accountability regimes, namely through their complex systems of “rights and obligations” (p. 448). In other words, systems of accountability consist of two components:

1. The right to demand and obligation to provide an account; and
2. The right to hold and duty (or liability) to be held to account for one’s actions.

In other words, accountability relationships depend on the demander’s right to review (and assign consequences), and the provider’s obligation to provide an account or review (and deal with any resultant consequences).

In the context of intra-organizational accountability systems and interactions, the authors identify that accountability may sometimes seemingly be unidirectional, asymmetrical and hierarchical within organizations. As a relational construct between providers and recipients of accounts, a multi-level analysis of accountability systems or relationships can be achieved through a focus on interactions and reproductions of structures of **Signification** (meaning), **Legitimation** (morality), and **Domination** (power) (ibid, p. 448).

In an intra-firm context, accountability, through the technical practice of accounting and control activities within the firm, “institutionalizes the rights of some people to hold others to account for their actions” (ibid). Even in such contexts, an important component of accountability is its multi-directional aspect. Specifically, accountability implies consequences and limits for those demanding accounts as well as those providing them. In this regard, the **scope** of accountability is an important factor – for example, in employer–employee relationships, employee accountability to employers may extend only to certain activities or for certain durations of time (such as work hours). As the authors state, “the rights and obligations defined through the practice of accounting are typically supported by a whole series of positive and negative sanctions ranging from disapproval and praise, to the manipulation of financial incentives and career prospects” (p. 449). In other
words, not only must demanders have the right to demand and enforce accountability, but also have the capacity to achieve such accountability.

The above is conditioned to the inner workings of the firm. Subsequent work by Roberts (1991) follows a similar view. Beginning with a consideration of individual accountability in the context of hierarchical and strategic systems within the firm, Roberts draws attention to the relational nature of accountability and holds that “in practice, accountability is a form of social relation which reflects symbolically upon the practical interdependence of action: an interdependence that always has both a moral and strategic dimension” (p. 367). Ultimately, he extends this concept to the external interactions and effects of organizational behavior and recognizes that current systems of accountability may fail to mitigate some of the unintended moral and societal consequences of organizational behavior (ibid).

In terms of consequences, accountability is strongly linked to but also distinct from liability. Accountability may imply simply a duty to give an account – that is, show or explain past or ongoing actions (see e.g. Roberts and Scapens 1985; Behn 2001, p.4). Conversely, it may also impute liability for some measure of sanction on a party that has failed in its duty of accountability (Mansbridge 2009). In the context of financial institutions, research by Raffer (2004) at an inter-organizational level, states for example that, “in a market economy, anyone must face the economic consequences of their actions and decisions” (p. 62). Linking such consequences to regulation, Raffer identifies the role of legal liability regimes as well as professional standards in deterring negligence or misconduct and promoting healthy behavior in line with a specific form of accountability: financial accountability. Such an understanding of accountability ties the concept directly to consequences, which can be legal or financial.

In other words, accountability highlights that, in addition to their monitoring function, regulators also serve an enforcement function, including imposing penalties or sanctions where warranted (see infra, p. 34–36). However, by itself, monitoring or even enforcement may not mean that legal liability necessarily follows from any misconduct identified through accountability reports and channels (see infra, p. 67-68).

Enforcement of regulation holds firms as well as their agents accountable (and sometimes liable) to different stakeholders (Moohr, 2003; Moohr, 2009), depending on the context being monitored. External accountability may be to stakeholders such as depositors, customers, and regulators, and internal accountability, much in line with Roberts and Scapens, to employees, unions, and other actors or monitors within the firm. In the context of internal control, the compliance function serves an important monitoring role.
for business activities and an equally important reporting role to the Board of Directors and executive management, as identified in Paper IV.

Relatedly, whilst accountability is linked to morality and ethics, these are three distinct terms and concepts within the regulation-practice nexus of banking. Thus, establishing accountability does not necessarily either depend on or promote better approaches or outcomes from either moral or ethical perspectives. As should be evident by this point in the discussion, terms and concepts tend to have many interpretations and meanings. Succinctly and for the purposes of this discussion, ‘morality’ can be philosophically understood as self-standing and in some sense universally applicable beliefs about what is ‘good’ or ‘right’ or, conversely, ‘bad’ or ‘wrong.’ As a philosophical concept, ‘ethics’ extends the applicability of moral positions into practice, and can take on different flavors such as utilitarianism, Kantian deontological ethics, or Aristotelian virtue ethics, to name but three of many ethical theoretical positions.

In modern applications, including in the regulation-practice interface of banking, the concept of ‘ethics’ takes on the expansive interpretation of equating ‘ethical conduct’ to an adherence or compliance to rules and principles. In this regard, the rules and principles refer not only to regulatory frameworks such as prudential regulation and accounting rules, but also to organizationally driven codes of conduct and modes of behavior. Recall, in this regard, what was briefly mentioned in the section on legal positivism earlier in this chapter regarding how morality is in some sense reflected in the link between accountability and liability (supra p.81–84), and consider how this may unfold in the regulation-practice interface of not just banking, but other fields as well.

Perhaps the clearest illustrative example of the link between accountability, morality, and ethics arises in criminal law, in the context of capital punishment. For those who are opponents of the death penalty, their opposition arguably rests in moral convictions (it is universally wrong or bad to take a life, regardless of the severity of the crime committed) rather than ethics (the same people who oppose the death penalty may, feasibly and concurrently, based on their ethical viewpoint, be staunch proponents of strict and harsh long-term punishments such as life imprisonment in maximum security prisons for defendants who, even in the absence of malice aforethought, are found guilty of crimes that indicate high levels of moral turpitude or depraved-heart indifference).

Similarly, in the regulation-practice nexus of banking, ‘ethical conduct’ may refer to actor conduct that adheres to the rules issued by regulators, standard-setters, or firms. Ethically, these rules may or may not prioritize certain stakeholder interests over others. In practice, the outcome of ‘ethical con-
duct’ within extant accountability relationships, channels, and proceedings may or may not result in processes or outcomes that maximize the well-being of even those prioritized stakeholders. And morally speaking, it is difficult to make an argument that either accountability or ethical conduct ensure or promote any kind of moral value. At most, one can say that some given and current values of society are in some sense reflected in accountability relationships and ethical codes. However, this is ultimately more of a rules-based and context-specific understanding that may incorporate multiple and perhaps even competing ethical perspectives and may lead to outcomes that are quite independent of both morality and ethics.

Finally, Accountability in the regulation-practice nexus may take one or several different forms, depending on the context of the relationship being analyzed and the direction(s) in which the accountability relationship functions. The accountability of banks to regulators is vastly different than from that of regulators to banks. The same is true of accountability relationships that can take countless iterative forms as relationships between legislators and regulators; legislators and constituents or the general public; regulators or banks and investors, customers, or the general public; and so on.

The potential differences in such accountability relationships are not just in terms of power relations, but also in terms of the actual form that accountability can take. For example, between banks and investors, the accountability relationship in place is often one of fiduciary responsibility. Between legislators and constituents, accountability is driven by a relationship heavily dictated by principal–agent considerations as well as public interest rationales. Between legislators and regulatory agencies tasked with implementing legislative instruments, accountability often takes the form of administrative accountability, whereby the regulations enacted must follow the bureaucratic administrative procedures that allow for final adoption and implementation. Normally, such administrative accountability includes public comment allowances and is an evident part of the original Lamfalussy process as well as the post-crisis financial supervisory structure and rulemaking process in the EU, as explored and described in detail in paper III.

In teasing out the different forms of accountability as they surface in the regulation-practice nexus of banking, Mansbridge (2009) identifies two perspectives derived from principal–agent theory in the political context that are of direct relevance to the banking regulation-practice nexus:

First, and in direct relation to the principal–agent considerations outlined earlier in this section, accountability relationships are always a mix of sanc-
tion driven and selection driven dynamics between parties.\textsuperscript{32} The former is characterized by misaligned interests between principals and agents, with heavy monitoring and enforcement costs; the latter is defined by aligned interests between principals and agents, with more latitude for principals to address residual costs and select the best performing agents. In reality, there are always elements of selection and sanction at play in accountability relationships within the banking regulation-practice nexus, which is something for both regulators as well as banks to consider in their activities and interactions.

Second, in relation to accountability relationships where the focus is less on liability or sanction and more on providing an account of past or current decisions and actions, the actors within the accountability relationship may not only provide their accounts, but also engage in communication with each other to clarify and address the areas where their approaches do not align (ibid, p.370). Accountability in these interactions may take the form of narration – that is, a unidirectional provision or clarification of an account or decision from one party to another, such as for example, court opinions regarding case law, or clarifications or guidelines issued by regulators regarding specific regulations. Conversely, accountability may also surface as deliberation – that is, an active interaction between the parties whereby accountability is achieved through an engaged back-and-forth exchange between the parties. Such interactions may occur, for example, through industry and interest group consultations in the financial sector rulemaking process, or through meetings between banks and regulators in the context of compliance and regulatory supervision activities.

\textbf{2.2.2.3 Tenets of Transparency}

Moving next to transparency, the important threads that emerge are as follows:

\textit{Transparency, like accountability, is a relational, information-based, and multi-directional concept.} Similar to accountability, understandings of transparency also focus on two aspects – namely, that it is an \textit{information-based} and \textit{relational} concept (Vishwanath and Kaufman, 2001; Oliver, 2004; Walther, 2004; Heald, 2006; Roberts, 2009). In other words, transparency requires a provider as well as a recipient of information that purports to ac-

\textsuperscript{32}Where there is no alignment between the interest of the principal and the interest of the agent, and close monitoring is required to reward well-aligned agent behavior and punish agents for actions poorly aligned with the interests of the principal, \textit{sanction} driven accountability relationships apply (Mansbridge 2009, p. 369–370). Conversely, accountability relationships are \textit{selection} driven where agents are selected (or self-driven) to have their own external motivations that push their objectives closer to the principal’s goals (ibid). In places where selection driven accountability exists, principals may be able to better invest resources towards mitigating residual costs and selecting the best performing agents rather than in monitoring and enforcement activities.
count for some underlying phenomenon or process. It, too, is the provision of an account by a party to other parties, offering insight through information disclosure. While it often serves the function of accountability in either a sanction or selection driven context, it can also exist for its independent merit that are completely separate from the principal–agent considerations of an accountability relationship – for example, to provide firms with competitive advantages (e.g. Potters, 2009) or to increase legitimacy in the field (e.g. Curtin and Meijer 2006; c.f. De Fine Licht and Naurin 2014).

Transparency is not only affected by power dynamics but can also affect power dynamics between parties. Beginning again at the intra-organizational level, Roberts and Scapens (1985) indirectly address the informational nature of transparency and how it is reflexively tied to power. They identify that “information itself is not neutral, but is itself an important power resource” (p. 449). Here, there is an important link to accountability, namely that transparency can be harnessed as a means to establish or augment accountability channels between parties, or to manipulate power within existing accountability structures. Accountability, through a provision of accounts, thus depends on a contextual or relational aspect of transparency, which differs depending on the interaction and understanding between information providers (those being held accountable) and recipients (those to whom the actors are accountable).

Whilst face-to-face interactions result in a deeper shared knowledge and understanding of the context of what is being accounted for and how it is being accounted for, distant interactions lack such personal knowledge and hence depend more upon the account itself as being representative of reality. In other words, where there is direct contact, a transparent and distinct informational account is not necessarily important, as the actors are able to more openly interact and observe each other and gain insight into the relevant actions or processes being conducted. An example of this is supervisory interactions between banks and financial regulators in the course of regulatory implementation and organizational response. For instance, although the scope of the case study did not allow for direct observation of these, Banque de Montagne, the case bank in Paper IV, engaged in regular interactions with the Swedish Financial Supervisory Authority, Finansinspektionen in the course of the bank’s implementation of GL44, through Swedish regulation FFFS 2014:1.

Conversely, where interaction is distinct or non-existent, the only way for actors to observe each other is through the provision of more distinct information-based accounts. In this context, providers of information may seek to present accounts in the most favorable light to them, thereby rendering certain aspects of their actions opaque. Simultaneously, users of the information who have the power to demand accounts may recognize the complexities and
fallibility inherent in the accounts, and thus request only certain information that they feel will be most useful for their purposes. As a consequence, the resultant accounts, even if they meet the issued demand, may fail to capture the reality of the underlying phenomenon (pp. 449–454). One clear example of this which is also referenced in Paper I is the reliance of prudential regulators on organizational transparency through accounting disclosures. As Paper I identifies, accounting disclosures are always retrospective in nature, and may not always provide an accurate depiction of the bank’s current risk reality. Thus, a significant potential for misalignment exists between accounting rules and disclosures, on the one hand, and prudential regulatory aims, on the other.

Transparency often functions as a central component of accountability relationships. Even though it is sometimes an independent tool, transparency has long been considered a central tenet of corporate accountability (Hood 2006; Hood 2007). As discussed above, transparency, understood as an information-based concept, necessarily requires a provider and a recipient. Whilst accountability may be unavoidable, transparency offers room for manipulation. In an organizational context, actors who lack the authority to demand accounts many nonetheless escape liability through manipulating the accounts that they provide (Roberts and Scapens 1985). What, then, does this mean for transparency as a tool of accountability?

The informational and relational aspects of transparency may be best understood under a multi-directional framework. In this respect, Heald (2006) provides a comprehensive account of the directional aspects and attributes of transparency. As he identifies, transparency possesses a directional aspect and can exist either vertically or horizontally.

Vertical transparency is hierarchical transparency, of the sort between superiors and subordinates within an organization as discussed by Roberts and Scapens (1985). Conversely, horizontal transparency involves either an outward focus or an inward focus. In the context of organizations, outward transparency allows those on the inside of the organization to observe the outside. Heald (2006) discusses this in the context of understanding the environment, and observing and responding to competitive concerns. He implicitly acknowledges the influence of institutional pressures on organizational behavior and response. The other form of horizontal transparency, inward transparency, allows those on the outside to look into the organization. Inward transparency is tied to information disclosure and mechanisms of regulatory and social control. It may be achieved in myriad different ways, ranging from supervisory interactions with regulators, to mandatory reporting, to public relations reporting and corporate social responsibility interactions. Along all these directions of transparency, relational accountability between account providers and recipients is an assumed predicate.
In informational terms, Heald (2006) further identifies that transparency may be classified along three dichotomies – it can measure events or processes; it can either be real-time or be retrospective; and it can either be effective or nominal. These dichotomies may be understood as follows:

1. **Event transparency** may be measured as inputs, outputs, or outcomes, while **process transparency** may be defined as how inputs transform to outputs, and how outputs are linked to outcomes.

2. **Retrospective transparency** allows organizations to conduct their activities and engage in transparency at periodic intervals, for example through accounting disclosures and investor-focused annual reports. Here, the organization is accountable to its stakeholders through its account, but only for the period for which it is providing the account. Conversely, **real-time transparency** allows a continuous inward transparency into the organization and implies that “the internal processes of the organization are continuously liable to disclosure” (p. 32). A practical example of this is again regulatory interactions that allow regulatory supervisors access to ongoing processes of regulatory implementation or compliance activities within the firm. Arguably, external audit also serves a similar function.

3. In order for **effective transparency** to be achieved, the information must be accessible and relevant, and receivers of information must have the capacity and capability to process it. On the other hand, **nominal transparency** is the mere provision of information where the real danger is that of information overload. Such overload though a surplus of information not only reduces transparency, but also discourages scrutiny into the organization.33

In light of the above, one facet of transparency that is important in the context of accountability relationships is that **effective transparency is dependent not only on the scope and the quality of information provided but also on the timeliness and relevance of the information as well as how understandable that information is to recipients.** In addition to the qualitative aspects of information itself, organizational transparency also depends on relational factors such as information accessibility, and the capability of information receivers to actually process the information (Vishwanath and Kaufman 2001; Heald 2006). Accessibility rests on a need for timely and equitable dissemination of information – how readily available is the information, and to whom is it available? It is not just regulatory requirements that affect information flow and access, but also any costs charged for data access, and through what or how many mediums of scrutiny the data is accessible (for example, newspaper and media coverage, internet access, journal publication, and other forms of dissemination). There is also a question of whether

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33 For further reference or explanation, Heald (2006) provides a detailed discussion of these dichotomies and framework.
the recipients themselves possess necessary attributes (e.g., education, aptitude, data storage and processing capabilities, and so on) to be able to process and appropriately act upon the information that they receive.

Additionally, from a governance perspective, regulators and other scrutinizers such as auditors must have adequate monitoring mechanisms in place to ensure that reporting is made in a good faith attempt to provide veracity, and that any changes in reporting are sufficiently disclosed to prevent distortion in how the information is perceived (e.g., mandated periodic reports, audit reports, and a reliance on the professional capacities of accountants to adhere to professional standards and responsibilities). Here, the role of normative, professional pressures is important, as these pressures often help enforce integrity in reporting by identifying anomalies and providing disincentives (e.g. bad press, failed audit, poor credit ratings) for firms to misreport.

In the context of transparency as a facet of accountability, actors, whether at the individual or organizational level, may face transparency demands within different accountability relationships. For banks, in addition to regulators, sanction or selection driven accountability relationships with other actors such as customers, investors, the media or various interest groups may also highlight inward transparency (Engwall, 2017). This may not always result in positive consequences during times of distress. Recall as a relevant example the previously discussed 2007 situation faced by Northern Rock in the UK context (Shin 2009; Goldsmith-Pinkham and Yorulmazer 2010). Recall that in the circumstances surrounding that situation, namely that, as the Northern Rock bank run exemplified, correct information, when disclosed to recipients who lack specialized knowledge or understanding but possess arguably coercive power over an organization, could result in rational yet unintended catastrophic consequences.

Lastly, transparency as a regulatory tool, if incorrectly designed, may not always promote accountability. Etzioni (2010) points out that the empirical benefits of transparency as opposed to other regulatory tools are relatively unexplored, and that existing studies indicate that transparency should not be heavily depended upon as a regulatory mechanism on its own. Whilst transparency controls may augment regulation, opacity through both information overload and recipient shortcomings render it a less than ideal control by itself (p. 398-399). Moreover, as identified above, reliance on banks and other intermediaries for transparent and trustworthy assessments may sometimes require heavy monitoring. As one example of such opacity, consider the ill-advised reliance by investors and regulators on loosely regulated credit rating agency assessments of bank investment valuations and risks leading up to the financial crisis (Roberts and Jones, 2009).

In consequence, transparency often must be regulated and monitored, as end
users are often unable to accurately evaluate poorly regulated risk assessments by intermediaries, even if such reports are perhaps more easily available and comprehensible than information directly from the organizations being evaluated. But the real question is how this should be done. It is at times unclear as to whether such opacity is a bug in the banking system or a feature of the system itself (Admati 2018). Whilst post-crisis prudential instruments have brought the activities of independent credit rating agencies more under the aegis of regulators, as Paper I identifies, misalignments in reporting versus regulatory needs and a strong reliance on market actors for information may increase nominal transparency through new regulation whilst failing to achieve the effective transparency necessary for the achievement of regulatory aims.

The above critique, when evaluated together with the other literature and empirics surveyed in this chapter, points to important considerations in how regulations approach issues of transparency, particularly within the context of accountability. Transparency as part of the regulatory toolbox is highly dependent on the normative goals of regulation itself. These in turn may depend on either principal–agent or institutional considerations, or a combination of both. Assessing and determining regulatory aims of specific regulatory instruments is always a balancing act that requires regulators to weigh the benefits of increased transparency against its potential costs. As the head of one association stated in regard of the costs and benefits of transparency, it is not always a clear-cut case of more transparency always being better. Depending on the needs of stakeholders as well as the market itself, regulators may sometimes be faced by conflicting political and market needs that they must then balance (Paper III).

In achieving regulatory balance, regulatory instruments must be placed within a wide spectrum, and regulators must select carefully from their toolkit. What activities should be subjected to heavy monitoring and supervision with strict penalties? What should be left to market discipline? What should be left to organizational discretion and addressed by regulators only through organizational resilience requirements such as capital and liquidity buffers?

Where, for instance, individual autonomy is highly valued, even to the potential detriment of parties who make ill-advised decisions, regulators may leave some spheres open to high degrees of self-regulation. For example, although investor protections have been strengthened in the wake of the financial crisis (through, for example, MiFID II requirements as outlined in Paper III), if an individual investor makes a decision to use her life savings to purchase certain securities based on her assessment of the (let us assume completely compliant) issuing firms, then if these assets decline in value and cause her to incur a significant loss, the regulators are unlikely to interfere or take action. At the same time, regulatory mechanisms in some sense reflect
the societal norms and values that shape them. Hence, where regulations may be seen to have failed in reaching their normative goals on account of either transparency or accountability considerations, reforms deemed to be in the best interest of society will usually be passed even at a high cost.\footnote{For example, under the Bank Recovery and Resolution Directive (Directive 2014/59/EU) and Single Resolution Mechanism (EU Regulation 806/2014) adopted by the European Parliament earlier this year, the ‘bail-in’ scheme for banks subject to the Resolution would reduce the risk of taxpayers having to bear the cost of any future bailout.}

In formulating their approach, regulators must balance together the multiple interests of different stakeholders. In the context of the banking sector, this requires regulators to balance the interests of banks as well as investors, depositors, and other interest groups, including societal interests. For regulated entities, there is a similar kind of balancing act that must be undertaken. On the one hand, regulatory demands, where mandated, cannot be avoided. However, as identified in the previous sections on legal positivism and institutionalism, this impact should not be considered a unidirectional imperative. Rather, interactions between regulators and banks can shape how banks meet regulatory demands for higher levels of transparency and accountability.

2.2.3.4 Transparency, Accountability, and Risk in banking regulation and practice

In the context of prudential regulation, risk and how it is controlled is something that both banks and regulators are concerned with. How to identify risk, how to assess risk, and how to control the impacts of risk are important concerns in banking. Risk as a concept in banking can be understood as organizational exposure to some possibility or calculable probability of loss, which usually translates in the end to financial loss (see Paper I for a list of different risks that a bank can be exposed to).

Both regulators and market participants understand that some level of risk in the system is necessary for continued innovation and growth. Nonetheless, prudential regulators are concerned with the minimization of systemic contagion risks and the maintenance of systemic and organizational resilience in order to avoid breakdowns and crises in the financial system if or when risk impacts are realized. This, succinctly, is the basic aim of prudential regulation. For banks, their role as risk intermediaries in relation to their strategic, competitive, and governance-based constraints dictate how well they are able to reap the benefits of sensible risk-taking and mitigate exposure to negative risks. In order to do so, banks must also be able to take a proactive approach towards risk identification, measurement, and mitigation – albeit with organizational aims that may sometimes be at odds with regulatory aims (\textit{supra} p.33).
In the context of risk control and regulatory compliance as influenced by the above dynamic between banks and regulators, transparency and accountability play an important if slightly paradoxical role. Particularly in the financial sector, higher levels of transparency may, in some cases, heighten certain risks. For example, as discussed earlier in this chapter in the context of Northern Rock, where higher levels of transparency about organizational distress increases the risk of lowered public and stakeholder confidence, which in turn may increase contagion, harnessing transparency as a regulatory or social tool may not be well advised. Similarly, what emerges from the discussions of transparency and accountability in this section is that whilst having strong accountability structures may be good in several respects, the shape and consequence of these accountability relationships, including through the use of transparency, are important in determining the overall resilience of financial organizations and the financial system as a whole during periods of risk realization. For example, while strengthened sanction regimes may serve as a deterrent for overly risky behavior, in a situation where organizational or distress has been realized, accountability through effective transparency that allows regulators or other stakeholders to either be aware of or possibly even intervene in organizational affairs may be more effective than sanctions that would only serve to spread organizational distress or contagion effects. Conversely, in other kinds of distress situations such as liquidity distress, an open and clear accountability interaction between banks and regulators may be enhanced by low transparency to the public or other stakeholders, as such an approach may serve the purpose of resolving the issue without negatively impacting systemic stability through decreased public confidence.
3. Methodological Approach

The earlier sections have provided the empirical and theoretical foundations of this dissertation. This section explains the methodological positioning and qualitative research design of the PhD project. It outlines how the methodological selections and decisions of this work were made, and how the research itself was carried out.

First, a brief reflection on the overall research design and methodology is provided (3.1). Second, the data collection procedures are outlined for each of the four individual papers in this dissertation (3.2). Finally, a description is provided of the analytical approach of the dissertation (3.3).

3.1 Research design and methodology

As a whole, this dissertation relies on a mix of qualitative methodologies, reflected in the four individual papers comprising this work. In terms of methodological selection regarding the collection and analysis of relevant data, qualitative methods were deemed to be most appropriate for several reasons. First, using a qualitative lens allowed for an easier reliance on a combination of theoretical perspectives rather than a singular theoretical lens. Additionally, an important empirical gap that was identified in the course of research work was a lack of insight into the practical systems, processes, and actions that comprise organizational and intra-organizational operations in the banking sector (Paper II; Kaplan 2011a, Kaplan 2011b). Succinctly put, there is a practical need for greater insight into how banks function. In this regard, the work undertaken in papers III and IV offers an enrichment of not only the theoretical but also the empirical knowledge currently ensconced within the fields of management, accounting, and law.

The qualitative approach of this work is perhaps best justified by the paraphrased words of the philosopher Henri Bergson. According to Bergson (1903, 1961), there are two distinct ways in which we may know a thing: We can go all around the thing and describe it from the outside, or we can enter into the thing and build an understanding of it from the inside. For the latter in particular, qualitative methods are best suited (Charmaz 2004).
Specifically in the case of paper IV, the established qualitative approach of a single, in-depth case study was deemed to be most appropriate, since the inquiry largely explored how related questions (Yin 2003). This type of design is also considered an attractive choice when the phenomena under investigation—such as the moving target of regulation-driven organizational change—is new, ambiguous, and requires rich, contextual, and real time data (e.g. Benbasat et al. 1987; Eisenhardt 1989; Yin 2003; Eisenhardt and Graebner 2007). In this case, the research setting allowed an opportunity to engage in an in-depth and revelatory study of organizational response to regulatory change across the triad of structural, process, and action-oriented dimensions. The revelatory nature of this work is due to the uniqueness of insight into an area that has previously been largely inaccessible to researchers (Benbasat et al. 1987; Yin 2003). In the present research context, access to the inner workings of banks has historically been difficult to establish given the sensitive and competitively secretive nature of banking activities. The opportunity to observe a bank redesign and rebuild its risk organization from the ground up (in many respects) is thus a fitting example of a revelatory case.

In terms of approach, this dissertation is a compilation of desk research, field observations, and interviews at multiple banking sector organizations as well as within the context of one in-depth case study of the risk-control organization of a large bank. A structured literature review and a pilot study were conducted as precursors to the case study. After the extensive desk exercise of document and article analysis that resulted in the published literature review (Paper II) was underway, a 2013-2014 pilot study and preliminary formulation of the concepts of transparency and accountability resulted in the conceptual framework presented in Paper III. Both these efforts highlighted a clear need to build a deeper understanding of the research questions required rich descriptions and intimate observations of ‘on the ground’ activities. For this, a qualitative case study method was deemed to be best suited and was conducted at the case bank, “Banque de Montagne” from 2015 through 2017 (Paper IV).

Legal research and analysis of legislative texts and judicial cases pertinent to financial regulations and disputes were conducted in parallel to these endeavors. The addition of legal analysis has often been ‘behind the scenes’ in that it is not reflected in the final text in the same way as it would be in a legal monograph. Nonetheless, this inclusion was imperative in order to accurately identify and explore the conceptual links between law and accounting within the context of this work (as reflected in Paper I), and also in reflexively and iteratively determining the best investigative approach to case selection and analysis. As a whole, the thesis is a combination of legal and social science research traditions, and follows a pragmatic and iterative abductive process of analysis (Haig 1995; Coffey and Atkinson 1996; Kelle
This general structure and approach are well grounded in established research practice (Denzin and Lincoln 2005; Creswell 2007).

3.2 Data collection

3.2.1 Literature Review

Aside from the literature review conducted for Paper 2, the construction of this dissertation relied on a consistent and iterative constructive process of going between theory, literature, and the empirical data. Three distinct phases of literature review helped to shape the formation of the undertaken research.

Phase 1: Familiarization within the field (2012–2013)

The initial literature review phase occurred during the first year and a half of the PhD process. At the time, I was familiar with theory and empirics in financial economics and in the context of legally oriented discourse. However, I was unfamiliar with the underpinnings of management and accounting theories beyond the standard neoclassical and behavioral influences within the finance stream. During this initial phase of literature familiarization, I began with seminal texts in the fields of management and accounting, and followed a snowball method of selecting journal articles and books to read from those initial perusals. I relied heavily on insights from coursework and guidance from colleagues who recommended interesting books and articles within their own areas of interest (some of which happily overlapped with my own focus). Through this somewhat meandering process, I familiarized myself with the basics of management and accounting literature. I was then able to begin building an understanding of the links between these areas and what I was already familiar with in law and economics. At this stage, the focus was on building understandings and recognizing areas of interdisciplinary overlap and interaction. Analysis consisted of classifying articles and portions of text into different categories of relevance and refining the thesis proposal and overall trajectory of the research project based on extant views within management and accounting.


The second phase of literature review was a combination of a structured and semi-structured approach to literature collection and analysis. This stage consisted of the literature-based work undertaken for each of the four articles. During this phase, I periodically conducted structured searches within legal (LexisNexis and WestLaw) and social science (SSDI) databases. Search criteria in the legal databases consisted of following the legal develop-
opments and any case law surrounding specific regulations at the level of the EU/ECJ. Search criteria for the social science research databases consisted of limiting the search to articles with relevance to transparency, accountability, and risk control in the financial sector in general. These searches and the literature consequently perused helped to build up my understandings of the ongoing developments within EU financial regulation and implementation. The results were then further narrowed to bank-specific articles. The findings of this phase had an important impact of shaping the articles written. Even aside from Paper II, these articles and texts were included explicitly in the ongoing research writings as appropriate.

**Phase 3: Consolidation and final refinement of literature (2018)**

During the last six months of writing this thesis, I revisited the literature previously collected, and engaged in a consolidation of articles referenced from previous literature searches. I also searched for new articles since 2016 that were of relevance to the specific focus of Papers III and IV (again, broadly placed within the search terms of transparency, accountability, and risk control in the financial sector). Whilst I tried to be thorough in my searches, it is important to acknowledge that no literature review or search can be all-encompassing. Thus, one limitation of my overall method is of course that some articles or cases may have been missed.

### 3.2.2 Legal Research

A line dividing the (relatively) modern common law approach from the more historically established domain of civil law distinguishes the legal field into two distinct traditions. Even within the field of finance and accounting studies, this is a recognized distinction (see e.g. La Porta et al. 1997; 1998; 1999). The legal perspectives contained herein are dependent on a mix of primary and secondary materials. These include statutory law, administrative acts and decisions, and case law within U.S. and European jurisdictions. In addition to publicly available information and legislative texts, I conducted searches through US and international legal databases in LexisNexis and WestLaw for US and EU case law and materials outside the public domain. The standard process of citator checks was undertaken to ensure the relevant history and extant applicability of the cases utilized in the formulation of this work.

### 3.2.3 Pilot study

In social science research, pilot studies may be used either as feasibility studies (Polit et al. 2001) or to test particular instrumentalization (Chenail 2011a, 2011b). My approach combined these two aims. For my purposes, the pilot study served to identify the best way forward to the in-depth case study that comprised the last part of my research design. It also served to verify and
refine the concepts of transparency and accountability as they applied and interacted within the regulation-practice nexus of the banking sector.

In order to test the quality of research design leading up to the intra-organizational investigation that is described in Paper IV, I conducted the pilot study prior to approaching Banque de Montagne for the in-depth case study. The pilot study and initial reflexive process of going back and forth between interview data and archival data began in 2013, when it became apparent that more information was needed for me as a researcher to understand the Swedish field of banking. Consequently, a decision was made to speak with three of the four listed banks in order to find out how they perceived the impact of regulations on their operations. As many of the regulations were in the process of being implemented (See papers 1 and 3), these initial interviews were necessary before a more detailed investigation could be formulated. In parallel, I identified that two important organizations in the banking sector that would be useful to also gain a perspective from were the SMDA and SBA. As sectoral organizations that represent the collective interests of all Swedish banks, these organizations have unique insight into the bridges between national and local practice, and regulation at both national and supranational levels.

The pilot study thus consisted of five interviews with the SBA, SMDA, and three listed banks. The interviews themselves followed a mix of structured and semi-structured design. They were built upon the thematic inquiries of how banks and related lobbying organizations within the sector perceived the impact of incoming regulations, and how these impacts related to transparency and accountability as concepts. Implicitly, I was looking to build an understanding of how banks and lobbying organizations viewed the concepts of transparency and accountability themselves, how they saw regulations as impacting the practical affordances of these concepts in banking, and also what they perceived the vulnerabilities of banks to be in the changing regulatory landscape.

The interviews were recorded and transcribed, and then analyzed thematically by hand using first-order codes of “transparency,” “accountability,” “risk,” “vulnerability,” and “regulatory impact.” These first-order codes were later narrowed down into more specific second order codes as related to specific banking activities and areas of importance (most notably liquidity and capital requirements, as well as external reporting). Technology and technological adaptation emerged as a third code during the iterative analysis. These themes were later reflected in the development of Papers III and IV.

In addition to the pilot study, in 2014, I also conducted four field interviews with three field experts – two in person with an expert IT consultant based in
Stockholm, with over a decade of experience working with Swedish banks; one interview in person with an Operational Risk manager of a Thai retail bank, and one telephone interview with a hedge fund trader based in Singapore. Additionally, I also coordinated with the expert IT consultant in Stockholm to organize a full-day workshop at Uppsala University in order to get a better understanding of how the IT systems and infrastructure within a large bank could actually look like and operate, and how they potentially linked to the broader management and control systems in banks. I took extensive hand-written notes during these interviews and the workshop. Although they are quite distinct from both the pilot study and in-depth case study, they provided useful background knowledge and understandings that augmented the pilot study and also contributed to the research design of the in-depth case study.

3.2.4 The in-depth case study

For researchers in general, the closeness and richness of in-depth case studies as explorations of real-life situations is important for two reasons. First, this interaction is important for the development of a research perspective that recognizes the nuanced nature of social reality. Second, engaging in research that mires the researcher in social reality and that concurrently requires an as-objective-as-possible observational detachment on part of the researcher fosters the development of the skills necessary for the researcher to conduct good research. On a personal level, embarking on an in-depth case study in 2015 in one sense represented the greatest challenge within the thesis development process. I had never before carried out a project of the scope envisioned in this case, it was daunting and more than a little frightening to confront the idea of conducting a project that promised to leave months-long timeframes behind and venture into the territory of years.

At the same time, it was energizing to grasp the opportunity to properly investigate what I believed to be an important interactive phenomenon and to apply the knowledge and understandings I had derived up until that point of time. Based on the desk research and analysis, informal conversations and discussions with academic experts in both law and accounting, and the results of the pilot study conducted, two things seemed clear. First, that regulatory development and banking practice shared intricate and sometimes murkily understood links through the conceptual (and practical) dimensions of transparency, accountability, and risk control. Second, that in terms of regulatory influences/impacts/interactions with organizational activity, these were likely to occur at multiple levels of the regulation-practice nexus of banking – namely, at the level of structures, processes, and actions/actors. One of the clearest influences of post-crisis regulation on organizations through these multiple levels was through GL 44/FFFS 2014: 1, which re-
quired a formal split between the compliance and operational risk functions of the risk organization within banks.

Based on the research I had conducted up until that point, I decided that the most appropriate and interesting case to study would be the compliance function within the risk organization of the case bank. One of the main reasons for this was the relative youth of the compliance function itself in EU banks. What the data indicated is that prior to the financial crisis, compliance as a function had been largely absorbed into the operational risk considerations of financial organizations. Following FFFS 2014: 1, the detachment of compliance from operational risk and the increased post-crisis regulatory scrutiny on compliance meant that the compliance function would, in essence, represent a newly created bounded entity within the risk organization. Representing a relatively young function, it was reasonable to assume that the compliance organization in banks would in a very real sense be quite ‘new’. Contemporaneously, by its very nature and role, an independent compliance organization was the first point of contact and reference between the bank and regulations (if not regulators). These factors made the compliance function the most logical choice for case selection. Whilst other facets of the risk organization, not the least of which was operational risk, would also be impacted by incoming regulations, given the more established nature of the operational risk management function, my reasoning was that it would perhaps not be as easy to identify and trace the multi-dimensional influences and interactions of regulation on that facet of the risk organization in the same way as would be possible within the newly reformed and independent compliance organization.

The work conducted up until that point of time made it clear that in order to trace the influences of EU regulatory developments on organizational activity, it would be necessary to select a representative case company – one of sufficient size and operational standing to adequately capture generalizable effects from description to theory as applicable beyond the Swedish setting.35

35 This is based on the framework presented by Lee and Baskerville (2003), which outlines four types of generalization: from data to description; from description to theory; from theory to description; and from concepts to theory. It is also directly tied to the reason why an in-depth case study was particularly beneficial to this endeavor. Whilst generalizability (or the lack thereof) is a criticism that qualitative case study research often faces, the rich contextual affordance offered by such an approach allows for a deeper understanding of the phenomenon under study, which can then be extrapolated into theoretical insights that can perhaps then be tested or further explored in other similar cases. This is not to say, of course, that case studies are not without their own dangers. Two of the most trenchant papers I have read on the topic of the value of in-depth case studies as well as the dangers they pose are Ahrens and Dent (1998) and Piekkari and Welch (2018).
Next, after organizations of the required size and scope of activities had been identified, Banque de Montagne was ultimately selected as the case bank.

I approached Banque de Montagne in 2014 with a formal research proposal to conduct the case study. Formal access to the case bank was obtained at the end of October, 2015. A confidentiality agreement was signed at that time, requiring anonymization of the case bank and all reported activities whilst simultaneously revealing and offering up a largely protected and sensitive set of organizational structures, processes, and activities to my research efforts. The initial meeting with two representatives of the compliance organization was conducted together with two of my supervisors. However, I was solely responsible for the research design, interview design, interviews, and analysis of the materials obtained over the course of the case study. In addition to primary data in the form of interviews, observations, and internal documents, the background research to the case study also involved the collection and analysis of the bank’s annual reports from the years 1992 until 2017. The analysis of the annual reports was synthesized into 22 pages of hand-written notes together with textual and visual extracts from the documents. Together with periodic public report searches of the case bank using key terms related to organizational events and developments related to regulatory developments and organizational compliance and risk control activities, this synthesis served as a very useful tool in formulating and triangulating the approach and analysis of the in-depth case study as it progressed.

Interviews

Prior to formal access being granted, I conducted five interviews with the executive management team of Banque de Montagne’s compliance organization. Once formal access was granted, I was able to arrange for interviews at multiple levels of the compliance organization. These interviews were conducted in person and over the telephone initially through targeted sample selection, and then through a snowball sampling. As stated, the interviews were carried out at multiple levels of the organization: (1) Group Compliance executive management team; (2) key implementation personnel within the compliance function, including external consultants involved with the change implementation process; and (3) compliance/risk officers at multiple field locations. The interviews were conducted in parallel with observations between 2015 and 2016. As such, the interviews can be classified into four phases:

- **PHASE 1:** Informal interviews preceding the confidentiality agreement; retrospective accounts provided by autumn 2015/ winter 2015 initial formal interviews;
- **PHASE 2:** First interviews following the signing of the confidentiality agreement (winter 2015/ early spring 2016) with regard to the ongoing and upcoming development of the reformed risk organization;

- **PHASE 3:** Follow-up interviews and focus on the evolving development of the reformed risk organization (Summer 2016); and

- **PHASE 4:** Outcome observations and interviews regarding the dissemination of the reformed risk organization (Autumn 2016).

Each interview lasted on average between 45 minutes and two hours. As reflected in Appendix 1, three interviews were shorter than 45 minutes. This was due to time constraints arising from scheduling conflicts. The interviews took place at Banque de Montagne’s home and field offices in the Nordic capitals. The interviews scheduled and conducted in person at the home office were digitally recorded and later transcribed. Where interviews were conducted directly after or before meeting observations, or were conducted via teleconference, hand-written notes were taken. The interviews conducted at field offices occurred during the observation period between September and November 2016. They were transcribed through hand-written and typed notes.

**Documents**

*Internal documents*

Internal documents in the form of planning and guidance documents, steering-committee overviews and outputs, operational-strategy documents, and internal guidelines were obtained for the period 2014–2016. They traced the internal discussions and decisions that comprised the formation of the group compliance function within the organization.

*Meeting summaries*

In the Spring and Summer of 2016, I attended several strategy and implementation meetings at both the executive group level as well as at the implementation and design level (notably the meetings between the business architecture and risk taxonomy leaders at the time). These meetings were not electronically recorded, but extensive hand-written notes were taken during the meetings.

*External documents*

Annual reports from 1991–2017 were also collected and analyzed both as a tool to formulate the approach in the case study, as well as to triangulate the other data gathered during the case study. As the annual reports in total far exceeded 1,000 pages, what was ultimately done in 2015 and then added to in 2016 and 2017 was that I extracted, synthesized, and reduced the content of the report to 22 hand-written and typed pages tracing trends of development in corporate governance and internal control disclosures, compliance
disclosures, and discussions of risk in the annual reports. The process of reading and analyzing the annual reports of Banque de Montagne helped me greatly in formulating and later refining the research inquiry and approach of the case study and interviews. The process also allowed me to gain insight into the broader environmental and organizational trajectories leading up to the regulatory implementation and resultant organizational change that I studied in a more practical fashion.

As an illustration of an identification that helped me to recognize how to better focus the case study and also understand the internal environment of Banque de Montagne over a longer period of time, this is one of the trends that emerged through reviewing the annual reports with an eye towards how ‘compliance’ was approached by the bank and what the effect of regulatory implementation as well as the bank’s response had amounted to:

1. Prior to 1998, there was limited disclosure other than pure financial accounting disclosures, at least as identifiable in public records;
2. Perhaps unsurprisingly, prior to 1998, there was no mention of compliance in the annual reports;
3. From 1998 to 2000, ‘compliance’ was mentioned less than three times in any substantive way in the annual reports;
4. Starting in 2001, ‘compliance’ was more explicitly mentioned (more than 6 times in the 2001 annual report), and was discussed more explicitly in the context of regulatory compliance (to paraphrase the annual report text, Banque de Montagne held that compliance amounted to the conscience of any financial services business, and was inherently tied to both ethics as well as reputation of the business); however this seemed to be limited to regulatory compliance. In terms of internal rules, ‘compliance’ was markedly decoupled from business practice and strategy, with a (paraphrased) statement that deviations from internal rules were acceptable provided that they added value to transactions.
5. By 2003, ‘compliance’ was mentioned more than 15 times in the annual report. There was a clear recognition of the link between compliance and operational risk in investment activities; however, in terms of investment activities, ‘compliance’ was still mentioned in the context of regulatory compliance. Interestingly, in the context of Corporate Social Responsibility (CSR), in 2003 Banque de Montagne’s annual report had an explicit recognition that the compliance function was linked strongly to internal rules and monitoring, as well as reporting within the organization.
6. In 2004, ‘compliance’ was mentioned fewer than 10 times, but was more strongly linked to internal control as well as explicitly linked to regulation—notably, Basel II;
7. The link between ‘compliance’ and CSR in terms of the banks’ internal reporting continued until 2008, although a broader under-
standing of ‘compliance’ as being linked to operational risk as well as the risk appetite of the bank was apparent in the 2008 annual report. An interesting (paraphrased) excerpt from the 2008 annual report is that Banque de Montagne explicitly tied compliance risks to the risk of violating external demands through regulation, market standards, or business ethics, and recognized a loss of stakeholder trust and confidence as well as reputational damage and financial losses as potential consequences of non-compliance;

(8) Beginning in 2011, ‘compliance’ began to rise to the forefront of Banque de Montagne’s annual report, with more than 20 mentions in the 2011 annual report and a strong focus on links between not only internal rules and compliance but also specific risk areas (such as financial crimes) and compliance;

(9) By 2013, compliance had risen even more in importance, being mentioned almost 30 times in the annual report and linked strongly to risk appetite as well as business practices. It was explicitly noted in the annual report in 2013 that compliance risk management comprised a part of operational risk management, but also that compliance was linked to internal rules and processes;

(10) By 2015 and the implementation of FFFS 2014:1, ‘compliance’ appeared to be one of the top priorities in the annual report (mentioned more than 40 times), this time being linked strongly not only to regulators, but also to the role of banks as responsible members of society and to organizational culture. Operational risk and compliance were recognized as two arms of the risk organization within Banque de Montagne, and compliance was now linked to business practices in a much more explicit way;

(11) In the 2017 annual report, risk and compliance were being explicitly recognized as being embedded in all organizational activities. The term ‘compliance’ was mentioned in the annual report more than 80 times. ‘Compliance’ was repeatedly and directly linked to the bank’s strategic considerations as well as to adding value to their business operations. Additionally, compliance reporting up to the Board level was explicitly recognized and highlighted in the annual report both textually as well as visually in a depiction of the bank’s reporting and control structures.

Note here that I was not engaging in textual analysis through recording the number of times compliance was mentioned and in what context it arose within the annual reports; rather, these recordings served a pattern recognition purpose in conjunction with the legislative and policy documents surrounding GL44/FFFS 2014:1 as well as the discussions and observations that were unfolding through my interviews and field visits. One aspect of the usefulness of such data triangulation was this: as I was in the midst of conducting interviews and observing meetings, how compliance was mentioned
in the annual reports over time offered a perspective that allowed me to bet-
ter contextualize what I was seeing and hearing in situ. At the same time, by
going back and forth between interview data and other data sources such as
internal documents and these annual reports, I was better able to reconcile
my interviews and observations with these other disclosures that Banque de
Montage was making through alternate channels and to different stakehold-
ers. This in turn helped me better understand what I was seeing and hearing,
and at the same time aided me in refining my approach towards the next
round of interviews and observations as they occurred.

Observations
From January through November 2016, several field visits were made to the
case organization. These consisted of planning and steering meetings led by
the executive management team of group compliance, and also planning
meetings between those in charge of specific components of the change pro-
cess. In October 2016, I accompanied the executive management group rep-
resentative, supporting staff, and external consultants on their final rollout to
four different field offices in the Nordics. These observations consisted of
three full days of training sessions and individual interactions at each of the
four field locations. Whilst these sessions were not recorded electronically, I
took copious hand-written and, where possible, typed notes during each visit,
amounting to a total of approximately 85 pages.

3.3 Data Analysis
Data analysis for the first two papers was largely a desk-based exercise that
relied on previously published literature (Papers I and II) and legal texts
together with cases, decisions, and other interpretative documents (Paper I).
Analysis for the first paper relied on prior technical understandings and tacit
knowledge that were used to identify and assess ongoing developments in
the field of financial-sector accounting and prudential regulation. Paper II
relied on a thematic classification approach that has already been briefly
outlined in this section. Thus, this section will focus on the data analysis
approach taken for the pilot study (Paper III) and in-depth case study (Paper
IV).

For data analysis of the pilot study and, perhaps especially, in-depth case
study, the abductive analytical process occurred in parallel with data collect-
ion, with care taken to focus attention towards similarities as well as dissim-
ilarities between theory and data. Data collection was performed until satu-
ration was deemed to have been reached. In practical terms, an important as-
pect of achieving such saturation meant, for example, that interviews and
observations were arranged and conducted until there was enough repetition
in interviews or observations that no new information was being gained through more interviews.

One of the predictable challenges this study faced was data overload, which is a fairly typical issue for in-depth studies, especially those with a longitudinal focus such as undertaken in Paper IV (Pettigrew 1990). An iterative thematic coding process (initially through NVivo in the first round of archival data collection, and then by hand once more documents and primary data had been collected) allowed me to organize and make sense of the data. The coding process consisted of initial broad coding into general areas or themes following the conceptual categories of transparency, accountability, and risk control. Second-order codes (some examples of codes used include: ‘planning phase,’ ‘structuring,’ ‘implementation,’ ‘risk recognition,’ and ‘control activity’) subsequently emerged, and were further refined into even narrower categories of risk recognition and organizational activity (‘implementation,’ for example, was further divided into ‘regulatory implementation,’ ‘business need,’ ‘internal reporting upward,’ and ‘internal reporting horizontal’; ‘structuring’ was similarly divided into ‘structural architecture,’ ‘communication channels,’ and ‘resource allocation’). Ultimately, several of these codes ended up being redundant to the focus of the case study and were excluded in the final analysis. However, even the codes that wound up being extraneous in the end (such as ‘structural architecture’ and ‘resource allocation’ as two examples) were an integral part of defining and refining the ultimate focus of the study.

3.3.1 Theorizing through analysis

As the research process emerged from an explorative and descriptive endeavor, front-end instrumentation was open-ended. Construct validity (how well the concepts of transparency, accountability, and risk control were grounded in theory), descriptive validity (how thorough and complete – how saturated – the account was), interpretive validity (how connected the constructed account was to observed reality), and reactivity (how much did observer interaction affect the setting) were important in establishing the strength of the study (Miles and Huberman 1984; Maxwell 1992; Miles and Huberman 1994; Kvale 1995; Onwuegbuzie and Leech 2007), and were taken into consideration throughout the iterative and abductive research process. The conceptual grounding was based on a mixed deductive and inductive approach through literature review and an analysis of legislative and policy texts. These were then refined based on the data collected in real-time. The data was analyzed in the context of the literature, and new emergent ideas were subsequently noted. After this, new literature sources were identified and consulted in order to understand the data and prepare the approach for the next round of data collection.
The above aspects are reflected in the breadth and depth of the theoretical and empirical foundations of this chapter as well as the analysis contained in Paper IV. Descriptive validity was also established by following the process from as close to inception as possible (with retrospective accounts provided through interviews and internal documents) until the final phase of rollout in the last months of 2016. Interpretive validity was augmented through on-the-ground interviews and observations, and consistent check-ins with interviewees to establish the veracity and accuracy of my understandings as the case study progressed and ultimately concluded. With regard to reactivity being most relevant to the in-depth case study at Banque de Montagne, the organizational change process of the bank was an occurrence of enough momentum that there was minimal (if any) danger of my interactions affecting the setting of the case study. Whilst the effects of myself as a researcher on the events and participants being studied were thus not a concern, one limitation that of course cannot be completely discounted is the effects and introduced bias of the research setting and interactions on me as a researcher (Miles and Huberman 1994; Onwuegbuzie and Leech 2007). The potential for this bias was unavoidable because no matter how objective I tried to remain, after interacting with the same organization and many of the same individuals over a long period of time, it seemed quite impossible to not grow to like the organization and the individuals, and to wish them well. However, what served to reduce the risk of researcher bias coloring the analysis and findings was following some of the suggestions outlined by Miles and Huberman 1994. Namely, I made a conscious choice to select interviewees at multiple levels of the compliance function in order to get different perspectives of the ongoing change phenomenon; to keep adequate time gaps between intensive periods of data collection at Banque de Montagne so that I could ‘detach’ from the case study and regain theoretical perspective; to triangulate data by using not only interviews and observations but also internal documents and annual reports; and to keep revisiting and abductively going between the data that was emerging and the conceptual framework and research design of the case study as a whole.

3.3.2 Establishing reliability and validity

Qualitative studies take place in a world founded on physical and social reality. Both the process and findings of qualitative research can and do have real and external consequences (Miles and Huberman 1994). The theoretical reasoning and empirical work conducted in the course of this study recognize that a reasonable view of reality rests on measurable positivistic outcomes and also on the more constructivist oriented beliefs, interpretations, and subjective responses that, when combined with the former, offer a better nuanced and complete picture as to what happens and why this is so in the situations examined.
Unlike quantitative studies where statistical inference affords the requisite credibility to the findings, the strength of qualitative studies center around a number of criteria that together establish the reliability and validity of such studies (ibid). In the course of this dissertation, the reliability and validity of the overall study were established through an iterative and triangulated process that considered factors related to the research design and methodology as well as factors specific to the reality of the situation being studied in Banque de Montagne.

Whilst in-depth case studies are often criticized for their lack of replicability, in this case external reliability and objectivity did not depend so much on replicability as it did on the representative nature of the case itself. Given the level of EU financial regulatory harmonization and the generally similar level of organizational complexity across all four Swedish listed banks (and, arguably, between the Swedish banks and other European banks), Banque de Montagne is a representative case (Yin 1984), the findings from which should be applicable across other EU jurisdictions to banks of similar size and complexity.

The reliability of the study has further been augmented through a triangulation of data sources (interviews, observations, and internal documents) and through independent interviews with multiple respondents at multiple levels of the organization. As many of the observations and later interviews were extemporaneous (in that some interview opportunities spontaneously presented themselves during the observations and were not planned beforehand), there is little reason to doubt the veracity of the answers I received. Similarly, I believe that the study reflects the reality of the case bank quite accurately, considering that all interviews and observations were conducted in the natural setting of the organization (Yin 2003). The richness of the narrative accounts provided (Connely and Clandinin 1990), together with the iterative process of checking, questioning, and re-theorizing back and forth between the empirics and the theoretical bases being used, allowed me to reliably and consistently choose between various competing and falsifiable explanations in a manner that lent confidence to the ultimate findings of the case study in Paper IV.

Finally, in terms of verification of the data collected and the final output of the individual papers, this chapter notwithstanding, these measures are largely identified in a transparent manner within the papers themselves. Additionally, and in terms of the in-depth case study specifically, Banque de Montagne was offered the opportunity to review Paper IV and comment on the validity of the case account and findings presented therein.

Beyond the in-depth case study, the compilation of this dissertation has relied on several measures to reinforce the reliability, validity, as well as veri-
fiability of this collective work. In more specific terms, Paper I emerged out of an expert conference on financial regulation, where its development was robustly reviewed by peers and experts prior to journal publication. Similarly, Papers II and III were subjected to peer-review through presentation and discussion at an internal anthology conference conducted as a part of the publication process. Finally, earlier drafts of Paper IV have also been presented at multiple conferences (with the permission of Banque de Montagne), where they benefitted from peer-review and discussion. The final draft, which is included in this dissertation, has been reviewed and approved by Banque de Montagne, and is currently under review for journal publication. Although the structure or wording of Paper IV may change slightly depending on future feedback received, the substance of the paper stands as it is in the version included in this dissertation.
4. Summary and Concluding Reflections

In large part, the analysis underlying this dissertation is incorporated within and surfaces through the various empirical, theoretical, and methodological threads presented thus far. In this section, I provide a synthesis summary that further identifies how these prior discussions address the research questions posed at the beginning of this chapter. In this way, the reader may better be able to discern the relevance of what has been found in the course of this PhD undertaking, as related to the questions that motivated this work.

This section is structured as follows: First, I present the overall research question of this dissertation as well as the research questions of each of the individual papers, definitions of the four key terms that drive this dissertation – ‘transparency’, ‘accountability’, ‘risk’, and ‘compliance’ – and a brief summary of how the research questions have been addressed (4.1). Next, I focus on the important threads raised in the empirical and theoretical discussions, as they apply to transparency, accountability, risk, and compliance within the regulation-practice nexus of banking in the context of this research undertaking as well as potential future endeavors (4.2). Finally, this section ends with some concluding reflections (4.3).

4.1 Revisiting the research questions

Recall that the overarching research question driving this dissertation has been:

*How have transparency- and accountability-driven post-crisis financial regulations within the European Union (EU) influenced risk control and compliance in banking?*

To answer the call of this question, each of the four individual papers within this dissertation has asked different questions that center on various related yet distinct aspects of this overarching inquiry. Rather than just summarizing the contents of those four papers, this synthesis chapter recognizes the role of each paper in the overall research journey of writing this dissertation. In so doing, this chapter has provided a description of the empirics and theories as well as the methodologies that underlie the individual papers and link
them together. In addition to definitional issues – what do we mean by ‘transparency’ and ‘accountability’ and ‘risk’ and even ‘compliance,’ the individual papers also address different empirical and theoretical points – sometimes more implicitly and sometimes more explicitly – that have been presented earlier within this chapter.

4.1.1 Definitions and conceptual understandings

Beginning first with definitions and conceptual understandings, as the theoretical section of this chapter, together with Papers III and IV identify, the concepts of ‘transparency’ and ‘accountability’ are both relational in nature and are connected to a large extent. In the context of the regulation-practice nexus of banking, transparency in particular may be used as an independent regulatory tool, or it may be used as part of the regulatory toolkit aimed at achieving accountability. Additionally, if used incorrectly, transparency may actually diminish the impact of accountability rather than enhance it – a fact that regulators in particular must bear in mind as they design their approach towards regulatory design and implementation.

Both transparency and accountability as concepts exhibit some shared qualities, namely:

1. Accountability and transparency are both relational, multi-directional, and information-based concepts;
2. Accountability and transparency both depend on scope and power dynamics;
3. Accountability and transparency in the regulation-practice nexus may take one or several different forms. Where transparency functions as a tool of accountability, the forms taken depend on the context of the relationship being analyzed and the direction(s) in which the accountability relationship functions.

Regarding accountability relationships in particular, two further facets of accountability in the banking regulation-practice nexus are as follows:

To begin with, accountability relationships, even where sanctions in some form are imposed, are not directly tied to legal liability. In other words, accountability is a necessary but not sufficient condition for legal liability and, conversely, liability is not an assumed component of every accountability relationship.

Additionally, whilst ethics and morality admittedly do factor into discussions of accountability as well as compliance, what is important to realize when one synthesizes the empirical and theoretical threads outlined in this chapter is that ethical conduct through compliance in line with accountability, whether in relation to regulators or any other stakeholder, does not neces-
sarily imply that a morally good action or outcome will result. Similarly, ethical conduct most often simply means that the rules are followed. Such rules may originate from regulators and standard-setters, or from organizations themselves in the context of their internal rules and codes of conduct. Where broad principles-based standards rather than narrow and detailed rules apply, ethically driven compliance may incentivize (but not guarantee) the promotion of conduct in line with regulatory aims or the ‘spirit of the law.’ Even so, unless one subscribes to the view that every law is a morally good or ethically good law and that regulatory implementation is always flawless, morality often remains outside the purview of both law and organizational practice. This is touched upon in the sections on legal positivism and accountability, as well as the empirical discussions surrounding different stakeholder interests and relationships that drive banking sector interactions and developments.

Moving next to ‘risk,’ recall that risk from an actor perspective may be understood as the effect of uncertainty on achieving some objective (supra p. 49-50). Such uncertainties may offer either positive opportunities or present obstacles or costs along the way to achieving the objectives in question. With a direct link to ‘compliance,’ risk management’ and ‘risk control’ by organizations, including banks, is rooted in the firm’s governance and control structures and mechanisms, including systems, processes, roles and practices, as well as communication and reporting channels at intra- and inter-organizational levels. In addition to links to ‘risk,’ ‘compliance’ in the banking sector more broadly refers to organizational conformity with not only regulatory rules and demands but also ethical (rule-following) conduct in regard to stakeholder interests as well as the strategic and business considerations, internal rules, and required practices for employees and agents of the banks themselves. This complex web of interactions is what ties together transparency, accountability, risk, and compliance in the regulation-practice nexus of banking.

With a summary of these understandings in place, let us turn to the research questions of the four papers and consider how they fit together under the overarching inquiry of this dissertation.

4.1.2 Re-examining the Four Papers

Recall that Paper I centers on three research questions, namely:

1. **What are the inherent risks in banking structures and practices;**
2. **How do prudential and accounting regulations account for these risks;** and
3. **What are the potential tensions between the aims and approach of prudential regulation, on the one hand, and how banks approach, take, and account for risk, on the other hand?**
The paper sets out the basic theoretical and structural empirical premises of the regulation-practice nexus of banking. In relation to the first research question, this paper describes the intermediation function of banks, and what peculiar vulnerabilities banks face due to the inherent structure of banking activities. It further identifies the important role of capital and liquidity in banking, and how these measures are linked to the solvency and viability of banks as organizations. In the context of the second research question, the article describes the different forms that risk in banking structures and activities may take, and how these tie in to the micro-and macro-prudential focus areas for prudential regulators. In so doing, the article points out the concurrent role of the accounting rules and frameworks that influence how banks document and communicate the risks they undertake as well as how these risks impact their financial health. Leading directly to the third research question, Paper I further identifies the potential misalignments between prudential oversight and accounting regimes. What is implicit in this regard is the awareness that there is, at both supra-national and national levels, a delineation between the remit of prudential regulators and accounting standard setters that sets up a strong potential for tension and misalignment between prudential regulatory aims and how banks account for and communicate their risks under applicable accounting frameworks.

At the EU level, the above is apparent in the SSM, for example, in recital 19 Regulation (EU) No 1024/2013 (The SSM Regulation), which stipulates that the SSM cannot be understood as changing applicable accounting frameworks. Article 16(2)(d) of the SSM Regulation as well as Article 104(1)(d) of the CRD provide that whilst prudential supervisory authorities do retain some power to influence how banks provision and account for certain assets (for example, in applying deductions and similar treatment to non-performing loans), even where a bank’s accounting provisions are deemed insufficient from a prudential viewpoint, prudential supervisors must exert their authority only within the limits of applicable accounting standards. Prudential regulators have limited to no accounting authority, and further, do not share their responsibilities with accounting standard-setters. What this means is that given the retrospective nature of accounting disclosures, and the often-retrospective effect of risk undertakings and realizations on accounting disclosures, there is a significant danger of misalignment between prudential regulation and accounting rules. In terms of risk control and compliance, the article also highlights the lack of in-depth studies into how banks actually account for and control their risks from a broad accounting perspective that includes not only financial accounting measures but also management-control and internal-governance perspectives. This latter vein of research is the one followed through the subsequent three articles in the dissertation.
Paper II then addresses the broad and, in some sense, foundational research question of:

*What knowledge currently exists in accounting research regarding internal and external influences on transparency, accountability, and risk control in the regulation-practice nexus of banking?*

This article provides an inclusive and cohesive overview of how banking research has been addressed in the accounting and management literature – the organizational and intra-organizational perspective. It specifically identifies the multi-level importance of transparency, accountability, and risk control in banking – at the field level, for banks as organizations, and within banks in the form of multiple and often-competing intra-organizational interests in strategy, control alignment, and risk management. Importantly, it sets the research foundation for Papers III and IV. For Paper III, this literature review contributed by providing important theoretical threads for transparency and accountability understandings that were then explored in Paper III. For Paper IV, the literature review identified gaps as well as empirical trends in risk-based internal control and governance within banks. Together with the pilot study undertaken and included in Paper III, this allowed for a better tailoring of the inquiry undertaken in Paper IV.

The next paper in this dissertation, Paper III, addresses two research questions, namely:

1. *How did financial regulation develop historically in the European Union before and after the 2008 financial crisis; and*
2. *How can the concepts of transparency and accountability be understood in the regulation-practice nexus of banking?*

This paper provides the first empirical exploration that I undertook regarding how the concepts of transparency and accountability could be understood and operationalized in the regulation-practice nexus within the EU context. Empirically, Paper III outlines the historical development of financial regulation in the EU, and how transparency, accountability and risk considerations played a role in both pre- and post-crisis regulatory developments. Markedly, it identifies the shift in regulatory approach from a pre-crisis market efficiency perspective to a stronger post-crisis prudential focus. At the same time, this undertaking identifies that transparency and accountability were important considerations for regulators as well as financial markets both before and after the crisis. From a theoretical standpoint, Paper III builds on Papers I and II to outline a more concrete understanding of these two concepts as they emerge in financial markets as well as between financial market participants and regulators. Through the pilot study, I was able to identify how these different perspectives arose for regulators, industry lobbying agencies, and banks. This, together with desk research and an over-
view of Banque de Montagne’s annual reports helped me to further develop the transparency and accountability framework in the context of risk control and compliance, and thus better tailor the case study approach of Paper IV.

Finally, Paper IV considers two research questions:

(1) How has post-crisis financial regulation influenced the risk-control and compliance function within a large listed bank in Sweden?; and

(2) What are the transparency and accountability implications of this regulatory impact on the structures, agent roles, and processes of the bank’s risk-control and compliance function?

These research questions concern the influence of prudential regulation, through the implementation of FFFS 2014:1 in Sweden, on transparency, accountability and risk control in banks in the context of their intra-organizational activities as well as their interactions with regulators. It studied a mandated change initiated by FFFS 2014:1 that impacted how banks were required to structure and manage their risk-control organizations and regulatory interactions – namely, by splitting their operational risk-management activities from their compliance activities. Under the three-lines-of-defense model that was applicable in the bank and also used for the theoretical framing of the research inquiry in order to analyze the changes resultant from regulatory compliance, the findings were framed in the context of transparency and accountability understandings across the dimensions of structures, processes, and roles within the governance framework of the bank.

The findings and analysis of this case study indicate that regulatory aims, even while dictating organizational change of the variety explored in this paper, often face translation challenges as they are inscribed into organizational structures, systems, processes, and routines. Transparency, accountability, and risk control themselves may at times concurrently comprise competing interests within organizations. Theoretically, the findings of Paper IV underscore the complexity of understanding transparency and accountability as operationalized concepts within the organizational setting. At the same time, this work also highlights (albeit implicitly) the delicate balance that both regulators and market participants must achieve in order to ensure prudential aims. According to at least some of the theoretical perspectives covered in this chapter, banks should arguably be as invested in prudential aims as regulators; at the same time, there is equal motivation for banks to prioritize their organization-specific strategies and competitive approaches. What this seems to mean is that in effect, increasing mandatory regulatory influences on banks may lead to higher degrees of response; however, this response does not immediately translate into a higher level of integration of regulatory aims within the extant organizational control systems in place.
Consequently, it remains unclear as to what the overall accountability and, even more so, the transparency implications of regulatory impact on risk control within organizations will be. This last finding in particular emphasizes the importance of including prudential risk-control considerations in accounting and management control discussions, and vice versa. Both Papers III and IV additionally highlighted that this synergy is currently not well developed and could benefit from additional attention on part of banks as well as financial regulators.

4.2 Weaving a tapestry: Some important threads

In terms of both theory and empirics, the discussions in this chapter strongly underscore three factors: The first is the complexity and depth of multiple areas of theoretical and empirical importance to the regulation-practice nexus of banking. The second is the strong degree of practical overlap between distinct areas of regulation and practice in banking. The third, which necessarily follows from the first two, is the high level of permeability between the boundaries of knowledge areas that dictate the role of individuals who are responsible for risk control in banking, regardless of whether they function as prudential experts, accounting experts, trading experts, compliance experts, or one of the myriad other indispensable roles that exist in the regulation-practice nexus of banking.

In this section, I showcase selected threads from this current work in relation to extant research and practice. I also identify areas of focus that may be fruitful for future explorations of the banking regulation-practice nexus.

4.2.1 Limitations and relevance

Before I try to highlight some of the important threads of what is contained in this dissertation, I must first acknowledge that its achievements are limited. Even within the relative freedom of a PhD dissertation, I have not, for example, been able to adequately study and present the strong links between the real economy and the financial sector other than what I outlined in the empirical section of this chapter. Relatedly, I have completely excluded the role of the central bank in monetary policy and overall financial stability in the actual field research I undertook within the four individual papers. This role is perfunctorily acknowledged in this chapter but, again, not expanded upon. In terms of interbank lending and liquidity rescues such as that achieved by the EU and its Member States in the direct aftermath of the 2007 financial crisis, the links between the real and financial sectors of the economy as well as the role of central banks in terms of monetary policy and lenders of last resort are of paramount importance in the banking regulation-
practice nexus. Yet, neither space nor time allow for an adequate explanation or exploration of these factors, amongst others. Similarly, the chosen qualitative and case-focused approach of this work comes with all of the limitations of qualitative methodologies and case studies. My own role as researcher, as objective as I have tried to be, comes with its own set of biases and idiosyncratic influences. None of this is unexpected.

So what have I managed to do?

The answer to that question is perhaps more accurately answered by the astute reader who has survived reading this manuscript up to this point (and will hopefully trudge through until the bitter end. It’s not that far off now, I promise).

My own answer is that I have tried to provide as detailed of a picture as I can of the numerous intricate interactions that underlie transparency, accountability, risk, and compliance in the regulation-practice nexus of banking. In addition to insights that are useful to building up theoretical as well as empirical knowledge in the field, at least some of what is contained herein is of use to regulators, policymakers, and banking practitioners who are situated beyond the ivory tower of academia. From my perspective which is, at this point, admittedly perhaps a bit myopic when it comes to how much value I assign to research in this area, there is so much beneficial scope for interdisciplinary advancement in research and industry within the regulation-practice nexus of banking that this current endeavor amounts to little more than dipping one’s proverbial toe into a vast ocean of what has been done, is being done, and remains to be done. The possibilities seem endless.

4.2.2 Contributions

Theoretically, I have sought to provide an overview of the links between the four areas that I think are most relevant and applicable to understanding the banking regulation-practice nexus: Economic theories of regulation, principal–agent considerations, legal positivism, and institutional perspectives. To the best of my knowledge, whilst some if not all of these bridges have been partially built before, there has not been any work (at least, that I have come across) that has attempted to link all four theoretical areas together in the manner of this dissertation. These theories are not always explicit in the individual papers, which admittedly rely more on the conceptual understandings of transparency, accountability, and risk control in their running text. Nonetheless, the empirics and analysis of the individual papers rely implicitly if not explicitly on these four theoretical areas, with all their interconnected connotations in banking regulation and practice.
Empirically, what was identified early on in the PhD process through the literature review (Paper II) was in-depth research that investigated the inner working of banks. This was not a surprising finding, given the generally high level of confidentiality and secrecy that enshrouds the banking sector. In research, there is much extant and ongoing work that focuses on different aspects of the regulation-practice nexus in banking, ranging from policy and academic research into bank secrecy in different jurisdictions may contribute to mismatches and tensions between banking practice and different aspects of regulatory control such as anti-money laundering (AML) efforts and tax evasion (Tanzi 1996; Blum et al. 1998; Picard and Pieretti 2011; Balakina and Masicandaro 2017; Smits and Badenhoop 2019; c.f. Rittberger and Goetz 2018). Analysis of these aspects nonetheless focuses on regulatory instruments and their interactions at the inter-organizational or event level, rather than through an examination of intra-organizational dynamics.

In the context of research that has looked into intra-organizational perspectives of risk management, there have been studies such as Arena et al. (2010) that investigate the organizational dynamics of risk management, albeit in a setting outside the financial sector. Similarly, risk management focused work situated in the financial sector has been conducted through studies along the vein of Mikes (2009), Mikes (2011), and Giovannoni et al. (2016), all of which examine risk management in the context of risk approaches, actor roles, and organizational change in banks.

Mikes (2009) for example, identifies the rising importance of Enterprise Risk Management (ERM) in regulatory, governance, and management control contexts, and explores how ERM practices may systematically vary between financial organizations. She identifies that ERM may surface as two different approaches within organizations – a ‘by-the-numbers’ approach dictated by “quantitative enthusiasm” and more rooted in shareholder primacy-driven quantitative risk analysis that is largely limited to quantifiable risks; and in contrast, a ‘holistic’ approach, which harnesses “quantitative skepticism,” where quantitative assessments are combined with qualitative analysis and judgments by risk experts within the organization.

Mikes (2011) extends these understandings by exploring the boundary work of risk experts within banks as they sought to claim relevance in risk management and control within the organization. This study introduces the term “calculative cultures” to describe how risk experts within organizations approach risk measurement and identifies that in organizational cultures of high “quantitative enthusiasm” there is a strong focus on risk measurement in quantifiable terms. Conversely, in organizational cultures with a propensity towards “quantitative skepticism,” risk experts focus more on “risk envisionment,” whereby the goal is not to quantifiably measure risks but rather
provide top managers with expert opinions and multiple possible future scenarios regarding how risk issues are emerging and may unfold.36

Giovannoni et al. (2016) is an excellent case study that explores the change process of risk management within an Italian bank (Banca Valle) using an institutional perspective of organizational change to explain risk-management developments within the bank over time. The study investigates “the role of roles during processes of risk management change” by focusing on the longer-term process of risk-management change within the organization, identifying two risk-management templates within the intr.organizational risk management dynamics that evolved over three phases from 2000 until 2012.

Of interest and relevance to the present work, particularly paper IV, the authors identified that during the 2000–2006 period, deregulation and the resulting competitive concerns led Banca Valle to adopt a more risk measurement-based management template focused on shareholder value creation. There was a strong push to integrate risk information into the formal planning and performance measurement systems of the bank and incorporate risk management into strategic and business operation dimensions in order to better harness profitable risk opportunities as well as avoid negative risks. Between 2006 and 2009, in response to accountability demands from regulators in the wake of scandals and crises, a more holistic risk-based internal control template emerged, which encouraged risk experts to not only measure risks through extant and still-dominant risk metrics, but also build an organizational risk narrative that was in some sense separated from the planning and control functions of the organization. In consequence, the risk-management function decoupled somewhat from the planning and control functions during this period, and two competing risk approaches coexisted within the risk-management function – a shareholder value-based measurement approach and a broader external stakeholder-oriented holistic approach that also allowed for strategic risk envisionment by the risk management function within Banca Valle. After 2009, the risk management function further rose in prominence with regard to power dynamics and communicative influence between risk management and the board. Collectively, these patterns of development shed one explanatory light on why, even after the failure of risk management leading up to the 2007 financial crisis, there is such

36 Interestingly, Mikes (2011) did not identify a propensity for one organizational culture over another depending on whether the activities being engaged in fell under investment banking or commercial banking. Rather, the differences in approach seemed to be more organization specific rather than activity specific. In the context of Paper IV, the boundary work that Mikes (2011) engages in was of interest to me during the background research phase, but ultimately was not used, given that I did not explore the boundaries between compliance and operational risk in Banque de Montagne. Given the chance to conduct the study all over again, I would not be averse to engaging in such an exploration, and I recognize that it remains a promising avenue for future research.
a strong focus on achieving better risk management by building on the same regulatory and practice models of the past.

Paper IV in particular builds on these prior works by adding to the same stream of literature that provides a view into the inner workings of banks. Importantly, the findings of Paper IV, as outlined earlier in this chapter and provided in entirety within the paper itself, complement these earlier studies by providing a perspective of compliance as one specific facet of a bank’s risk organization, and analyzing organizational change along the dimensions of transparency and accountability across structures, processes, and roles.

4.2.3 Threads for the future

In addition to the discussions presented within the text thus far, there are many links in this dissertation that interested readers may draw out on their own. Below, I present three such threads that I myself find the most interesting and relevant for both this current work as well as potential future endeavors namely:

(1) The role of banks and banking in society;
(2) The reflexive influence between technology, regulation, and practice in the banking sector; and
(3) The evolving and increasingly interconnected nature of banking regulation and practice.

In the following sections on the above-listed threads, I also identify the context in which I think they matter most for those outside the research setting of academia, namely regulators and policymakers, as well as bank representatives and banking-sector practitioners.

4.2.1.1 The role of banks and banking in society

In my estimation, one of the most important open questions that emerges from this work is what role we see banks as fulfilling in society. Rather than some abstract philosophical musing, the perceived answers to this inquiry can serve to shape meaningful regulatory, political, economic, and social attitudes and actions as regards the regulation-practice nexus of banking.

Accepting the basic recognitions that have previously been identified in this dissertation – that banks function as financial and risk intermediaries in the broader economy; that well-functioning banking sectors and, more broadly, financial markets, promote real economic growth and development; that in some sense, the banking function is indispensable within society – we are still left with two unanswered questions: First, we may well assume that banks are indispensable in society, but is their function and importance captured correctly by the extant approach of regulators as well as other stake-
holders? And second, can we truly not question the basic assumption that banks are truly indispensable?

With regard to the first question on whether current relationships between banks, regulators, and other stakeholders are appropriately aligned, it is important to recognize that in practice, banks occupy a space somewhere between the private sector and public sector – essentially, even privately owned banking enterprises invariably serve, to different degrees, a public sector function of financial and risk intermediation. Given this, I personally believe that there continues to be a marked misalignment between the public-sector-oriented expectations from stakeholders and the private-sector-driven governance and control mechanisms that are still dominant within the banking sector at large. In research, this misalignment has been identified by work in law and management research (see e.g. Blair and Stout 1999) that questions whether the current model of regulation and corporate control is appropriate for the oft-diverging expectations that we, as a society, seem to hold for banks. As Paper IV identifies in line with such research, prudential regulation necessarily departs from shareholder primacy in its considerations, and yet shareholder primacy continues to remain the defining model upon which the management control and governance of banks are built – a facet of the regulation-practice nexus that also has a significant impact on the structure of accountability channels as they exist both within and between organizational actors.

Here, I cannot help but refer back to the role of theory as being highly relevant to how this misalignment can be further empirically explored in future research. First, whilst multiple competing theories can be used to singularly illuminate a given issue, any given theory typically sheds light on only one aspect of the issue under scrutiny. Understanding not only which theory is dominant but also why and, more importantly, whose perspective and interests it promotes is an imperative component of formulating an appropriate research design. In practice and regulation as well, the role of theory is important in this regard. Whilst researchers can happily sit back and write numerous papers that explain apparent theoretical mismatches and paradoxes between regulation and practice, it is up to experts in regulatory and policy circles to actually harness these understandings in order to better design the rules and standards that dictate the rules of the game in banking and other

37 Without delving into further theoretical discussions when this chapter is so close to its finish, I will merely include this footnote to point out two excellent articles that harness the recognition and applicability of the same multiple theories – principal–agent theory, property-rights theory, and team-production theory – in a manner that each bolsters a completely different yet cohesive and arguably singular theoretical lens to study the issue of control within the firm: Jensen and Meckling (1976) who serve as proponents for the principal-agent perspective, and Blair and Stout (1999), who staunchly support a team-production model of corporate governance, particularly in the context of public sector firms.
areas. To a large extent, a dawning if not growing awareness of these underpinnings is arguably apparent on part of regulators, as visible in the emergent post-crisis regulatory landscape. Regulatory developments have not escaped criticism as well as well-founded identifications of continued areas for development (see e.g. Hynes 2009; Arnold 2009; Akseli 2013). Similarly, it is up to banks and practitioners to understand and navigate these differing perspectives that are increasingly, through regulation if nothing else, a part of organizational reality.

With regard to the second question pertaining to whether banks are actually truly crucial to the economy, the answer is similarly multifaceted and open. Whilst certain aspects of banking, such as the provision of funding and credit in the setting of transactions between parties may indeed be a fundamental part of economic activity, does this mean that banks themselves absolutely must continue to exist? Recent developments in allegedly disruptive innovations within the sphere of financial technology (fintech) seemingly do call this assumption into question (e.g. Carney 2017). This is something that is worth further exploration both in the context of the perceived importance of banks as intermediaries as well as in the context of the second thread under exploration – the reflexive influence between technology, regulation and practice in banking. Further, the rise of the shadow banking system coupled with the increasing reliance of corporations on special-purpose entities such as hedge funds and mutual funds rather than banks for financing and what can arguably be called the “disintermediation” of the financial sector (Schwarcz 2013). Yes, the function of banking may always exist in some form; however, must banks exist forevermore? Can they be displaced by the Google Wallets and Paypals and Klarna ABs of this world, or do they offer some benefit to customers and the public at large that no other type of business can provide? And even if banks are displaced, how should prudential regulators treat new and emerging intermediaries in the financial sector? These are questions and challenges that banks and regulatory authorities continue to face. These are questions and challenges that research can help address.

4.2.1.2 The reflexive influence between technology, regulation, and practice in the banking sector

As identified earlier in this chapter, regulation and technological innovation are in a constant cycle of evolution in tandem with each other. On the one hand, as research by Niehans (1983), amongst others, identifies, financial innovations that have largely been a part of the banking landscape since at least the 1970’s have largely been centered on three basic product and service offerings:
(1) The exchange of present money of value of products against future money or value of products (for example, interest against deposits, as well as futures and other derivative hedge instruments);

(2) Facilitating as a broker or broker-dealer to bring together borrowers and lenders, or buyers and sellers of products or services; and

(3) The execution of payment services on behalf of clients.

Further, Niehans (1983) also recognizes that financial innovations may either be “adaptive” in nature (that is, bundle together these products or services in new ways) or “technological” (that is, some development that changes the way that information is created, stored, retrieved, or transmitted). Ancient innovations of the latter variety included the development of double-entry bookkeeping, for example, whilst modern technological innovation is largely reliant on the development of electronically digitalized and digitized creations of products and services (ibid). In addition to transaction cost reductions and arbitrage opportunities, perhaps the most interesting identification by Niehans in this context is his postulation that technologically based financial innovation leads to “a reduction in the costs of interpersonal cash transfers through electronic transfer systems. This increases the utility of demand deposits relative to currency. In the limit, currency would become obsolete, but this stage will not be reached in the foreseeable future” (p. 539).

In this current era of cryptocurrencies and blockchain technologies, we may not quite have reached the limit Niehans spoke of just yet, but we are certainly closer than we have ever been before (Piazza 2016). For regulators who have to contend with both adaptive and technological financial innovations, the challenge they face is how best to exert limits on the allowable characteristics, market operations and activities, and contractual enforceability of innovative financial products and services. Additionally, from a prudential perspective, regulators also have to assess how financial innovations restructure and influence micro- and macro-prudential risks within the financial system. In this regard, the EU has, like other jurisdictions, sought to find a balance between promoting the beneficial economic and social effects of innovation whilst controlling for negative risks and resultant externalities in financial markets and the economy at large. This is an ongoing area of development in regulation and policy, where there is a great potential for research and practice to come together for mutual advancement. As mentioned earlier in this chapter, one such post-crisis regulation is PSD2. In very general terms, PSD2 seeks to open up the payment-services market to third party providers such as fintech companies whilst at the same time levelling the playing field between banks and these new entrants through two requirements: first, that banks adjust their technological interfaces to allow for interfacing with third-party providers (within prescribed limits) and second,
that third-party providers meet the arguably higher regulatory burdens of PSD2 and related banking regulation as appropriate.

For banks, developments such as the above mean that they will face increased competition from third-party payment-service providers in the EU market. Banks may thus be motivated to rethink their stakeholder dependencies as well as their risk-based internal control frameworks to adjust for this shifting business environment. In this respect, given that regulatory compliance has risen on the governance agenda of banks and banks already seem to be considering the how best to integrate the potential value of regulatory compliance into their extant business models and strategic considerations (see Paper IV), it may be time for banks as well as researchers to delve more deeply into how best to balance regulatory demands with strategic innovation and market competition concerns.

4.2.1.3 Evolving and increasing interconnections between banking regulation and practice

The above areas of potential future development lead directly into this last discussion on the interconnections between banking regulation and practice. As this chapter has pointed out, there are significant areas of overlap between the distinct areas of prudential regulation and how banks account for risks under extant financial-accounting rules and internal-control models. Here, in addition to empirical explorations of overlap in the regulation-practice interface, there are theoretical research investigations that could also benefit regulators and legislators.

The first of this is in the area of accountability in relation to the regulation-practice interface of banking. Through the discussions in this chapter, it should be clear that accountability, even under an ethics-based perspective (see e.g. Shearer 2002), is not a clear-cut issue in the regulation-practice nexus of banking (or indeed, in any regulation-practice nexus). In terms of regulatory monitoring and enforcement as well as legal liability for individuals acting in their capacity as corporate representatives, this chapter has illustrated some issues that arise in approaching accountability and liability considerations. When it comes to corporate accountability, that is, holding the corporation itself accountable, establishing an appropriate framework is, if anything, even more complicated. At the heart of this lie two questions:

(1) How should one should classify an organization for the purposes of establishing an appropriately applicable accountability framework; and

(2) What would an appropriate accountability framework for organizations look like?
This vein of thought has been well explored in prior literature (see e.g. Arrington and Francis 1993; Schweiker 1993; Shearer 2002; Roberts 2009), but there is still no definitive answer, either in research or in practice, as to how moral accountability should apply to a corporate entity. For me personally, one of the most formative papers I read on accountability during my PhD journey was the 2002 article titled “Ethics and Accountability: from the for-itself to the for-the-other,” by Teri Shearer.

In that article, without any explicit distinction between morality and ethics, Shearer assigns moral/ethical agency as a prerequisite for accountability at the level of the firm; however, this assignation rests on two unquestioning assumptions, namely that:

1. Economic entities (organizations) constitute an identity “which is sufficiently similar to that portrayed by an individual to invest that entity with moral agency” (ibid, p.544), and
2. Such an ascribed agent’s (organization’s) moral obligations depend upon “the community’s shared understanding of the moral obligations entailed by the personal, inter-subjective relationship” (ibid).

As has been described in this chapter, it is difficult to establish moral or even ethical outcomes through legal systems as applicable to individuals, let alone corporations. Additionally, one instinctively questions whether these two assumptions, grounded in neoclassical economic theory as they are, can truly apply to organizations in a moral or ethical context. If we are to accept that accountability is indeed tied to questions of morality and ethics, then we must logically question whether morally or ethically grounded accountability determinations at the individual level may accurately be applied to the organizational level. Organizations are not and, more importantly, cannot be held liable for their actions in the same manner as individuals are. Indeed, the restitution that is usually sought from organizations takes the form of either injunctive relief or pecuniary damages. There is no true equivalent to imprisonment for organizations. Can we then say that organizations are even capable of being held accountable in the same way as individual human beings? Can we say that organizations, with their shareholder-primacy governance models and profit-based business models, even occupy the same moral or ethical sphere as human beings? If, as I strongly believe, we cannot claim equivalence between corporations and human actors, what can we envision as an appropriate accountability regime for organizations as actors? How, then, should financial regulators and legislators consider augmenting existing accountability regimes in banking regulation and practice?

38 Other than dissolution, which has, admittedly, been enforced in a few rare cases such as HQ bank in Sweden.
For banks, some more practical considerations may center on risk and strategy, and potential synergies that exist between research and practice in this regard. Under still-developing regulatory frameworks and rapidly shifting competitive landscapes, there are still many uncertainties that banks (and arguably new market entrants in the financial sector) face as they navigate their regulatory and business environments. In line with prior research conducted by Mikes (2011), Giovannoni et al. (2016), and others, are there research learnings that banks can benefit from in order to better tailor their risk management and control systems to their strategy and business operations?

In regard to the regulatory-practice nexus, one question that regulators, legislators, banks and other market participants, and researchers too would do well to ask is this: Why is banking so complicated, really? As Niehans (1983) rightly points out, “Except for electronic technology, if an experienced banker from medieval Venice or Genova came to life again, he could understand the operations of a modern bank in a matter of days” (p. 538).

Why, then, has the regulation-practice interface of banking, for all of the similarities that the actual practice of banking shares across jurisdictions, become so opaque and difficult and so terribly, terribly convoluted? How much of this complexity represents the realization of unavoidable bugs in the system, so to speak, and how much of this complexity is actually by design of banks, or regulators, or politicians, or perhaps some mishmash of all of these groups? What can be streamlined, and how can regulators, practitioners, and researchers come together to augment this bid for simplicity? These are the questions, I think, that should drive future developments in the field.
Afterword: Revisiting the Monsoon Paper Dragons

Enough with all of this dry writing.

Let’s revisit the monsoon paper dragons again: the banks and how they’re built, how they fly through the relentless torrential deluge of regulations that has continued since the 2007 financial crisis. Let’s reconsider the parade planners – the regulators – the actors that have such an influence on the construction and flight path of these banks, these paper dragons. Let’s take another look, a final look, at the broader relationships and interests, and the potential for destruction, which the dragons wield towards all those standing by and watching… the enchanted audience. In the rain, perhaps some of these spectators are more trapped than enchanted, but nonetheless. There they are. Some of them have contributed to the dragons’ manufacture and flight. The dragons may owe them something. To others, the dragons owe no formal allegiance or debt, even as their precarious flight poses a severe threat to the wellbeing of these hapless watchers, so many of whom remain oblivious to the potential menace that these great dragons bring with them.

Let’s take a last lingering glance inside the carcasses as paper-dragon skins tear and dissolve. Let’s appreciate, one more time, the gristly underbelly of the beast… the delicate and unassuming sticks and thread that hold together under the intimidating shell… whose hands are these, holding the creatures up in their faltering dance through the downpour? How are they moving, these dragon dancers, and why?

And let’s talk about the monsoon, too. The rains that can be so destructive to paper-dragon skin. The rains that are needed for the rivers to flow and the harvests to thrive. And let’s envision possible futures. Without the monsoon, what would happen to the city? Would the city slowly fail to thrive? Would the city die? Or conceivably, would the city change into something else? Into a place where paper dragons fill the sky all through the year? Or a place perhaps, where no more dragons fly? And what would happen to the city if the monsoon never ended?

Enough with this dry writing. Let’s go where there be dragons.
Understanding the dragons

What are these paper dragons? What is their skin like? How do they move? How can they dance in the rain? Perhaps, most importantly, why do they even exist?

These are some of the questions pertaining to the nature of the dragons – the banks – that the individual papers as well as this synthesis chapter address. As has been discussed, banks serve the function of financial and risk intermediaries in the broader economy. In both these contexts, they arguably serve a public sector function by providing service inputs that are needed by the economy and its constituents at large, even if these inputs are not strictly classified as public sector services. Namely, the function of banking facilitates the provision of capital and funds by which businesses can finance production and growth, and by which individuals can similarly finance consumption and growth through investments such as home purchases, capital market investments, and entrepreneurial ventures that collectively foster healthy economic development.

In terms of risk, as this chapter and Paper I present, the structure of banking itself is one that is reliant on risk intermediation. Risk intermediation in turn is a function that banks are arguably better able to bear the cost of rather than, for example, individuals or small and medium enterprises seeking to raise capital for investment and growth. In banking practice, this risk intermediation function is perhaps most easily understandable through the lending function of banks (as identified also in Paper II), and through the understanding of ‘credit risk’ as it is reflected in, for example, the Basel Accords.

On the one hand, banks have the resources, expertise, and capacity to gather information and more accurately assess risks such as, for example, credit risk in a manner that is simply not feasible for many other market actors to do. On the other hand, the establishment of many banks as private-sector entities driven by shareholder primacy and its accompanying value maximization concerns has meant that risk-taking and risk disclosures by the dragons as well as the dragon dancers – the managers, the traders, the myriad different actors ensconced within the aegis of the bank – have historically not always operated in proper alignment with optimal risk control from micro- and macro-prudential perspectives. The result of such reckless dancing has been damage to the environment and sometimes to the spectators surrounding the dragons.

As Paper IV identified, dragon bones and organs and blood – the structures and processes and roles and systems within banks – are a complex and convoluted collection of interactions, dependent on internal dynamics as well as
external influences. Yes, perhaps the dragon should presumably be aware of everything that happens within its body, but from a corporate governance and internal control perspective, this is impossible. Just as not every disease has easily discernable symptoms, not every misstep in corporate activity is apparent from the outside or, indeed, even to the corporation itself. The mismatch between accounting rules and prudential regulatory aims as identified in Paper I are directly related to this point, and highlight how the negative effects of risk-taking, even risk-taking that is compliant with extant regulations, are often unseen until the damage has already been done. Sometimes, nobody, not even the dragon itself, realizes that a dragon is faltering until the dragon crashes. Nonetheless, as Papers I, III, and IV identify, the parade planners – the regulators – do seem to have devised a post-crisis regulatory framework that focuses more on early-warning systems and greater scrutiny into the organizational structures and practices of banks in the hope of detecting dangers sooner rather than later.

This is where considerations of transparency and accountability come in. This is where a dragon’s skin matters to not only the dragon, but also all those involved in planning and executing and even just witnessing the parade. In this regard, the compilation of research that comprises this dissertation takes a decidedly benign view of corporate activity. Whilst this chapter has outlined the tenets of a transparency and accountability framework that can be harnessed within the regulation-practice nexus of banking, it does not ascribe willfully malicious or deliberate intent on part of either banks or their agents to engage in behavior that goes against the interests of either the public or the myriad stakeholders who comprise the bystanders milling by the dragons. This neutral perspective is by design, as it serves the purpose of the current research endeavor. Even under this view, as the present chapter identifies, enforcement of liability against corporate and individual actors remains a daunting challenge in the legal sphere – especially in the context of criminal suits. The dragon’s skin is shielded indeed, from prosecutorial arrows that seek to punish those accused of engaging in willful wrongdoing.

A less benign view, and one that is held in extant research, is reflected for example in the work that prompted the title of this dissertation: a 2017 article titled “Paper Dragon Thieves” by Josephine Nelson. Nelson (2017) investigates the question of how legal enforcement mechanisms should react and respond if the dragon-dancers “moving the feet of the paper dragon cause harm by exploiting their anonymity and power to snatch the purses of spectators along the route” (p. 889). She describes a disturbing trend of what she terms “form-hardening” (p.873), whereby there is an increased opacity of the corporate form that disallows individual liability for instances of malfeasance or misconduct by actors within financial corporations, a strengthening, if you will, of the dragon’s skin against individual-focused regulatory en-
forcement. The issue, she points out, is that “the paper dragon does not move unless animated by dancers” (p.890). As Nelson identifies, “the fundamental problem with failing to penalize agents for their actions is that the dancers under the costume can benefit themselves by damaging spectators in the crowd without consequences. Unless that aspect of the corporate form changes, the public along the edges of the parade route is correct to be wary of every paper dragon in the parade. There is no way for these spectators to know who is really under the paper dragon costume and what actions the dragon may take at any point along the route” (ibid).

The views of Nelson (2017) support the conjecture that this chapter brings forth of a mismatch in accountability frameworks in the corporate context. At the same time, this dissertation identifies that even if we agree with the identification of a hardening of dragon-skin through increased opacity in the corporate form, the fact that the dragons and their dancers have faltered and stumbled seems to have amounted to some parody of a rain dance that has invited the wrath of a regulatory monsoon upon the international financial sector. The resultant heightened focus of post-crisis regulation on issues of corporate governance, internal control, and the inner workings of banks is apparent in Europe as well as the United States. The perspective taken in this endeavor is that such developments indicate a significant weakening of dragon-skin in this post-crisis regulatory monsoon. What this means for how liability frameworks in the regulation-practice nexus of banking will develop in the coming years is still an open question, one that researchers, regulators, and practitioners would do well to consider.

If we are to restrain ourselves and maintain a benign view of dragons and dragon-dancers, another question pertinent for dragons to consider is how best to strengthen their skins so that they can maintain resilience under the ongoing regulatory deluge while at the same time retaining the organizational and operational risk strategies and approaches that allow them to grow and hopefully thrive.39 As recent events in the Nordics and Baltics have shown, strategic decisions by certain Nordic banks such as Danske and Swedbank to expand into Baltic markets, even if they were well-intentioned, have led to a flurry of money laundering scandals for these banks (Milne 2019). Even though both banks suffered reactionary capital market losses and took actions to replace their CEOs and Board Members as well as many of the managers tainted by the scandal, they are now also facing increased scrutiny from regulators in the Nordics, Baltics, as well as the United States (ibid). Within the regulation-practice nexus of banking, how can investor and public confidence be maintained, even as the dragons slip in the rain? Is one

39 The cynical reader would do well to question how much of such resilience rests in actual good intentions versus token window-dressing, but that is fodder for another inquiry.
avenue to foster a renewed focus on corporate social responsibility through ‘green banking’ and environmentally friendly investments? And if something in the strategy undertaken by these dragons were to change, what should underlie that change? Shareholder primacy through value maximization or some other imperative? Again, these are open yet important questions for those interested or involved in the banking regulation-practice nexus.

Understanding the monsoon

After the 2007 financial crisis, it is undeniable that there has been a monsoon season of scrutiny in the financial sector – a deluge of new legislation and public inquiry within the banking sector on both sides of the Atlantic. These developments are motivated by the desire and legitimate need to address the factors that allowed the dragons to crash in the first place. At the same time, the monsoon threatens to crush the dragons under its weight. The procyclical nature of regulatory response in the wake of financial crises is well recognized (see e.g. Banner 1997; McDonnell 2013; Romano 2014), although the increasing reach of regulatory scrutiny into organizational governance and control functions (as explored in Papers III and IV especially) is a comparatively recent development.

In parallel with regulatory development, it behooves those interested in banking research as well as those involved in it to remember that the heavy weather of post-crisis regulatory monsoon is rooted in the broader and longer-term socio-economic-political climate of different cultures, institutions, and societal settings. These factors all contribute to different environmental conditions that, monsoon aside, nonetheless distinctly affect the dragons’ flight. These are the forecasts and reality of the winds and precipitation that are undoubtedly in play during the monsoon, but that also affect financial markets and the economy during other seasons. In the United States, heavy lobbying efforts and political interests have, for example, led to widely divergent perspectives on what shape applicable regulatory frameworks should take as well as how financial-sector-focused legislative instruments should be designed (see e.g. Schoen 2017; O’Brien 2018; and Zwirn 2019). In the EU with its increasingly centralized supra-national financial-sector rulemaking, in addition to high levels of scrutiny from the media, what also remains significant is the high levels of political and social interest in how financial regulations are impacting markets and market participants, and what new risks may be introduced into the system as a consequence (see e.g. Weber 2019; Dupre 2020).

In the regulatory-practice nexus of banking, such broad weather forecasts have important connotations beyond the regulatory monsoon. For regulators,
three things are important: first, that all dragons have skin that strikes a good balance between transparency and durability; second, that there is proof that the dragon and its dragon-dancers will not behave badly or flounder to an unacceptably dangerous degree in adverse weather conditions; and third, that there is some mechanism of accountability or recourse in place should damage nonetheless be caused by dragons during the parade. Additionally, regulators must bear in mind that not all dragons are the same. Whilst some dragons do not have either the size or the flexibility to survive in a strong monsoon without very durable and transparent skin that allows a close monitoring of the dragon-dancers’ moves, other dragons are less vulnerable to adverse conditions and can therefore dance more flexibly in bad weather, even if their skin is more opaque.

Balancing regulatory aims and broader prudential needs with ensuring that regulations do not stifle the healthy growth of organizations as well as the healthy maintenance of depth, efficiency, and robustness in financial markets remains an important and delicate balancing act for regulators. In Sweden for example, Nordea, which is the only Nordic bank classified by regulators as systemically important at a global level, has recently re-domiciled its headquarters from Sweden to Finland in order to save on regulatory compliance costs and maintain an edge against Eurozone competitors (Nordea 2017; Rosendal and Kauranen 2019). Within Sweden, this move led to both the Central Bank of Sweden (Riksbank) as well as Finansinspektionen having to reassess regulatory oversight in the context of maintaining market stability and competition within the Swedish financial sector (Riksbank 2018; Finansinspektionen 2018). Concurrently, even as the move has been welcomed in Finland, Nordea may well bring new risks to the Finnish financial sector as well as new challenges for Finnish financial supervisory authorities who are now in charge of monitoring what remains the largest Nordic bank (Rosendahl 2018).

For dragons, deciding on the most suitable skin depends not only on the weather and the parade planners, but also on other factors in the environment. A dragon arguably has the most direct if not accurate insight into how flexible and resilient it is. Thus, how dragons perceive their relationship with the regulator parade planners may dictate their approach towards what kind of skin they think they need. Benign regulatory relationships may encourage more transparency, whilst antagonistic or adversarial relationships may encourage more opacity or, as Nelson (2017) terms it, organizational ‘skin-hardening’. Recall also that risks are not always negative for organizations and individual actors; risks can unfold as either threats or beneficial opportunities. Sometimes, if opportunities turn into threats, as Baltic expansions arguably did for some Nordic dragons, then a perceived fight for survival against either regulators or other dragons may also impact how dragons wish to construct their skins.
In terms of the dragons’ accountability for maintaining their skins, weather forecasts as measured by recent judicial decisions in the United States indicates continued unpredictability. As a 2019 review of securities litigation and enforcement in the U.S. identifies, legal liability has strengthened and widened its reach in recent years, most notably through the Supreme Court decision in *Lorenzo v. SEC*40 that widened fraud liability, and also through the continued priority given by the SEC to retail-customer protection and cybersecurity and cyber-enforcement issues as related to new technologies and digital assets (Halper et al. 2020). At the same time, whistleblower protections have arguably decreased, most notably through the Supreme Court decision in *Digital Reality Trust, Inc. v. Somers*,41 where the Court held that in order to avail themselves of whistleblower protection under the Dodd-Frank Act, whistleblowers were required to report information regarding violations to the SEC, thus effectively excluding whistleblowers who reported internally to company channels the anti-retaliation protections under the Dodd-Frank Act (ibid).

Concurrently, in the US as well as the EU, there continues to be a high focus on financial innovation, through the development of ‘regulatory sandboxes’42 as well as ‘innovation hubs’43 (ESA 2018), as reflected in the 2018 Fintech Action Plan published by the European Commission (EC 2018), the corresponding 2018 Joint Report by the European Supervisory Authorities (ESA 2018), and the 2018 Basel Committee of Banking Supervision publication on the implications of fintech developments for banks and bank supervisors (BCBS 2018).

Collectively, this ongoing monsoon on both sides of the Atlantic highlights a few important possibilities for the future. Just as an endless monsoon may drown a city, endless heavy regulatory rain may of course stifle economic growth. Even so, a drought can be just as destructive. Without legal frameworks and regulatory protections in place, a hypothetical total reliance on

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40 139 S. Ct. 1094 (2019). In *Lorenzo*, the Supreme Court affirmatively held, in a 6-2 majority decision, that the dissemination of false or misleading statements with an intent to defraud, even if the actor or individual thus charged is not responsible for making the statements, can fall within the scope of SEC Rules 10b-5(a) and (c), even if the disseminator cannot be held liable under Rule 10b-5(b).


42 Which “provide a scheme to enable firms to test, pursuant to a specific testing plan agreed and monitored by a dedicated function of the competent authority, innovative financial products, financial services or business models. Sandboxes may also imply the use of legally provided discretions by the relevant supervisor (with use depending on the relevant applicable EU and national law), but sandboxes do not entail the disapplication of regulatory requirements that must be applied as a result of EU law” (ESA 2018, p. 5).

43 Which “provide a dedicated point of contact for firms to raise enquiries with competent authorities on fintech-related issues and to seek non-binding guidance on the conformity of innovative financial products, financial services or business models with licensing or registration requirements and regulatory and supervisory expectations” (ESA 2018, p. 5).
market self-regulation would, as the transparency, accountability, and risk discussions in this dissertation implicitly indicate, probably introduce greater prudential risks into the financial system as it currently stands.

In terms of predicting what shape the future financial sector landscape might take, the possibilities are both interesting and open. What we can identify at the present time is that technology is arguably the main driving force of the financial sector environment as well as the entities that inhabit it. Whether the current trajectory of technological innovation in the regulation-practice nexus of banking heralds a world filled with dragons or a world with no more dragons remains to be seen. Yet, an awareness of the potential for change that fintech brings is well-recognized by regulators and policymakers today.

As the Chair of the BCBS, Pablo Hernandez de Cos stated in a November 2019 keynote conference speech, the BCBS continues to consider the implications of technological innovations for banks, other stakeholders, other market participants, and bank supervisors (de Cos 2019). What that speech importantly identified was that the BCBS considers several potential scenarios that could arise in future customer-oriented financial services, ranging from incumbent banks digitizing and modernizing to the extent that they adjust their business models to retain all their current customer relationships and core banking services, to banks and third-party service providers coexisting in modularized financial sector where the platforms and services of incumbent banks and those of new market entrants may be independent but are also able to be fit together for the benefit of customers, to complete disintermediation, where incumbent banks become irrelevant and customers directly interact with individual service providers, such as through peer-to-peer lending platforms where any party can directly function as either a borrower or a lender of capital funds (ibid). In this last possible scenario, the dragons have gone extinct. And yet, the function of banking remains important. New creatures will fill the skies.

For banking supervisors then, the issue of addressing prudential concerns remains. In this respect as well, the BCBS has, within its Sound Practices publication on the implications of fintech for banks and bank supervisors, identifies ten broad key considerations for supervisors to consider. Amongst other things, these include the need to balance prudential controls with beneficial innovation, to identify new risks introduced into the financial sector through financial innovations, to harness the possibilities of using innovations as supervisory tools, and to foster better cross-sectoral cooperation between financial and other supervisory authorities (BCBS 2018, p.33-39). However the climate evolves, the landscape will always need some measure of water, if not rain, to survive. However the landscape evolves, there will
always be something left alive.\textsuperscript{44} There is much to understand about how the weather and the climate and the evolution (or extinction) of the dragons are linked together. In this respect, there is much work that is being done, and much that still remains to be done, in the spheres of regulation, policy, practice, and yes, research too.

Understanding the parade

Understanding the dragons and the weather is well and good, but experiencing and understanding a parade constitute something on another level entirely. The dragon dances are an important part of the parade, but the parade is so much more than the dragon dances. The parade is the planning and the execution and the attendance and the cleanup. The parade is also the motivations and the tangible impacts and the intangible memories that all those involved take with them. It is the audience and the vendors who come to sell their wares amongst the crowd. It is the interactions, both good and bad, that collectively come together to form the event as a whole. The parade is not just the regulation-practice nexus of banking; it is also the financial markets, the links to the real economy, the actors – organizational and individual – that make up all the different parts of the socio-political-economic whole.

There is just so much happening in a parade, all at once and all together. The smells, the sounds, the sights, everything combining into a wild rippling crescendo of celebration… it’s hard not to get swept up in the colorful chatter and dance, the fragrant, delicious merriment of it all. Look, there a small child on her father’s shoulders, laughing in joyful abandon as the dragons twirl past. Did her family contribute to the construction of one of those dragons, perhaps? There, an old woman balanced precariously close to the dancers, leaning on her cane as she claps the performers on. Is it really safe for her to be here? Did she come just for the sights? Could she be cheering on a young relative who is performing in the parade? And there, just a few feet away, delicious chestnuts in little paper bags, piled high on a hawker’s tray, spreading tendrils of a delicate mouthwatering fragrance as he ambles through the crowd, his voice lost amidst the beat of the cymbals and drums that drive the dancers on. And turn your eyes just a fraction, and see a young woman selling spun sugar figures on thin wooden sticks. See her standing in a corner, a small frown of concentration on her brow competing with the hint of a smile as her customers gleefully trade a few coins and notes in exchange for her artistic delicacies, such a strangely serene tableau amidst the mayhem. But have they passed any health and safety inspections, these street-food sellers? Do these little vendors even have the requisite permits to ped-

\textsuperscript{44} And if there isn’t, then this entire research endeavor, like much else, will have been for naught.
dle their wares here? Or are they cheerfully hawking their unchecked products to an unwary public because the parade planners have not thought to monitor such activities? But really, are they harming anyone? After all, what is a parade without good snacks? And there is more, so much more, and not all of it is beautiful and good. There are pickpockets in the crowd, perhaps even under the dragon costumes. There are decrepit beggars too, watching the parade as they entreat passers-by for alms. There is the smell of sewage competing with incense, if you pause long enough to register it. Here, a laugh. There, a cry. Every person, every sight, wherever you look, whether it is wonderful, terrible, or nondescript, has a unique story surrounding it, and the whole spectacle, in all of its little parts, weaves together in a beautiful cacophony of being. And this, all of this, is the parade.

And there you are, researcher, taking it all in. And you have been given, or perhaps you have given yourself, the responsibility of understanding some aspect of what it is that you perceive, of what you glean from all that is happening around you. And you can’t know it all, really. You can’t feel it all. You can’t absorb it all. But you can, if you just breathe and observe and remind yourself of why it is that you are here, now, build up an understanding and a memory of what it is that you are experiencing in the midst of this parade. And you can take that with you. And it may not be the same, what you have experienced, as what your neighbor in the crowd has perceived. And if you turn to the side and try to talk to the men and women beside you, try to exchange pleasantries and ask how they find the parade, some of them may respond and add to your understandings with some new insight, some new viewpoints. And that is wonderful. Or, they may turn away for their own reasons. And that’s all right, too. Just keep observing. Keep taking in as much as you can. And when it’s all over and you write your account of the parade, or you recount the parade to others who were there or others who couldn’t be there, you know, and they know, even if it remains unsaid, that yours is just one voice. And there were countless others. There are countless others, with their own tales and memories; a mess of similarities and unique outlooks surrounding one complex and unabridged whole.

You and I, we’re observers. We may never truly understand everything within the jumble that comes together to form these beautiful parades. And that is perhaps just as it should be, because that’s what keeps things interesting.

Arguably one of the four horsemen of any good public celebration—the other three being inevitable dehydration, mild indigestion, and the predictably unpredictable loss of some random sartorial accessory or small item.
Personal Acknowledgements

This PhD expedition has been a long one. Now, at last, it is coming to an end. Looking back, I can wholeheartedly say that my exploration took shape not only because of my own decisions and efforts, but also because of the input and support of many other people. There is no way that I can adequately acknowledge or thank everyone who has had an impact on me over the past few years. Even so, there are those who I simply cannot help but want to mention for their role and influence during what has been a most interesting sojourn indeed.

Nils-Göran, Einar, and Fredrik – your patience in reading, commenting on, re-reading, and re-commenting on endless pages of my work, particularly in the last stage of the dissertation drafting, is something that I am immensely grateful for. Nils-Göran, your insights and encouragement helped me find my feet and clarify my words countless times during the research journey. Even though you surely could not have found every single thing I wrote along the way to be interesting, you always made me feel like you did, and that encouraged me more than I can express. Einar, your cheerfully practical and soundly logical grounding in empirical work has provided me with methodological training that I am very thankful for. It has been a lot of fun co-authoring with you during this PhD process, and I am looking forward to more collaboration and project-building coming up! Fredrik, your organized eye for details and structure – all the ‘little things’ that make a project as good as it can be – is something that I have very much respected over the years of building this dissertation. It is a wonderful skill that I hope to be able to emulate and grow into as well. You were my supervisor from the very start of this journey, and here, now, is the finish-line. We are a team that has endured. That says something!

In addition to my supervisors, I am immensely thankful to two other senior researchers who took an interest in the path I was taking, and offered insights and guidance along the way. Professor Daniel Stattin, I remain humbled and grateful for your encouragement and support, both of which have always been there when they were most needed during my PhD journey. Professor Brett McDonnell, your work the law-and-economics sphere has influenced me greatly in the dissertation process. Thank you for hosting my 2019 visit to the University of Minnesota Law School – a short and excellent trip which not only motivated me to add even more to the ‘kappa’ of the dissertation once I got back, but has also given me several interesting
ideas for how to potentially further explore the ‘regulation-practice nexus’ in banking and beyond.

To Banque de Montagne, its Executive Management, employees, and consultants, thank you for welcoming me into the fold for the case study, and for taking the time and energy to sit through all the interviews and follow-ups in the midst of tight deadlines and hectic activities.

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For always being present, and always showing me how much I can achieve, my deepest love and gratitude remain for my family. My mother, Hema. My father, Rangan. My big brother, Neeraj. And, my little brother, who I think we can all agree will forever remain the family favorite, Bear. Thank you for giving me a lifetime of unconditional love.
Appendix 1: Interview List

Pilot Study (2013 – 2014)

<table>
<thead>
<tr>
<th>No</th>
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<th>Location</th>
<th>Duration</th>
<th>Date</th>
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<tr>
<td>1</td>
<td>Swedish Securities Dealers Association, Head</td>
<td>Stockholm</td>
<td>60 min.</td>
<td>27/11/2013</td>
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<td>2</td>
<td>Bank 1, Senior Risk Officer</td>
<td>Stockholm (telephone)</td>
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<td>19/12/2013</td>
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<td>3</td>
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<td>Stockholm</td>
<td>60 min.</td>
<td>09/01/2014</td>
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<tr>
<td>4</td>
<td>Swedish Bankers Association, Senior Advisor 2</td>
<td>Stockholm</td>
<td>60 min.</td>
<td>09/01/2014</td>
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<tr>
<td>5</td>
<td>Bank 2, Senior Risk Officer</td>
<td>Stockholm</td>
<td>90 min.</td>
<td>14/9/2014</td>
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Additional Interviews (2014)

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<th>Duration</th>
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<tr>
<td>1</td>
<td>Operational Risk Manager (Thai Retail Bank)</td>
<td>Bangkok</td>
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<td>Hedge Fund Trader</td>
<td>Singapore</td>
<td>60 min.</td>
<td>22/07/2014</td>
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<td>IT Consultant</td>
<td>Stockholm</td>
<td>75 min.</td>
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<td>4</td>
<td>IT Consultant</td>
<td>Uppsala</td>
<td>45 min.</td>
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</table>

In-Depth Case Study (2014 – 2017)

*The first five interviews (in italics) were informal interviews conducted before formal access was granted. They have been included for the purposes of this comprehensive account; however, they have not been included in the count of 41 interviews as used for Paper IV.*

<table>
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<td>Change Operations Lead</td>
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<td>(3) Group Compliance, Retail Banking Lead</td>
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<td>Stockholm 60 min. 16/04/2014</td>
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<td>(4) Group Compliance, Communications Lead</td>
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<td>Stockholm 50 min. 22/04/2014</td>
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<td>(5) Group Compliance, Wealth Management Lead</td>
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## Appendix 2: Sample Interview Questions

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<th>QUESTIONS</th>
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| Understanding the risk control function – systems and structures | (1) How does the compliance function fit into the risk control function of Banque de Montagne?  
(2) What has changed since FFFS 2014:1 in terms of how the risk control function in Banque de Montagne has evolved?  
(3) How is the concept of “risk” understood by Interviewee XX?  
(4) What are the types of risk reported on, and to whom?  
(5) What and who does Interviewee XX oversee, and who reports to Interviewee XX? |
| Specific compliance instances: New training system | **The system**  
What was the training about and who/what in the bank felt the effects? (Which regulation, which business areas, geographic locations, and users within the bank? What did the training aim to achieve)  
(1) Who was responsible for designing the training system (e.g.: external consultants, vendors, etc)?  
(2) Internally, who was responsible for giving input into and/ providing quality assurance regarding how the training system was designed?  
(3) What determined the training system design, and what was the training system designed to achieve?  
(a) Who/what determined the desired outcome?  
(b) What was the main aim of Banque de Montagne introducing the training system?  
(c) What were the skills/specific things that the users had to show competence in, in order to satisfactorily complete the training? |
(d) How active or passive did the users have to be – was it just watching/listening to material, or did they have to complete some assessments?

(4) In regard of the system design:

(a) What were the different interests that needed to be worked into the system? (what regulatory aim had to be achieved; How did the bank feel it could best achieve this goal; who was responsible for designing the system; what functionalities did the system design take into account regarding users of the system, etc)

(b) What was the testing/trouble shooting process? Who was involved in this process? How was the launch organized and executed? When was 100% training achieved?

(c) How many offerings of the training were needed to achieve full training? From the interviewee perspective, what were the learnings from these subsequent offerings?

(d) How did the training affect performance (in terms of compliance requirements at firm level of course, but also firm performance and local performance through KPI measurements)?

(e) How is the system maintained now? Are new training offerings being given periodically (to refresh old learning, train new employees, etc)? Are there changes to these offerings, and if so, what motivates them?

The actors

(1) Who were the designers of the system? (Which regulation/regulatory aims, which 3rd party vendors, management consultants, IT specialists, both in-house and external)

(2) Walkthrough of the process- who did what from start (when bank first learnt it had to/ should issue the training) to finish (when 100% training was achieved)?

(3) Who maintains the system now that training is complete?  
(a) who ensures that everyone adheres to the new standards?  
(b) How do they assure this adherence?  
(c) How do they communicate this adherence, and to whom?
<table>
<thead>
<tr>
<th>Risk management and IT</th>
<th>(1) In terms of the currently set up risk control function, what are the IT systems in place?</th>
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<tr>
<td></td>
<td>(2) What kind of data is used in these systems? Are there some specific examples to illustrate?</td>
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<td>(3) What kind of decision-making does the system impact, and who are the decision-makers impacted by these IT systems?</td>
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<td>(4) Who is responsible for the functioning of these systems: (a) Overarching responsibility (b) Design (c) Operations</td>
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<td>(5) Are there some instances of any events that have relied on the information generated by the system (eg, any decision made recently, or some event that has come to regulatory attention?) (a) Description of the event (b) Actors involved</td>
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<td>(6) What insight can be drawn from interviewee’s perspective about how Banque de Montagne uses this IT and similar technology in relation to the external environment – is this structure and use Banque de Montagne-specific, or is it pretty much what everyone is doing?</td>
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<td>(7) How much flexibility did Banque de Montagne have in deciding to implement the system?</td>
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<td>(8) How much flexibility do users of the system have in making their inputs?</td>
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<td>(9) How much flexibility do decision-makers have when relying on the output of the system?</td>
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<th>Impact of external actors and environment on use of specific risk control systems</th>
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<td>(1) Who were the external actors, and what expertise/areas of input did they represent?</td>
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<td>(2) How are these expertise areas represented in the system?</td>
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<td>(3) Is this a standard system, or one specific to Banque de Montagne? If specific, then in what way?</td>
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| Implementation of FFFS 2014:1 – intra-organizational perceptions of the change process | (4) How flexible were the requirements of the system at the time it was being designed? And how about once it was implemented?  
(5) What, if any, external factors triggered the introduction?  
(6) What, if any, external factors impacted the introduction?  
(1) How successfully is the implementation going?  
(2) How is ‘success’ defined from the perspective of Interviewee XX?  
(3) Any challenges?  
(4) Is there dialogue between the compliance organization and operational risk management organization?  
(5) How has communication and reporting changed, if at all, between the overall risk control organization generally and the reformed and newly formalized compliance organization specifically, in the context of their interactions with:  
(a) The Board of Directors/CEO of Banque de Montagne?  
(b) Business units and first-line operations?  
(c) Regulatory authorities? |
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<td>• Compliance Process Guidelines – 178 pages</td>
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<td>• Steering Committee Documents – 281 pages</td>
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<td>• Compliance Scope Statements – 122 pages</td>
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<td>• Internal Directives (Governance and Risk Areas) – 411 pages</td>
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<td>• Compliance Policies and Guidelines – 564 pages</td>
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<td>• Risk Committee Charters – 34 pages</td>
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<td>• Steering Committee Meeting Minutes – 34 pages</td>
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<td>• Powerpoint presentations (meetings) – 228 pages</td>
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References


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Institute of Internal Auditors (2013). ‘The three lines of defense in effective risk management and control’, *IIA Position paper*.


