The Role of the Board of Financial Services Firms in Improving Their Firm's Culture

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INTRODUCTION

In recent years, a number of "scandals" have come to light in the financial services industry around the world that have caused significant harm to consumers and have cost the financial services industry considerable sums, in terms of fines, redress, and legal costs. It has been estimated, for example, that since the financial crisis in 2007, financial services firms have paid aggregate fines in excess of $320 billion worldwide in connection with employee misconduct.[1]

More significantly, the "scandals" and failures of governance in financial services firms have damaged trust in the financial services industry. For example, Mark Carney, Governor of the Bank of England, has stated that "the incidence of financial sector misconduct has risen to a level that has the potential to create systemic risks by undermining trust in both financial institutions and markets."[2]

As noted by the Dutch regulator, De Nederlandsche Bank (DNB), "Trust is the foundation on which our financial system is built."[3] If the financial services industry is not trusted, customers may choose to engage less by investing less in their pensions, saving less, or purchasing fewer financial services products. This, in turn, "damage[s] both the industry and

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1. Gavin Finch, *World's Biggest Banks Fined $321 Billion Since Financial Crisis*, BLOOMBERG (Mar. 2, 2017), https://www.bloomberg.com/news/articles/2017-03-02/world-s-biggest-banks-fined-321-billion-since-financial-crisis [https://perma.cc/3CMQ-ZYL2].

2. Letter from Mark Carney, Chairman, Fin. Stability Bd., to G20 Leaders, at 7 (Aug. 30, 2016), https://www.fsb.org/wp-content/uploads/P20160831.pdf [https://perma.cc/D5X7-EGFG].

3. MIREA RAAIJMAKERS ET AL., DE NEDERLANDSCHE BANK, SUPERVISION OF BEHAVIOUR AND CULTURE: FOUNDATIONS, PRACTICE & FUTURE DEVELOPMENTS 30 (2015) [hereinafter SUPERVISION OF BEHAVIOR AND CULTURE], https://www.compliance-instituut.nl/wp-content/uploads/Supervision-of-Behaviour-and-Culture_tcm46-334417.pdf [https://perma.cc/BDC3-K83Z].

the economy, by reducing the availability of capital for productive purposes."[4]

Also, the U.K. Banking Standards Board, the U.K. financial services industry-funded body set up in 2015 that aims to promote high standards of behavior and competence in the industry, recently stated:

> A successful, dynamic UK economy needs a strong, stable banking sector that serves the best interests of its customers. For the sector to contribute fully to the economy and society it needs to be trusted; not only by its customers (in the UK and globally), but also by its staff, by potential employees, by regulators and by policy makers. Trust in the sector has been damaged, and it is only the industry itself – by demonstrating honesty, reliability and competence on a consistent and collective basis – that can rebuild it.[5]

The introduction of increasingly onerous legal and regulatory requirements on financial services firms, backed up by more intrusive supervision by regulators and the imposition of more significant sanctions on firms and individuals who have breached legal requirements, has led to improvements in the industry in recent years. It is generally recognized, however, that these developments, by themselves, do not sufficiently address the industry problems, given that the misconduct that has arisen appears to be symptomatic of a wider problem of "culture" in the financial services industry that needs to be addressed.

As to the "cultural nature" of the problem, the then-Deputy Director of the Bank of England, Minouche Shafik, described the problem as one of "ethical drift" in the financial services industry; that "[c]learly it was not the case of a few bad apples, but something was rotten in the entire barrel."[6] Also, John Williams, President and Chief Executive Officer (CEO) of the New York Federal Reserve, stated in a June 2018 speech that "underlying these scandals is often an inadequate corporate culture, where accountability and ethical conduct have fallen by the wayside."[7]

To address this cultural problem, regulators around the world have increasingly focused their supervisory attention and resources on firms'

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4. *See generally* Sue Jaffer, Nicholas Morris & David Vines, *Why Trustworthiness is Important*, *in* CAPITAL FAILURE: REBUILDING TRUST IN FINANCIAL SERVICES 7–8 (2014).

5. *What is the BSB*?, BANKING STANDARDS BOARD, https://www.bankingstandardsboard.org.uk/what-is-the-bsb/ [https://perma.cc/F9X3-S8FQ].

6. Minouche Shafik, Deputy Governor, Markets & Banking, Bank of Eng., Panel Discussion at the Federal Reserve Bank of New York Conference: From 'Ethical Drift' to 'Ethical Lift': Reversing the Tide of Misconduct in Global Financial Markets 2 (Oct. 20, 2016), https://www.bankofengland.co.uk/-/media/boe/files/speech/2016/from-ethical-drift-to-ethical-lift-reversing-the-tide-of [https://perma.cc/8GS2-XP53].

7. John C. Williams, President & Chief Exec. Officer, Fed. Reserve Bank of N.Y., Remarks at Governance and Culture Reform Conference: Now Is the Time for Banking Reform (June 18, 2018), https://www.newyorkfed.org/newsevents/speeches/2018/wil180618 [https://perma.cc/2YNJ-CT9B].

cultures in order to seek to preemptively address root causes of misconduct risks. The Dutch regulator, De Nederlandsche Bank, for example, has adopted a groundbreaking approach to supervising the behavior and culture of firms (as described in its textbook, *Supervision of Behaviour and Culture: Foundations, Practice and Future Developments*).[8] Also, the New York Federal Reserve (Fed)[9] and U.K. Financial Conduct Authority have focused efforts on culture reform in the industry.

It is very clear, however, that for regulators it is primarily for firms rather than legislators or regulators to improve culture in firms: "[C]ultural problems are the industry's responsibility to solve. The official sector can monitor progress and deliver feedback and recommendations. In fact, many individual supervisory findings are often symptoms of deeper cultural issues at a firm. But the banks themselves must actively reform and manage their cultures."[10] So, who is responsible within a firm for improving its culture, and what can they do about improving culture in their firm?

Regulators have typically focused their supervisory efforts, in relation to culture, on the senior executive management rather than the board,[11] as they are considered to be the key influencers of a firm's culture.[12]

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8. SUPERVISION OF BEHAVIOR AND CULTURE, *supra* note 3, at 30. The DNB approach was, for example, relied on by the Central Bank of Ireland for the purposes of its culture review of the retail banks in Ireland. *See* CENT. BANK OF IRELAND, BEHAVIOUR AND CULTURE OF THE IRISH RETAIL BANKS (2018) [hereinafter IRISH BANKING CULTURE REPORT], https://www.centralbank.ie/docs/default-source/publications/corporate-reports/behaviour-and-culture-of-the-irish-retail-banks.pdf?sfvrsn=2 [https://perma.cc/A5CL-RCXW].

9. *See, e.g.*, Kevin J. Stiroh, Exec. Vice President, Fed. Reserve Bank of N.Y., Remarks at the 4th Annual Culture and Conduct Forum for the Financial Services Industry: The Complexity of Culture Reform in Finance (Oct. 4, 2018), https://www.newyorkfed.org/newsevents/speeches/2018/sti181004 [https://perma.cc/32LR-XSKL].

10. Alberto G. Musalem, Executive Vice President, Fed. Res. Bank of N.Y., Remarks at Toward a New Age of Responsibility in Banking and Finance: Getting the Culture and the Ethics Right: Why Focus on Culture? (Nov. 23, 2015), https://www.newyorkfed.org/newsevents/speeches/2015/mus151123 [https://perma.cc/7HPT-22HW].

11. As stated by the DNB, "[t]here are two reasons for the assumption that formal and informal leaders function as a primary 'lever' for the supervision of behaviour and culture. First, because of the impact of the board on performance. Second, because of the impact of leaders on organisational change." SUPERVISION OF BEHAVIOR AND CULTURE, *supra* note 3, at 59. The DNB reference to a "board" is to the management board or executive board. *Id.* at 18. Reference to a "board" in this Article is to a single-tier board structure (composed to some extent or wholly of non-executive directors), which is common in, for example, Anglo-Saxon countries. This is different to a two-tier board structure, which is common in, for example, many Continental European countries; this latter structure involves a supervisory board (composed wholly of nonexecutive directors), which sits above a management Board (composed of the senior executive management).

12. DNB, for example, which is a globally recognized thought-leader in the area of regulatory supervision of financial firms' culture, noted in its book that its supervision has focused mostly on the management board level. SUPERVISION OF BEHAVIOR AND CULTURE, *supra* note 3, at 18; *see also* IRISH BANKING CULTURE REPORT, *supra* note 8, at 3 (stating that its review, which was prepared in

Boards do, nevertheless, have clear legal responsibilities regarding the culture of their firms. The 2015 Basel Corporate Governance Principles for Banks, for example, provide as Principle 1 that "[t]he board has overall responsibility for the bank, including approving and overseeing management's implementation of the bank's strategic objectives, governance framework and corporate culture." [13] At the European Union (EU) level, these principles are reflected in the European Banking Authority (EBA) Guidelines on Internal Governance.[14] The question then becomes, what role can and should the board of a financial services firm play in improving the culture of the firm? A difficulty is that, as noted in a November 2018 G30 report, *Banking Conduct and Culture: A Permanent Mindset Change*, "[T]here is still a lack of clarity in many organizations on how the board will champion, oversee, and monitor conduct and culture issues . . . . "[15]

In this Article, we look at the role the board is expected to play under regulatory requirements and guidance; we then look specifically at the failings of boards in a number of the recent "scandals." Finally, we offer a number of suggestions on ways in which the board can have a more effective role in improving firms' culture. In this latter regard, we specifically focus on industry (rather than firm-specific) initiatives that could enable the board to have a more effective role, particularly in light of the setting up of the industry-funded Banking Standards Board in the U.K. and the recent setting up of the industry-funded Irish Banking Culture Board.[16]

As to the particular areas where an industry-based approach, looking specifically at the role of boards, could assist the improvement of the

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close collaboration with the DNB "focused primarily on the executive leadership team . . . due to the importance of its members in driving effective cultures.").

13. BASEL COMM. ON BANKING SUPERVISION, GUIDELINES: CORPORATE GOVERNANCE PRINCIPLES FOR BANKS 8 (2015) [hereinafter GUIDELINES], https://www.bis.org/bcbs/publ/d328.pdf [https://perma.cc/ET4A-A43T].

14. EUR. BANKING AUTH., GUIDELINES ON INTERNAL GOVERNANCE UNDER DIRECTIVE 2013/36/EU, at 3 (2017), https://eba.europa.eu/sites/default/documents/files/documents/10180/2164689/531e7d72-d8ff-4a24-a69a-c7884fa3e476/Guidelines%20on%20Internal%20Governance%20%28EBA-GL-2017-11%29_EN.pdf?retry=1 [https://perma.cc/L5SZ-9W3F]. The EBA is mandated by Article 74 of Directive 2013/36/EU to develop guidelines in this area. *Id.* Pursuant to paragraph 1 of these Guidelines, "[i]n accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authority and financial institutions must make every effort to comply with the guidelines." *Id.* at 12.

15. GRP. OF THIRTY, BANKING CONDUCT AND CULTURE: A PERMANENT MINDSET CHANGE, at xi (2018), https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2018/december/Oliver_Wyman_G30_Report_on_Banking_Conduct_and_Culture.pdf [https://perma.cc/FQ5M-SSEW].

16. For the U.K. Banking Standards Board, see BANKING STANDARDS BD., https://www.bankingstandardsboard.org.uk/ [https://perma.cc/P75N-VQQ2]. For the Irish Banking Culture Board, see IRISH BANKING CULTURE BOARD, https://www.irishbankingcultureboard.ie/ [https://perma.cc/36F9-MJG6].

culture of financial services firms—and, thereby, potentially in due course, the trustworthiness of firms—we discuss in this Article below the following:

In the first place, the board needs to ensure that it is properly informed—including on the basis of sufficiently reliable information from staff and customers—of potential issues of behaviors that diverge materially from espoused values. As is clear from the recent "scandals" discussed further below, in many cases, boards often fail to ensure they are properly informed of these issues, which provide an early warning signal of misconduct risk. The development of industry norms and possible benchmarking in relation to this failure to stay informed could be useful in assisting this process. In this regard, one of the potential areas of focus could usefully be in relation to customer complaints.

Secondly, constructive challenges at the board level could be enhanced through the development of industry norms and peer review of board engagement. Such an approach could benefit from the approach to such reviews already developed by the DNB. As discussed further below, "groupthink" at the board level and lack of effective challenges have been found to be significant contributing factors to ineffective cultures in financial services firms and the DNB has developed particular expertise in assessing such issues.

Thirdly, boards may benefit from encouraging the industry to address more clearly the "purpose" of a financial services firm and its wider role in society (i.e. going beyond the aim of pursuing profits, which is an intended outcome of any business "purpose"). Under the 2018 U.K. Corporate Governance Code,[17] for example, one of the key functions of the board is to establish the company's purpose. Any proper consideration of this issue would serve to tackle a core issue of public concern, namely that the financial services industry cannot be trusted because its mindset is one of focusing on short-term profitability to the detriment of any stakeholders other than shareholders.[18] The idea of the "purpose" of a

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17. U.K. FIN. REPORTING COUNCIL, THE UK CORP. GOVERNING CODE 2, 4–5 (2018), https://www.frc.org.uk/document-library/corporate-governance/2018/uk-corporate-governance-code-2018 [https://perma.cc/U99R-37TV]. All companies with a premium listing of equity shares in the UK are required under the Listing Rules to report in their annual report and accounts on how they have applied this Code. They are required to report on the basis of a 'comply or explain' approach. *See* Introduction to the Code; *see also* U.K. FIN. REPORTING COUNCIL, GUIDANCE ON BOARD EFFECTIVENESS (2018), https://www.frc.org.uk/document-library/corporate-governance/2018/guidance-on-board-effectiveness [https://perma.cc/QR3R-HYM5]; *What is the BSB?*, *supra* note 5.

18. *See, e.g.*, Andrew Bailey, Chief Exec. Fin. Conduct Auth., Speech at the Launch of St. Mary's University School of Business: Trust and Ethics—A Regulator's Perspective (Oct. 16, 2018), https://www.fca.org.uk/news/speeches/andrew-bailey-trust-ethics-regulators-perspective [https://perma.cc/H7Q8-A9W5].

corporation in society is one of increasing public debate[19] and boards of financial services firms could assist in improving trust in the industry by encouraging constructive engagement on this issue.

The particular benefit of developing industry-wide standards, benchmarking, and peer-pressure around these issues is that, as noted by the DNB, "in essence, peer pressure regulates behaviour."[20]

I. What Do We Mean by a Firm's "Culture"?

While most financial services firms will likely have in place detailed values statements, codes of conduct, and various processes and procedures that are intended to ensure that all employees of the firm behave in accordance with specified standards of behavior, the "way things get done around here" will likely be more complex than can be described in written documents and can often diverge from the high-level general expectations set out in the firm's documentation.

Employees are more likely to look to their peers and "tone from the top" than to written manuals of the firm for guidance on what behaviors are acceptable within the firm. As noted above, "in essence, peer pressure regulates behaviour."[21] Additionally, "[f]or employees, organisational culture is the social glue that holds the organisation together by providing appropriate standards for the ways employees should behave. As a consequence, culture reduces employees' uncertainty and anxiety about appropriate and expected behaviours."[22]

An important theoretical framework for identifying and assessing organizational culture has been provided by the organizational psychologist Edgar Schein.[23] The DNB's model for assessing firms' culture is strongly based on Schein's conceptual model.[24]

According to Schein, culture exists simultaneously on three different levels: (1) on the surface are artifacts; (2) under the surface are espoused values and beliefs; and (3) at the core are basic assumptions. The DNB uses the metaphor of an iceberg to describe these three levels because only the first layer is directly observable.

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19. *See, e.g.*, David Brooks, *The Remoralization of the Market*, N.Y. TIMES (Jan. 11, 2019), https://www.nytimes.com/2019/01/10/opinion/market-morality.html?action=click&module=Opinion&pgtype=Homepage [https://perma.cc/2RKE-82PK].

20. IRISH BANKING CULTURE REPORT, *supra* note 8, at 50.

21. *Id.*

22. *Id.* at 45.

23. *See generally* EDGAR H. SCHEIN WITH PETER SCHEIN, ORGANIZATIONAL CULTURE AND LEADERSHIP (5th ed. 2017).

24. IRISH BANKING CULTURE REPORT, *supra* note 8, at 46.

The first level, the artifacts of a firm, are the "visible and feelable" phenomena in a firm: the "phenomena that you would see, hear and feel when you encounter a new group with an unfamiliar culture."[25]

For present purposes, these artifacts include, for example, the formal governance structure of a financial services firm, its values statement, its code of conduct, and its formal policies relating to financial incentives for staff, diversity, and inclusion. These artifacts also include observable behaviors. The DNB's supervisory approach in relation to this layer of the iceberg involves reviewing the behaviors of firms' senior leadership teams in relation to decisionmaking, leadership, and communication.

Clearly, the board has the key role in approving many of these "artifacts," including those relating to, for example, a firm's statement of its values and its code of conduct.[26]

The second level of culture, espoused values and beliefs, are the consciously understood and spoken of assumptions of the group, or firm, as to their values and beliefs; they are "explicitly articulated because they serve the normative or moral function of guiding members of the group as to how to deal with certain key situations as well as in training new members how to behave."[27]

For the DNB, this layer of its iceberg metaphor involves assessing group dynamics, in particular at the level of the senior leaders. In its assessments of firms, the DNB looks at the "atmosphere" of interactions within groups, in particular the senior leadership team (management board in a two-tier board structure). It looks at issues such as: Is there an atmosphere where people can address unwanted or "bad" behavior? Is there an atmosphere of co-operation or competition, perhaps infighting? Is there a basis of mutual trust within a (management) board, between the senior management and the board, or does mistrust dominate in the working relationship?[28]

Boardroom dynamics can be assessed at this level of the "iceberg" and can have an important impact on a firm's "tone from the top," and hence, overall culture.[29]

Assessing these two levels, however, may not be sufficient. The third level, relating to taken-for-granted underlying basic assumptions, is a key level. These are assumptions about behavior, where members of a group

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25. SCHEIN, *supra* note 23, at 17.

26. *See, e.g.*, EURO. BANKING AUTH., *supra* note 14, at 34 (stating that the board "should be responsible for setting and communicating the institution's core values and expectations").

27. SCHEIN, *supra* note 23, at 20.

28. IRISH BANKING CULTURE REPORT, *supra* note 8, at 50.

29. *Id.* at 59–60.

holding these assumptions may find behavior based on any other premise "inconceivable."[30] The DNB has described this layer as the "mindset."[31]

According to Schein, where a leader identifies a culture involving widespread discrepancies between desired behaviors and observed behaviors, in order to achieve culture change the leader will need to "locate the cultural DNA and change some of that,"[32] or in other words, address culture issues at the level of taken-for-granted underlying basic assumptions and not merely at the level of artifacts or espoused values and beliefs.[33]

Based on Schein, the DNB also notes that a detailed understanding of all three layers is necessary in order to understand organizational culture and to be able to target changes.[34]

Schein's model is helpful for the purposes of considering what aspects of a culture can be influenced or managed by a board. We rely on Schein's model for the purposes of our discussion of suggestions on this issue in Part VI below—particularly, the issue of considering the purpose of a firm.

II. REGULATORY REQUIREMENTS AND EXPECTATIONS ON BOARDS TO APPROVE AND OVERSEE CORPORATE CULTURE

As noted above, the 2015 Basel Corporate Governance Principles for Banks provide that the board of a bank has the overall responsibility for the bank, including approving and overseeing corporate culture.[35] These Principles note that "a fundamental component of good governance is a corporate culture of reinforcing appropriate norms for responsible and ethical behaviour" and state that, in order to promote a sound corporate culture, the board should reinforce the "tone from the top" by:

- Setting and adhering to corporate values that create expectations that all business should be conducted in a legal and ethical manner, and overseeing the adherence to such values by senior management and other employees;

30. SCHEIN, *supra* note 23, at 22.

31. IRISH BANKING CULTURE REPORT, *supra* note 8, at 51.

32. SCHEIN, *supra* note 23, at 27.

33. As noted by the DNB, "challenging behaviour and culture [by a supervisor] means questioning underlying beliefs and threatening stability and security. These kinds of changes in organisations often involve an emotional and confusing process. Not only for the financial organisation's leaders and managers but also for the supervisors who address issues concerning behavioural and cultural change. All in all, this requires perseverance." IRISH BANKING CULTURE REPORT, *supra* note 8, at 95.

34. *Id.* at 52.

35. GUIDELINES, *supra* note 13, at 8.

- Promoting risk awareness within a strong risk culture, conveying the board's expectation that it does not support excessive risk-taking, and that all employees are responsible for helping the bank operate within the established risk appetite and risk limits;
- Confirming that appropriate steps have been or are being taken to communicate throughout the bank the corporate values, professional standards, or codes of conduct it sets, together with supporting policies; and
- Confirming that employees, including senior management, are aware that appropriate disciplinary or other actions will follow unacceptable behaviours and transgressions.[36]

The Basel Corporate Governance Principles also provide that an appropriate code of conduct should be put in place, and that Boards should have oversight of the whistleblowing policy mechanism and of ensuring that senior management addresses legitimate issues that are raised. Additionally, the board should oversee and approve how, and by whom, legitimate material concerns should be investigated and addressed by an objective, independent internal or external body—senior management, the board itself, or both.[37] At the EU level, these principles are reflected in the European Banking Authority (EBA) Guidelines on Internal Governance.[38]

More recently, the 2018 U.K. Corporate Governance Code,[39] which came into force in January 2019, provides that: "The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example, and promote the desired culture."[40] In addition,

> The board should assess and monitor culture. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action. The

36. *Id.* at 9.

37. *Id.* at 9–10.

38. EURO. BANKING AUTH., *supra* note 14, at 12. The EBA is mandated by Article 74 of Directive 2013/36/EU to develop guidelines in this area. Pursuant to paragraph 1 of these guidelines, "[i]n accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authority and financial institutions must make every effort to comply with the guidelines." *Id.*

39. FIN. REPORTING COUNCIL, THE UK CORPORATE GOVERNING CODE 2 (2018), https://www.frc.org.uk/document-library/corporate-governance/2018/uk-corporate-governance-code-2018 [https://perma.cc/U99R-37TV]. All companies with a Premium Listing of equity shares in the UK are required under the Listing Rules to report in their annual report and accounts on how they have applied this Code. They are required to report on the basis of a "comply or explain" approach. *Id.*; *see also* GUIDANCE ON BOARD EFFECTIVENESS, *supra* note 17.

40. FIN. REPORTING COUNCIL, *supra* note 39, at 4.

> annual report should explain the board's activities and any action taken.[41]

Whilst the legal responsibility on boards to approve and oversee an appropriate culture is clear, the practical difficulties faced by boards must also be recognized. As noted in an important 2015 G30 report setting out recommendations for culture change in the industry:

> Most Boards struggle in addressing culture. Difficulty defining the underlying concepts, a lack of clear metrics, diffuse responsibilities across the Executive team, a lack of sufficient time to consider cultural issues properly, and lack of visibility on key cultural issues are cited as challenges to improving the Board's oversight and engagement on conduct and values.[42]

III. HIGH-PROFILE RECENT EXAMPLES OF BOARD FAILURES

A number of reports into the failings of banks in the run-up to the financial crisis in 2007–2008, highlighted failures of the boards, particularly in terms of failures to challenge the executive effectively. The 2009 Walker Review, which reported at the behest of the U.K. Prime Minister on corporate governance in the U.K. banking industry and made recommendations for reform, emphasized that "[t]he most critical need is for an environment in which effective challenge of the executive is expected and achieved in the boardroom before decisions are taken on major risk and strategic issues."[43] More generally, as noted in the above-mentioned 2015 G30 report,

> In the lead-up to the 2008–2009 financial crisis, Boards in certain banks allowed their management to take decisions and actions that ultimately led to poor outcomes for the firms' employees, customers, shareholders, and the wider economy. Boards had neither sufficient expertise nor the ability to effectively challenge management strategies. And Board decisions suffered from self-reinforcing groupthink and herd behavior.[44]

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41. *Id.*

42. GRP. OF THIRTY, BANKING CONDUCT AND CULTURE: A CALL FOR SUSTAINED AND COMPREHENSIVE REFORM 31 (2015), https://group30.org/images/uploads/publications/G30_BankingConductandCulture.pdf [https://perma.cc/2RRC-SY5Q].

43. DAVID WALKER, A REVIEW OF CORPORATE GOVERNANCE IN UK BANKS AND OTHER FINANCIAL INDUSTRY ENTITIES: FINAL RECOMMENDATIONS 12 (2009), https://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/walker_review_261109.pdf [https://perma.cc/8HPR-8PPD].

44. GRP. OF THIRTY, *supra* note 42, at 19.

The April 2013 Salz review[45] of the business practices of Barclays PLC prior to the financial crisis, also provides useful insights into the governance and culture problems that gave rise to excessive risk-taking and ethical issues. With regard specifically to the role of the board, the report notes:

> The board sets the tone from the top of the organisation, and must carry ultimate responsibility for its values, culture and business practices. With the benefit of hindsight, we believe that the Barclays Board did not give sufficient attention to this area. We also believe the Board found it difficult at times to penetrate into what was a large, complex organisation. It was significantly stretched in coping with the many issues that arose in the financial crisis – the Board met on 30 occasions in 2008 (at times by conference call) and 27 times in 2009 – and many of the events that have raised questions about culture and business practices only clearly emerged after the beginning of the financial crisis.
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> One of the principal roles of the Board is to provide challenge to management. Whether it is successful is influenced by a number of factors, including the composition of the Board, the skills of the Chairman, Board members' understanding of the Group's businesses, the time they have to give, the openness of the executive directors and the information available to the Board. Barclays has made progress in improving the specialist financial experience on the Board, as well as its diversity, but there is more to be done.[46]

The findings of the U.K. Parliamentary Commission into banking standards, in its June 2013 report *Changing Banking for Good*,[47] were starker.

> Banks whose board-level governance arrangements could be described on paper as approximating to best practice have run into serious governance problems. There were frequently several common elements to bank governance failures. Some CEOs were overly dominant, which the Board as a whole failed to control.

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45. *See generally* ANTHONY SALZ, SALZ REVIEW: AN INDEPENDENT REVIEW OF BARCLAYS' BUSINESS PRACTICES (2013) [hereinafter SALZ REVIEW], https://online.wsj.com/public/resources/documents/SalzReview04032013.pdf[https://perma.cc/5HLU-7BCT].

46. *Id.* at 8.

47. HOUSE OF LORDS & HOUSE OF COMMONS, PARLIAMENTARY COMMISSION ON BANKING STANDARDS, CHANGING BANKING FOR GOOD, VOL. 1, 2013, HC 175-I, at 4 (UK), https://www.parliament.uk/documents/banking-commission/Banking-final-report-volume-i.pdf [https://perma.cc/VAM5-NU3W]. The terms of reference of this Parliamentary Commission state that it is to "consider and report on professional standards and culture of the UK banking sector, taking account of regulatory and competition investigations into the LIBOR rate-setting process, lessons to be learned about corporate governance, transparency and conflicts of interest, and their implications for regulation and for Government policy and to make recommendations for legislative and other action." *Id.*

> Chairmen proved weak; often they were too close to, and became cheerleaders for, the CEO. NEDs provided insufficient scrutiny of, or challenge to, the executive, and were too often advocates for expansion rather than cautioning of the risks involved. There was insufficient wider banking experience among NEDs and the resources available to them were inadequate. Central functions, including risk and control, had insufficient capability and status to perform their functions and were often regarded as an impediment to the business, rather than essential to its long-term success.[48]

The U.K. Parliamentary Commission also identified the importance of individual accountability at the highest levels.

> Too many bankers, especially at the most senior levels, have operated in an environment with insufficient personal responsibility. Top bankers dodged accountability for failings on their watch by claiming ignorance or hiding behind collective decision-making. They then faced little realistic prospect of financial penalties or more serious sanctions commensurate with the severity of the failures with which they were associated. Individual incentives have not been consistent with high collective standards, often the opposite.[49]

In Ireland, the 2011 Nyberg Commission of Investigation into the Banking Sector noted, with regard to the responsibilities of the Board: "Banks' management and boards embraced a lending sales culture at the expense of prudence and risk management.[50] This view then spread down through the ranks, partly through the effects of volume targets and bonus systems and partly through indoctrination, causing the massive run-up in risky assets."[51] More recently, in a July 2018 report on the culture of the five retail banks in Ireland,[52] the Central Bank of Ireland (CBI) noted that Irish banks have a way to go in developing a customer-focused culture; as to the role of boards, the CBI noted that more needs to be done to improve the effectiveness of challenges at the board level.[53]

Furthermore, in Australia, the April 2018 report by the Australian Prudential Regulation Authority (APRA) into the Commonwealth Bank of Australia (CBA), the largest financial institution in Australia, provides

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48. *Id.* at 41.

49. *Id.* at 8.

50. *See generally* COMM'N OF INVESTIGATION INTO THE BANKING SECTOR IN IRELAND, MISJUDGING RISK: CAUSES OF THE SYSTEMIC BANKING CRISIS IN IRELAND 96 (2011), https://www.bankinginquiry.gov.ie/Documents/Misjuding%20Risk%20-%20Causes%20of%20the%20Systemic%20Banking%20Crisis%20in%20Ireland.pdf [https://perma.cc/9GCL-8HU7].

51. *Id.* at 96.

52. IRISH BANKING CULTURE REPORT, *supra* note 8.

53. *Id.* at 30.

some interesting insights into the role of the board and board failings.[54] This report, following a number of misconduct issues at the bank, found that there were significant shortcomings in governance and management of nonfinancial risk. In particular, it found that the board "did not demonstrate rigour of oversight and challenge to CBA management" or "have the right balance of both summarised and detailed reporting" in relation to non-financial risks.[55] With regard to customers, CBA's board focused on aggregate customer satisfaction survey results (such as Net Promoter Scores, discussed further below) and alarm bells from the treatment of aggrieved customers "did not sound loudly."[56] "Although CBA has drawn comfort from strong customer satisfaction metrics, which reflect an aggregated view of customer sentiment, it has missed the tail where customer issues reside."[57]

More recently, in February 2019, the Australian Royal Commission report[58] into misconduct in the Australian financial services industry was published. This report was highly critical of the extent of misconduct in the financial services industry in Australia and noted that primary responsibility lies with the entities and "those who managed and controlled those entities: their boards and senior management."[59]

A. Board "Blind Spots": Wells Fargo

The recent Wells Fargo scandal is an example of a board "blind spot," in that the commercial success of a particular business model blinded it to the underlying conduct risks of the model. Specifically, it appears that the Board failed to consider/look for information on whether the successful business model was in line with the stated values of the firm.

Essentially, the Community Bank business of Wells Fargo in the U.S. incentivized/pressured its staff to cross-sell products to existing clients—in particular to open new bank accounts and take on new services.[60] The pressures on sales staff to meet overly-ambitious sales

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54. JOHN LAKER ET AL., AUSTL. PRUDENTIAL REGULATION AUTH., PRUDENTIAL INQUIRY INTO THE COMMONWEALTH BANK OF AUSTRALIA (2018), https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf [https://perma.cc/TYQ6-L27D].

55. *Id.* at 11.

56. *Id.*

57. *Id.* at 92.

58. 1 ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY, FINAL REPORT (2019) [hereinafter ROYAL COMMISSION FINAL REPORT], https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf [https://perma.cc/D63J-8MAE].

59. *Id.* at 4.

60. The then-Wells Fargo Chairman and CEO, John Stumpf, regularly used the infamous mantra "eight is great" to motivate staff to get customers to take eight of the company's products. Maggie McGrath, *How the Wells Fargo Phony Account Scandal Sunk*, FORBES (Sept. 23, 2016),

targets resulted in them taking short cuts or engaging in fraudulent activity to meet their sales targets. In 2016, Wells Fargo was fined $185 million by U.S. regulators for these activities.[61] Additionally, as noted in an October 2018 settlement agreement between Wells Fargo and the Attorney General for the State of New York, Wells Fargo was fined $65 million.

> As a result of its cross-sell driven sales culture, certain Wells Fargo employees engaged in the following misconduct without customer knowledge or consent: opened deposit accounts; transferred funds from customers' authorized accounts in order to temporarily fund unauthorized accounts; used email addresses not belonging to customers to enroll customers in on-line banking services; requested debit cards and created personal identification numbers (PINs) in order to activate them; and submitted applications for and obtained credit cards.[62]

The mis-selling affected approximately 3.5 million customer accounts.[63] In July 2017, Wells Fargo announced that, following a review, it would provide a total of $2.8 million in refunds and credits due to customers on top of $3.3 million previously refunded.[64]

In June 2018, Wells Fargo settled a class action lawsuit in California relating to these practices for $142 million.[65] Wells Fargo has also been forced to pay compensation to former employees of the firm who lost their jobs as a result of whistleblowing about the sales practices—in one case the compensation amounted to $5.4 million.[66]

In testimony to the U.S. Senate Banking Committee, John Stumpf, the Chairman and CEO of Wells Fargo during the period in question, famously stated that what had happened at the bank went against "our

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https://www.forbes.com/sites/maggiemcgrath/2016/09/23/the-9-most-important-things-you-need-to-know-about-the-well-fargo-fiasco/#74a6dbf3bdc4 [https://perma.cc/5VCK-67T7].

61. *See* Wells Fargo Bank, CFBP No. 2016-CFBP-0015 (Sept. 8, 2016) (consent order).

62. Settlement Agreement at 3, In the Matter of Wells Fargo & Company, No. 18-121 (Oct. 18, 2018).

63. *See* Wayne Thompson, *Wells Fargo Expands Remediation Plans After Additional Analysis*, WELLS FARGO (Aug. 31, 2017), https://stories.wf.com/wells-fargo-remediation-plans/ [https://perma.cc/C7WL-QW9V].

64. *Id.*

65. Ben Lane, *Court Finally Approves Wells Fargo's $142 Million Fake Account Class Action Settlement*, HOUSINGWIRE (June 15, 2018), https://www.housingwire.com/articles/43698-court-finally-approves-wells-fargos-142-million-fake-account-class-action-settlement [https://perma.cc/3C5G-EKBH].

66. Press Release, U.S. Dep't of Labor, OSHA Orders Wells Fargo to Reinstate SoCal Whistleblower; Pay $577K in Back Wages, Damages, Attorneys' Fees (July 21, 2017), https://www.osha.gov/news/newsreleases/region9/07212017 [https://perma.cc/B395-KGH9].

values, ethics and culture and runs counter to our business strategy."[67] In October 2016, he resigned from Wells Fargo.[68]

On February 2, 2018, the U.S. Federal Reserve issued a letter[69] to Mr. Stumpf, in his capacity as then Chair of the Board of Wells Fargo, noting that Wells Fargo pursued sales strategies that "motivated compliance violations and improper practices"[70] and that Mr. Stumpf was aware of sales practices issues but failed to investigate them or inform the Board about them in a timely manner.[71] The U.S. Federal Reserve letter concluded by stating, "[Y]our performance in addressing these problems is an example of ineffective oversight that is not consistent with the Federal Reserve's expectations for a firm of [Wells Fargo's] size and scope of operations."[72]

In April 2017, Wells Fargo published a report[73] on the mis-selling scandal, which was commissioned by independent directors of the Board of Wells Fargo. This report gives some useful insights into the background of the mis-selling. The principal findings of this report included

> The root cause of sales practice failures was the distortion of the Community Bank's sales culture and performance management system, which, when combined with aggressive sales management, created pressure on employees to sell unwanted or unneeded products to customers and, in some cases, to open unauthorized accounts. Wells Fargo's decentralized corporate structure gave too much autonomy to the Community Bank's senior leadership, who were unwilling to change the sales model or even recognize it as the root cause of the problem. Community Bank leadership resisted and impeded outside scrutiny or oversight and, when forced to report, minimized the scale and nature of the problem.[74]

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67. Matt Egan & Chris Isidore, *Wells Fargo CEO Denies Orchestrated Fraud in Accounts Scandal*, CNN (Sept. 22, 2016), https://money.cnn.com/2016/09/20/news/companies/wells-fargo-ceo-apology/index.html?iid=hp-stack-dom [https://perma.cc/HA77-J8D5].

68. Zeke Faux, Laura J. Keller & Jennifer Surane, *Wells Fargo CEO Stumpf Quits in Fallout from Fake Accounts*, BLOOMBERG (Oct. 12, 2016), https://www.bloomberg.com/news/articles/2016-10-12/wells-fargo-ceo-stumpf-steps-down-in-fallout-from-fake-accounts (last visited Jan. 28, 2020).

69. *See* Letter from Michael S. Gibson, Dir., Bd. of Governors of the Fed. Reserve Sys., to John Stumpf, Chair of Bd. Of Dirs., Wells Fargo & Co. (Feb. 2, 2018), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a4.pdf [https://perma.cc/7GF9-QY52].

70. *Id.* at 1.

71. *Id.* at 1–2.

72. *Id.* at 2.

73. INDEP. DIRS. OF THE BD. OF WELLS FARGO & CO. & SHERMAN & STERLING LLP, SALES PRACTICES INVESTIGATION REPORT (2017) [hereinafter INVESTIGATION REPORT], https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf [https://perma.cc/3F8Y-AUTW].

74. *Id.* at Overview of the Report.

The report found that sales practice violations were identified as far back as 2002—when the Community Bank took steps to address it, including through the creation of a sales integrity task force.[75] The volume of sale practice violations steadily increased over time.[76] Carrie Tolstedt took over as CEO of Community Bank in 2007.[77] Her aggressive sales approach was fully supported by Wells Fargo CEO, John Stumpf, who considered her to be the "best banker in America."[78]

It appears that, at least prior to the October 2013 and December 2013, articles in the *Los Angeles Times* about the sales practices showed that the practices were not considered to be a material issue within Wells Fargo.[79] This was despite the fact that between 2011 and 2016, over 5,300 Wells Fargo employees were fired for sales practice violations[80]—indeed, Mr. Stumpf concluded as late as May 2015 that the fact that around 1,000 employees per year were fired because of sales practice violations, meant "[t]his is not systemic."[81] Also, as far back as 2004, an Internal Investigations report that went to the Chief Auditor of Wells Fargo found that staff "feel they cannot make sales goals without gaming the system. The incentive to cheat is based on the fear of losing their jobs for not meeting performance expectations" and that this gave rise to ethical issues and reputational risks for Wells Fargo.[82]

Importantly, "The Community Bank identified itself as a sales organization, like a department or retail stores, rather than a service-oriented financial institution. This provided justification for a relentless focus on sales, abbreviated training and high employee turnover."[83] Indeed, from 2011 to 2015, the average annual staff turnover was 30%, reaching 41% for the twelve-month period to October 2012.[84] Additionally, the April 2017 report of the independent directors found that

> This underreaction to sales practice issues resulted in part from the incorrect belief, extending well into 2015, that improper practices did not cause any "customer harm"; and "customer harm" itself was narrowly construed to mean only financial harm such as fees and penalties. This flawed perspective made it easy to undervalue the risk to Wells Fargo's brand and reputation arising from the misuse of

75. *Id.* at 31.
76. *Id.* at 6.
77. *Id.* at 19.
78. *Id.* at 56.
79. *See id.* at 32.
80. *Id.* at 16.
81. *Id.* at 55–56.
82. *Id.* at 89.
83. *Id.* at 7.
84. *Id.* at 27–28.

customer information and the breaches of trust occasioned by improper sales practices.[85]

More generally, an important factor was that CEO John Stumpf was Wells Fargo's principal proponent of the cross-sell and general sales culture. Also, he "was not perceived within Wells Fargo as someone who wanted to hear bad news or deal with conflict."[86]

As to the role of the Board, the report found that the Board's actions could have been improved in three respects: (1) it should have centralized the risk function sooner than it actually did—in 2016; (2) from 2014, when it was informed of the sales practices as a noteworthy risk, it should have insisted on more detailed and concrete plans from the various reporting functions; and (3) it should have been more forceful in pushing Mr. Stumpf to remove Carrie Tolstedt as CEO of the Community Bank, at least by October 2015.[87]

The report was widely criticized in the press when it was published[88] because it appeared to be overly generous to the Wells Fargo Board. In particular, the report notes that "[t]here was a growing conflict over time in the Community Bank between Wells Fargo's Vision & Values and the Community Bank's emphasis on sales goals"[89]—but the report fails to consider this central question in any meaningful way and the Board's responsibility for addressing it. This growing conflict was evident from whistle-blower reports that could and should have been considered by the Wells Fargo Board. For example, an April 2017 report by the Office of the Comptroller of the Currency[90] noted that by 2010, there had been about 700 whistle-blower complaints of gaming of the incentive plans[91]—this volume of whistle-blower complaints alone should have been a "red flag" to the Board. Furthermore, the Wells Fargo Board was, at best, remarkably incurious about the high volume of staff turnover at the Community Bank, along with the nature and volume of firings for sales practice violations and the reasons for these firings. Ultimately, the Board failed to attach

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85. *Id.* at 14.

86. *Id.* at 53–54.

87. *Id.* at 16–17.

88. *See* Eleanor Bloxham, *Here's How Wells Fargo's Board of Directors Just Failed Customers*, FORTUNE (Apr. 14, 2017), http://fortune.com/2017/04/14/wells-fargo-fake-accounts-2/ [https://perma.cc/K9DP-QQK8].

89. INVESTIGATION REPORT, *supra* note 73, at 4.

90. *See generally* OFFICE OF ENTER. GOVERNANCE AND THE OMBUDSMAN, ENTERPRISE GOVERNANCE SUPERVISION: LESSONS LEARNED REVIEW OF SUPERVISION OF SALES PRACTICES AT WELLS FARGO (2017), https://www.occ.gov/publications-and-resources/publications/banker-education/files/pub-wells-fargo-supervision-lessons-learned.pdf [https://perma.cc/D6KS-FEKK] (reviewing the supervision of Wells Fargo sales practices).

91. *Id.* at 5.

adequate importance to ensuring that the culture of Wells Fargo lived up to the espoused values of the firm.

B. Board "Blind Spots": U.K. Payment Protection Insurance (PPI)

The U.K. PPI issue provides a useful example of a board blind spot of focusing on the commercial benefits of the high profitability of a product, while ignoring the potential conduct risks inherent in such high profitability.

PPI policies are intended to assist borrowers in loan repayment where they are otherwise unable to do so because of a specified event (e.g., loss of job or illness). In the U.K., they were typically offered by banks and other credit providers when providing credit to consumers (e.g., for a mortgage or unsecured loan).

PPI was a very lucrative business for the banks in the U.K.. For example, Barclays Bank PPI comprised between 32% and 42% of its U.K. retail and business bank pre-tax profit between 2001 and 2005, when almost 70% of borrowers taking some loan products also bought a policy. Additionally, between 2002 and 2012, Barclays' total revenues from PPI, net of claims, and provisions for alleged mis-selling amounted to an estimated £940 million.[92]

A 2005 Citizens Advice report described the PPI business in the U.K. (with its estimated 20 million policies in force and annual gross premiums in excess of £5 billion) as a "protection racket."[93] Indeed, concerns about mis-selling of PPI had been in the public domain in the U.K. since at least 1998.[94] The mis-selling involved various practices such as selling PPI to customers who were not eligible to claim on the policy; high-pressure sales tactics, giving people the impression that they had to take out PPI in order to get a loan; and various exclusions which significantly limited the scope of the potential benefits sales to people with no incomes to protect. In 2009, the U.K. Financial Services Authority estimated that PPI mis-selling may have affected around three million people in the U.K. since the 1990s.[95]

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92. SALZ REVIEW, *supra* note 45, at 56–57.

93. PETER TUTTON & FRANCESCA HOPWOOD ROAD, PROTECTION RACKET: CAB EVIDENCE ON THE COST AND EFFECTIVENESS OF PAYMENT PROTECTION INSURANCE 1 (2005), https://www.citizensadvice.org.uk/Global/Migrated_Documents/corporate/protection-racket-final.pdf [https://perma.cc/Y674-DT3M]; *see also* Graeme Wearden, *How the PPI Scandal Unfolded*, GUARDIAN (May 5, 2011), https://www.theguardian.com/business/2011/may/05/how-ppi-scandal-unfolded [https://perma.cc/78QP-PGAX].

94. Richard Evans, *Timeline: How the PPI Scandal Unfolded*, TELEGRAPH (Aug. 4, 2011), https://www.telegraph.co.uk/finance/personalfinance/insurance/incomeprotection/8681344/Timeline-how-the-PPI-scandal-unfolded.html [https://perma.cc/KYG8-9NGD].

95. SALZ REVIEW, *supra* note 45, at 56.

The PPI market was investigated by the U.K. Competition Commission.[96] Its 2009 inquiry report noted that there was considerable customer confusion about the features and benefits of PPI[97]—there was evidence of consumers being under the impression that their credit application was more likely to be successful if they also bought PPI.[98] Additionally, PPI customers were more likely to earn below the national average wage or come from more disadvantaged socio-economic sections of society.[99] The Competition Commission's 2011 market investigation order imposed various restrictions on future selling of PPI.[100] As of September 2019, financial services firms in the U.K. have refunded over £36.4 billion to customers affected by the PPI mis-selling in the U.K..[101]

As to the role of the boards of firms involved in the PPI scandal, it appears from the Competition Commission investigation report that PPI was discussed at the board level, but the focus of the discussion was on its profitability. The Salz Review found that the Barclay Bank Group Executive Committee reviewed PPI in 2005; it found that PPI was "highly profitable" and was aware that "there were potential concerns relating to the fairness of single premium policies, policies sold where customers could not make claims and sales practices that were 'not customer friendly' or 'high pressure.'"[102] The Salz Review criticized Barclays Bank, stating that "the high profitability of PPI should have raised questions as to whether this was consistent with Barclays' obligations to customers," it was "slow to address control failures" and "[t]he culture of the bank had developed into one which at times valued meeting financial targets more than meeting customer needs."[103] These are all issues that could and should have been addressed at an early stage at the board level. It is likely that the conclusions of the Salz Review regarding PPI mis-selling could equally apply to the other U.K. banks and other financial institutions that mis-sold PPI in the U.K..

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96. *See* COMPETITION COMM'N, MARKET INVESTIGATION INTO PAYMENT PROTECTION INSURANCE (2009), https://webarchive.nationalarchives.gov.uk/20140402202346/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2009/fulltext/542.pdf [https://perma.cc/YC9T-2GBV].

97. *Id.* at 107.

98. *Id.* at 34–35.

99. *Id.* at 3.

100. *See generally* COMPETITION COMM'N, PAYMENT PROTECTION INSURANCE MARKET INVESTIGATION ORDER 2011, at 1 (2011), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/330608/ppi_order.pdf [https://perma.cc/DGQ3-4M6G].

101. *Monthly PPI Refunds and Compensation*, FIN. CONDUCT AUTH. (Nov. 20, 2018), https://www.fca.org.uk/data/monthly-ppi-refunds-and-compensation [https://perma.cc/H7M6-GXV6].

102. SALZ REVIEW, *supra* note 45, at 57.

103. *Id.* at 58.

C. Board "Blind Spots": Danske Bank

The recent Danske Bank scandal is an example of a board blind spot: uncritical acceptance of indications from a second line of defense function (compliance, in this case) that outstanding potential conduct risk concerns relating to anti-money laundering were being ineffectively addressed within the bank.

Danske Bank, the largest financial institution in Denmark, established a presence in Estonia when it acquired Sampo Bank together with its Estonian branch in 2007.[104]

The Estonian branch had a specific "Non-Resident Portfolio" of non-resident clients from 2007 to 2015 (when the non-resident accounts were closed). There had been around 10,000 non-resident customers in this Portfolio,[105] many from Russia, Azerbaijan, and Ukraine.[106] During the period 2007–2015, there was a flow of funds amounting to approximately €200 billion from external parties to these non-resident bank accounts and on to external third parties.[107]

Concerns about the possible use of these non-resident accounts for money laundering emerged from 2007. This scandal was reported on by a Danish law firm for the Danske Bank Board in September 2018, sometime after the issue became the subject of significant public comment, stating that[108]

> In 2007, shortly after completing the acquisition of Sampo Bank, Danske Bank had a real opportunity to conclude that the Non-Resident Portfolio involved suspicious activity not caught by AML procedures at Sampo Pank in Estonia. In 2007, the Estonian FSA came out with a critical inspection report, and at the same time Danske Bank at Group level received specific information from the Russian Central Bank, through the Danish FSA. This information pointed to possible 'tax and custom payments evasion' and 'criminal activity in its pure form, including money laundering', estimated at

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104. BRUUN & HJEJLE, REPORT ON THE NON-RESIDENT PORTFOLIO AT DANSKE BANK'S ESTONIAN BRANCH 3 (2018), https://danskebank.com/-/media/danske-bank-com/file-cloud/2018/9/report-on-the-non-resident-portfolio-at-danske-banks-estonian-branch.pdf?rev=56b16dfddae94480bb8cdcaebeaddc9b&hash=B7D825F2639326A3BBBC7D524C5E341E [https://perma.cc/NN2D-ZLV2].

105. *Id.* at 5.

106. *Id.* at 3, 5.

107. *Id.* at 6.

108. *See generally* Pamela Barbaglia & Teis Jensen, *Danske Bank Money Laundering 'Giga Scandal' Spreads to Britain*, INDEPENDENT.IE (Sept. 21, 2018), https://www.independent.ie/business/world/danske-bank-money-laundering-giga-scandal-spreads-to-britain-37340762.html [https://perma.cc/J4T6-6MBR] (EU Commissioner Vestager referred to it as a "giga scandal").

> 'billions of rubles monthly'. However, Danske Bank missed this first real opportunity.[109]

In 2007, the above letter from the Russian Central Bank was on the agenda of a Danske Bank Board meeting and information was given to the effect that the matter would be investigated internally.[110] Additionally, a 2007 anti-money laundering inspection by the Estonian regulator found that the Estonian branch of Danske Bank did not fully comply with relevant legal requirements.[111]

A further red flag that should have been considered by the Board of Danske Bank at the time was that, whereas the Estonian branch's share of total assets of the Danske Bank group was minuscule, at 0.5%, at its height in 2011, it represented only 10.7% of the group's entire profits before tax.[112]

The issue became a matter of public concern following the publication of news reports in March 2017 of a "Russian Laundromat" money laundering operation in which the Danske Bank entity featured prominently.[113] News stories about an "Azerbaijani Laundromat" emerged subsequently in 2017.[114]

The report to the Danske Bank Board concluded that neither the Danske Bank group CEO nor Board had breached their respective legal obligations.

> [I]t is clear that problems were reported to the Board of Directors and the Audit Committee, and it is equally clear that such reporting was accompanied by assurances that problems were being dealt with and mitigation was ongoing. This information came from within the bank where the severity of the situation and the risks facing the bank had not been comprehended, and this affected the reporting. In hindsight, the question may be raised whether the Board of Directors or the Audit Committee could reasonably have done more. This, however, would not, in our view, form sufficient basis for legal criticism when taking into account the information available combined with the nature and extent of the responsibilities of the Board of Directors.[115]

As with the above-mentioned report, commissioned by the Board of Wells Fargo,[116] the conclusions of this report, which was commissioned by the Board of Danske Bank, seem somewhat narrowly focused and

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109. BRUUN & HJEJLE, *supra* note 104, at 8.
110. *See id.* at 80.
111. *Id.* at 40.
112. *Id.* at 26.
113. *Id.* at 73–74.
114. *Id.* at 76.
115. *Id.* at 81.
116. INVESTIGATION REPORT, *supra* note 73.

generous to the Board and CEO in light of the above information that was available to it.

In any event, shortly after the publication of this report, the then CEO resigned and the chairman was removed at the behest of the bank's largest shareholder in order to "strengthen the bank's ability to address its culture, compliance program and engagement with regulators."[117] Various national investigations into the issues are on-going.[118]

IV. ENHANCING BOARD EFFECTIVENESS IN ITS ROLE OF OVERSEEING A FIRM'S CULTURE—ISSUES TO BE ADDRESSED

Quite apart from board failures in addressing key structural issues that give rise to conduct risk issues, such as lack of diversity and distorted financial incentives—having the effect of incentivizing staff not to take adequate account of customer interests—the recent reports and high-profile cases outlined in the previous section have highlighted significant further failings of boards, particularly those discussed below.

A. Lack of Adequate Data

Boards have often failed to attach sufficient importance to ensuring that they receive sufficiently useful and adequate data that would give them insight into whether there is a material divergence between the firm's espoused values and how it actually behaves in practice. Such data would provide potentially important early-warning signals to the board of possible issues around, for example, excessive risk-taking and unethical conduct, illegal conduct, or both. This was one of the areas where the recent Australian Royal Commission report was particularly critical of financial institutions, noting that "too often, boards did not get the right information about emerging non-financial risks; did not do enough to seek further or better information where what they had was clearly deficient; and did not do enough with the information they had to oversee and challenge management's approach to these risks."[119] The Royal Commission report emphasized that boards must have the right information in order to discharge their functions:

> When I refer to boards having the *right* information, I am not referring to boards having *more* information. As I noted earlier, it is

117. *Maersk Family Ousts Danske Bank Chairman After Scandal*, IRISH TIMES (Nov. 6, 2018), https://www.irishtimes.com/business/financial-services/maersk-family-ousts-danske-bank-chairman-after-scandal-1.3688352 [https://perma.cc/4QBW-GMQZ].

118. *See Danske Bank Faces US Investigation into Money Laundering*, GUARDIAN TIMES (Oct. 4, 2018), https://www.theguardian.com/world/2018/oct/04/danske-bank-faces-us-investigation-into-money-laundering [https://perma.cc/WLE3-GDFR].

119. ROYAL COMMISSION FINAL REPORT, *supra* note 58, at 395.

> the quality, not the quantity, of information that must increase. Often, improving the *quality* of information given to boards will require giving directors *less* material and more information.
>
> I do not pretend to be able to offer any single answer to how boards can ensure that they receive the right information. But boards and management must keep considering how to present information about the right issues, in the right way.[120]

Similarly, in a recent U.S. report on corporate governance it was noted that "if the board relies solely on management reports, the risk is that information may be incomplete, filtered, or edited, even in good-faith ways. The general name for this problem is 'asymmetric information,' and this imbalance can weaken the board's ability to oversee the corporation properly."[121] In this regard, whilst a board might take some comfort from knowing that adequate processes and procedures are in place to enable and facilitate speaking up within the firm, this is of relatively little use in practice if staff within the firm do not actually feel comfortable speaking up about sensitive matters and the board remains ill-informed about potential issues.

Additionally, when assessing customer-related data, boards can often focus on data that will not give them a sufficient insight into customer outcomes. For example, often boards rely on data relating to complaints made by customers, although many poor customer outcomes may not give rise to customer complaints until long after the customer harm has arisen, if at all. Also, a customer-related metric commonly used by boards is the Net Promoter Score. As noted in a recent report by the New Zealand financial services regulator:

> Many banks used a survey tool known as "Net Promoter Score", which gauges customer loyalty. These surveys are typically done immediately after the customer interacts with the bank. However, the harm caused by poor product design or inappropriate sales or advice may not manifest for years. We do not consider Net Promoter Score or other similar surveys sufficient to measure customer outcomes.[122]

It must be recognized, however, that this is a complex issue. As noted in a recent G30 report, "[b]anks are searching for metrics to assist in monitoring and understanding cultural progress over time, and while a

120. *Id.* at 400.

121. STUDY GRP. ON CORP. BDS., BRIDGING BOARD GAPS 24 (2011), https://www0.gsb.columbia.edu/faculty/ghubbard/StudyGroup_3%2025.pdf [https://perma.cc/M5BK-4C4Z].

122. FIN. MKTS. AUTH. & RESERVE BANK OF N.Z., BANK CONDUCT AND CULTURE: FINDINGS FROM AN FMA AND RBNZ REVIEW OF CONDUCT AND CULTURE IN NEW ZEALAND RETAIL BANKS 15 (2018), https://fma.govt.nz/assets/Reports/_versions/11883/Bank-Conduct-and-Culture-Review.1.pdf [https://perma.cc/2WRG-G9PE].

broad range of metrics has been adopted, most banks are still experimenting and have neither found a definitive set of indicators nor concluded what those metrics should be."[123]

B. Ineffective Challenge of Management

Boards have failed to challenge executive management adequately and effectively. It may be difficult for boards to effectively perform this essential task of supervision of executive management in circumstances where the executive management has not provided the board with adequate data to enable them to do so. This can arise where, for example, the executive management has a conscious or unconscious bias against providing data to the board that may raise an issue with the performance of the executive management. This is a matter for the board to resolve, given its overall responsibility for corporate governance.

Lack of effective challenge can also arise where there are issues of groupthink at board level, where the board chooses—again, consciously or unconsciously—not to dig too deeply and challenge generally accepted approaches within the firm.

A group, such as a board, is particularly vulnerable to groupthink when its members are similar in background, the group is insulated from outside opinions, and there are no clear rules for decision-making.[124] Additionally,

> One of the root causes of Groupthink is cultural cohesiveness. In a cohesive group, members avoid speaking out against decisions, avoid arguing with others and work towards maintaining friendly relationships in the group. If cohesiveness gets to such a high level that there are no longer disagreements between members, then the group is ripe for Groupthink.[125]

In light of this potential problem of groupthink, regulators internationally have increasingly focused attention on ensuring increased diversity at the board level, including gender diversity, given that "a lack of diversity at senior management and board level is a leading indicator of heightened behaviour and culture risks."[126]

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123. GRP. OF THIRTY, *supra* note 42, at 33.

124. Yousef A. Valine, *Why Cultures Fail: The Power and Risk of Groupthink*, 11 J. RISK MGMT. FIN. INST. 301, 302 (2018).

125. *Id.*

126. Ed Sibley, Deputy Governor, Cent. Bank of Ir., Speech at the Central Bank/Trinity College Dublin School of Law Conference: Culture, Diversity and the Way Forward for Corporate Governance in Ireland (Oct. 25, 2018), https://www.centralbank.ie/news/article/culture-diversity-and-the-way-forward---deputy-governor-ed-sibley [https://perma.cc/WB7G-HA8E].

C. Over-Focus on Short-Term Profitability

Boards have focused on short-term profitability to the detriment of longer-term sustainability or to an adequate consideration of stakeholders other than shareholders. This shareholder value "mindset" has resulted in decisions being taken at board level (or issues not being adequately considered at board level) that have eventually proven to be very costly to the financial services firms, as well as to their customers and to wider society.[127]

In the sections below, we consider how boards could improve their effectiveness in relation to each of these three issues, and in particular, in the context of an industry-wide approach that could facilitate the development of (1) improved norms of behavior across the industry (i.e., greater clarity around what "good" performance looks like for boards, as opposed to mere minimum legal requirements); (2) benchmarked assessments that could enable boards to gain a better insight into how they are progressing, in particular by reference to the industry as a whole; and (3) peer pressure to improve performance.

V. The Benefits of Industry-Wide Initiatives to Address These Board Effectiveness Issues

Before considering the above three specific proposals for an industry-wide approach, we should first consider the benefits of addressing these issues on an industry-wide basis.

A. The "Coordination Failure" Problem

In the first place, in our view, certain types of industry initiatives have the potential to improve firms' cultures because they can address the "coordination failure" problem identified by the New York Federal Reserve. A December 2017 New York Federal Reserve White Paper on "Misconduct Risk, Culture and Supervision"[128] identifies a number of market failures to explain why firms do not invest adequately in "cultural capital," the reasoning including coordination failures. The coordination failures reflect the inability of private actors to reach a common objective

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127. Salz, *supra* note 45, at 11 ("Sir David Walker [Barclays Bank Chairman] and Antony Jenkins [Barclays Bank CEO] acknowledge that there were gaps between Barclays' publicly articulated values and its business practices. They accept that Barclays took some decisions which were based on short-term considerations and were not always in the interests of its customers. As Antony Jenkins said in the 2012 Annual Report: 'For the past 30 years, banking has been progressively too aggressive, too focused on the short term, too disconnected from the needs of our customers and clients, and wider society and we lost our way.'").

128. Stephanie Chaly et al., Fed. Reserve Bank of N.Y., Misconduct Risk, Culture, and Supervision 8–9 (2017), https://www.newyorkfed.org/medialibrary/media/governance-and-culture-reform/2017-whitepaper.pdf [https://perma.cc/876T-96KC].

that is in the collective best interest—this is because short-term competitive pressures make it difficult to invest in longer-term cultural capital.

In this regard, the financial services industry as a whole is becoming increasingly aware of the positive impact of a good ethical culture on its business success and the profitability.[129] This may become an increasingly significant factor, in particular, in those areas of the financial services industry that are, as a result of technological innovation and regulatory change, opening up to competitors who are not traditional financial services operators. There is also the potential benefit of lower compliance costs in the longer term as improved culture leads to fewer breaches of regulatory requirements (for example, where an improved culture of speaking up leads to potential regulatory issues being identified and addressed at a much earlier stage than they might otherwise be) and a more constructive relationship with the regulator.

The New York Federal Reserve White Paper recognizes that "the Group of Thirty efforts around standard-setting and convening the industry and the U.K.'s Banking Standards Board should help solve coordination failures and drive industry solutions."[130]

The U.K. Banking Standards Board—and the setting up in Ireland of an equivalent industry-funded body, the Irish Banking Culture Board—provides a particularly interesting forum for industry initiatives to improve banking culture.

In this regard, the U.K. Banking Standards Board states that its role is to "provide challenge, support and scrutiny for firms committed to rebuilding the sector's reputation, and it will provide impartial and objective assessments of the industry's progress."[131] It is partly doing this through annual assessments of member banks (carried out through, *inter alia*, an anonymous survey questionnaire within firms and interviews) and the publication of non-firm specific information about the results of the assessments.[132]

B. Peer Pressure

Peer pressure is a key influencer of behaviors and can be used to complement regulation to improve behaviors (if appropriately harnessed).

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129. *See* CHRISTOPHER HODGES & RUTH STEINHOLTZ, ETHICAL BUSINESS PRACTICE AND REGULATION: A BEHAVIOURAL AND VALUES-BASED APPROACH TO COMPLIANCE AND ENFORCEMENT 104–107 (2017).

130. CHALY ET AL., *supra* note 128, at 15–16.

131. *What is the BSB*?, *supra* note 5.

132. *Assessment Results*, BANKING STANDARDS BOARD (2018), https://www.bankingstandardsboard.org.uk/assessment-results-2018/ [https://perma.cc/SLF6-QLCT].

As noted by the DNB, "In essence, peer pressure regulates behaviour."[133] Additionally, the 2013 U.K. Parliamentary Commission on Banking Standards report, which recommended the creation of an industry standards body in the U.K., stated that

> [It] believe[s] that the influence of a professional body for banking could assist the development of the culture within the industry by introducing non-financial incentives, which nonetheless have financial implications, such as peer pressure and the potential to shame and discipline miscreants. Such a body could, by its very existence, be a major force for cultural change.[134]

A peer-based approach can serve to identify best practice internationally—in relation to matters such as constructive challenge at board meetings, to address groupthink concerns—and facilitate the "normalization" of such practices and their "internalization," so that executives and board members more readily accept these norms as the appropriate way to behave rather than merely a form of regulatory requirement or expectation to be tolerated, at best.

As to whether there are sufficient incentives for the industry to engage meaningfully in such peer-based initiatives, at least in Ireland, there is significant political pressure on banks to improve their culture,[135] particularly in light of the recent tracker mortgage scandal, and this political pressure gave rise to the creation of the Irish Banking Culture Board.[136]

C. Focusing of Resources

Industry initiatives in this area enable firms to combine and focus resources on complex multi-disciplinary issues relating to behaviours that firms may have practical difficulties in addressing on their own (or may be unprepared to invest internally or provide the resources to invest in external experts to address these issues).[137]

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133. SUPERVISION OF BEHAVIOR AND CULTURE, *supra* note 3, at 50.

134. HOUSE OF LORDS & HOUSE OF COMMONS, *supra* note 47, at 44.

135. *See, e.g.*, Press Release, Paschal Donohoe T.D., Minister for Fin. & Pub. Expenditure & Reform, Statement on the Tracker Mortgage Examination (Oct. 25, 2017), http://paschaldonohoe.ie/?p=47378 [https://perma.cc/2QZ6-U8KM].

136. *See, e.g.*, Press Release, Paschal Donohoe T.D., Minister for Fin. & Pub. Expenditure & Reform, Minister Donohoe Welcomes Banking Initiative That Aims to Rebuild Trust in the Industry (Dec. 31, 2017), http://paschaldonohoe.ie/minister-donohoe-welcomes-banking-initiative-that-aims-to-rebuild-trust-in-the-industry/ [https://perma.cc/VW2H-A328]. *See generally* Aengus Cox, *Explainer: The Tracker Mortgage Scandal*, RAIDIÓ TEILIFÍS ÉIREANN (Oct. 27, 2017), https://www.rte.ie/news/business/2017/1025/915149-explainer-the-tracker-mortgage-scandal/ [https://perma.cc/E5EY-DGZ8] (discussing the tracker mortgage scandal in Ireland).

137. BANKING STANDARDS BD., ANNUAL REVIEW 2018/2019, at 7 (2019), https://www.bankingstandardsboard.org.uk/pdf/banking-standards-annual-review-2018-2019.pdf [https://perma.

D. The Benefits/Drawbacks of Relying on Regulators to Achieve Culture Change

It must be recognized that in terms of addressing complex behavioural issues within firms, only so much can be achieved by the imposition of increasingly onerous regulatory requirements, greater regulatory scrutiny, and increased sanctions on firms and individuals. For example, a 2016 U.K. Financial Conduct Authority paper found that

> The evidence that we have suggests that there are limitations on the extent to which greater compliance can be achieved by increasing fines and the probability of detection. For example, there is a tendency of certain firms to carry on breaking rules in spite of continuing to accrue large fines.[138]

More generally, relying wholly on increased regulation and enforcement can be counterproductive in terms of improving behaviours. As argued by Hodges and Steinholtz in their recent book *Ethical Business Practice and Regulation*,

> An increase in monitoring, reporting and compliance in general can inadvertently *increase* unethical behaviour, as people feel they are not trusted. Companies can spend large amounts of energy on compliance and have little left over for ethics. Focusing on rules crowds out objective thought on whether behaviour is ethical. Focusing on compliance can engender cynicism and disengagement, as the implicit message is 'we are only doing this because it is the law' and 'we don't trust you'. Disengagement clearly feeds unethical behaviour directly and indirectly as disengaged employees are less likely to speak up and report issues.[139]

The DNB supervisory approach has the potential to significantly improve the level of self-reflection at the board level of behavioral issues, including in relation to constructive challenge and addressing risks of groupthink, to lead to improvements in the industry. The DNB has a highly experienced team of experts in organizational behavior, which assesses firms' organizational behaviors—including by way of attending board meetings—and makes suggestions, if appropriate, to firms for improvement.[140]

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cc/7ZK2-LFNC] ("We are committed to identifying, supporting and sharing best practice across a wide range of issues, and to helping firms develop practical interventions and assess the effectiveness of these interventions. To carry through this wider work, we are very much supported not only by many member firms but by other organisations in other sectors and wider civil society.").

138. ZANNA ISCENKO ET AL., BEHAVIOUR AND COMPLIANCE IN ORGANISATIONS 15 (2016), https://www.fca.org.uk/publication/occasional-papers/op16-24.pdf [https://perma.cc/5XU9-SXNG].

139. HODGES & STEINHOLTZ, *supra* note 129, at xxv.

140. *See* SUPERVISION OF BEHAVIOR AND CULTURE, *supra* note 3, at 82–83.

The DNB approach is highly significant and influential, in terms of providing the expertise and constructive challenge to firms regarding the behaviors that is expected of firms, including board members.[141] Nevertheless, the DNB has some potential limitations in terms of achieving the desired outcome of improved behaviour and culture:

- It is a "top-down" regulatory approach that has the potential to give rise to moral licensing (all behaviors that are not specifically criticized by the regulator may be considered by the firm to be perfectly acceptable). Some firms and board members might also take a minimalist regulatory compliance-based approach and not look beyond what they may deem to be regulatory "impositions" in terms of standards of behavior to be adopted by them. In other words, the DNB methodology might possibly "have the unintended effect of crowding out firms' intrinsic motivations to think seriously about cultural risks."[142]
- The approach depends, to an important extent, on sufficient mutual trust between the regulator and the senior individuals in the firm so that open conversations can be had between them to enable a fuller mutual understanding of behaviors and culture, on the basis of which constructive engagement on potential changes can be held. If senior individuals in the firm are concerned, however, the information or views that they provide to their regulator may subsequently be used by the regulator against them or colleagues (for example, in the context of a fitness and probity review of an individual) or in a formal sanctions proceeding against the firm, it may be very difficult to establish the necessary level of mutual trust to achieve sufficiently meaningful reforms.[143]

E. Industry Initiative Risks?

There is, of course, the risk that industry initiatives may be more inclined to serve the interests of industry firms rather than consumers. As Adam Smith famously stated, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."[144] Such a risk is significantly mitigated, in the case of the Irish Banking

141. *See, e.g.*, John Conley et al., *Can Soft Regulation Prevent Financial Crises? The Dutch Central Bank's Supervision of Behaviour and Culture*, 51 CORNELL INT'L L.J. 773 (2019).

142. HODGES & STEINHOLTZ, *supra* note 129, at 54.

143. *See, e.g.*, *id.* at 54–55.

144. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 145 (R.H. Campbell et al. eds., Liberty Classics 1981) (1776).

Culture Board, by virtue of the fact that the board of this organization is chaired by a former Court of Appeal judge, and a majority of the board is composed of individuals who are not from the banking industry (they include representatives of consumer groups).[145]

VI. SUGGESTIONS FOR INDUSTRY-WIDE APPROACHES TO IMPROVE BOARD EFFECTIVENESS

A. Enhancing the Quality of Data Available to the Board to Enable It to More Effectively Assess the Alignment of the Firm's Behaviors with Its Espoused Values

As noted above, it is important for a board not to have as its sole source of information the information provided to it by its senior management team. In this regard, as stated in a U.S. report on corporate governance, boards should "[e]ncourage direct dialogue with the entire organization by having routine contact with employees beyond the senior management team."[146] A useful development in this direction is the U.K. Banking Standards Board's (BSB) comprehensive benchmarked annual assessment process for all of its member banks and building societies. This provides detailed and benchmarked feedback to boards from their staff. The high-level results of the first annual assessment were published by the BSB in 2016.[147] Its third annual assessment was published in April 2019.[148]

The assessment involves an employee survey of over 72,000 employees regarding firm-specific focus groups with employees, written submissions from boards, and interviews with non-executive directors and executives.[149] The survey results are provided through an online dashboard that allows the firm to cut and analyze the data in multiple ways, subject always to constraints imposed to protect respondents' anonymity.[150] Such

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145. For information on the current membership of the board of the Irish Banking Culture Board, see *Meet the Board*, IRISH BANKING CULTURE BOARD, https://www.irishbankingculture board.ie/meet-the-board/ [https://perma.cc/N2ZW-Y25R].

146. STUDY GRP. ON CORP. BOARDS, *supra* note 121, at 13.

147. *See* BANKING STANDARDS BD., ANNUAL REVIEW 2016/2017, at 28 (2017), https://www. bankingstandardsboard.org.uk/pdf/banking-standards-annual-review-2016-2017.pdf [https://perma. cc/C67Y-AFEP].

148. *See* BANKING STANDARDS BD., *supra* note 137.

149. *Id.* at 6.

150. *See* Alison Cottrell, *The UK Banking Standards Board: An Outcome-Based Approach to Assessing Organisational Culture*, 11 J. RISK MGMT. FIN. INSTS. 47, 52 (2018); *see also* BANKING STANDARDS BD., BSB WRITTEN EVIDENCE FOR THE AUSTRALIAN ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY 4 (2018), https://www.bankingstandardsboard.org.uk/wp-content/uploads/2018/10/BSB-submission-to-Aus tralian-Royal-Commission-into-Misconduct.pdf [https://perma.cc/MG76-LZ9V].

an industry-wide assessment approach is particularly useful for the reasons outlined below.

First, it provides a common language to describe relevant cultural factors and metrics for assessing those factors across the industry. This makes it easier for boards and other stakeholders to engage in an effective discussion of culture within their firm, on the basis of a uniform or common language and a set of metrics derived from industry best practice.

The U.K. Banking Standards Board is clear that it does not seek to assess firms against a template of what a "good" culture looks like. Rather, it assesses firms against nine identified characteristics: honesty, respect, openness, accountability, competence, reliability, responsiveness, personal and organisational resilience, and shared purpose. According to the Banking Standards Board

> We do not . . . set out to measure or rank culture directly. Rather, we ask how far each of our nine characteristics is demonstrated by the firm and relative to other firms. We would expect a firm that strongly exhibited our nine characteristics to be better equipped and more likely to service its customers, members and clients well, than one in which these elements were lacking.[151]

These nine characteristics are very similar, although not identical, to the nine common attributes of a healthy culture, identified in the U.K. Financial Reporting Council's July 2018 non-binding Guidance on Board Effectiveness (which accompanies the 2018 U.K. Corporate Governance Code).[152]

Second, the U.K. Banking Standards Board assessment is in-depth and provides a rich source of data, including firm-specific data, that enables boards of financial services firms to gain an in-depth understanding of the culture of their firm. The assessment methodology was, for example, relied on by the Irish Banking Culture Board in its survey of its five retail bank members; the survey findings, which were published in April 2019, included: (1) only 59% of respondents believed that senior leaders in their organization meant what they said;[153] (2) 49% of respondents stated that they see instances where unethical behavior is

151. BANKING STANDARDS BD., BSB ANNUAL REVIEW 2017/2018, at 81 (2018), https://www.bankingstandardsboard.org.uk/pdf/banking-standards-annual-review-2017-2018.pdf [https://perma.cc/T9SZ-QGES].

152. FIN. REPORTING COUNCIL, GUIDANCE ON BOARD EFFECTIVENESS 6 (2018) (identifying the following nine characteristics: honesty, openness, respect, adaptability, recognition, acceptance of challenge, accountability, and shared purpose).

153. IRISH BANKING CULTURE BD., EMPLOYEE SURVEY 2018, at 9 (2019), https://212528-644444-raikfcquaxqncofqfm.stackpathdns.com/wp-content/uploads/2019/04/Irish-Banking-Employee-Survey-2018-summary-report.pdf [https://perma.cc/8J89-BUJ6].

rewarded;[154] and (3) 47% of respondents believed that if they raised concerns about the way they work, they would be worried about the negative consequences for them.[155] The Banking Standards Board provides firm-specific data to the board of each participating firm and discusses it with the firm (but publishes only high-level aggregated data).[156] The Board is clear that participation in the assessment "demands a readiness on the part of board members and the executives to be self-critical and to ask questions of themselves and their employees that may elicit unexpected and unwelcome answers."[157]

Third, firms receive benchmarked data, so that they can assess their performance in the context of the norms of the wider industry. The relevant comparison data "include a range and quartile against the equivalent category across all relevant firms."[158]

Fourth, the published results may create a form of peer pressure for boards to address any identified issues of concern.

And fifth, the results also enable the Banking Standards Board to carry out further work on industry standards of good practice, where issues of concern have been identified.

B. Better Understanding the Customer Perspective

In order for a board to properly assess whether its firm's behaviors are aligned with its espoused values, it will also need a data set related to the perspective of its customers. This is particularly important given the opportunities for financial services firms to take advantage of customers, especially retail customers.

In the first place, such opportunities for taking advantage of customers can arise as a result of market power.[159] This market power can derive particularly in retail markets from, for example, customer inertia and their lack of financial literacy. As stated in a recent U.K. Competition and Markets Authority (CMA) retail banking market investigation report

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154. *Id.* at 35.

155. *Id.* at 20 (responding to the survey question, "[i]f I raised concerns about the way we work, I would be worried about the negative consequences for me," 22% of respondents responded with "strongly agreed" and 25% with "somewhat agree").

156. *See, e.g.*, BANKING STANDARDS BD., *supra* note 137, at 19.

157. *Id.* at 64.

158. *Id.* at 66.

159. OFFICE OF FAIR TRADING, ASSESSMENT OF MARKET POWER: UNDERSTANDING COMPETITION LAW 9 (2004), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284400/oft415.pdf [https://perma.cc/XN3G-WEXD] ("Market power can be thought of as the ability profitably to sustain prices above competitive levels or restrict output or quality below competitive levels. An undertaking with market power might also have the ability and incentive to harm the process of competition in other ways; for example, by weakening existing competition, raising entry barriers or slowing innovation.").

> The behaviour of customers can play a central role in providing competitive constraints on providers. This happens if customers are engaged and willing to search for and implicitly threaten to switch to another provider, which offers them a better deal. Conversely, a lack of customer engagement in the market reduces banks' incentives to compete.[160]

Customer inertia and limited financial literacy appear to be particular issues of concern in retail financial services markets. With regard to customer inertia, a November 2017 bulletin from the CBI noted that the number of bank current accounts held by personal consumers in Ireland in the first half of 2017 was just over 5.28 million and that, during this period, the number of switches of current accounts from one credit institution to another was 2,715—a switching rate of 0.05%.[161] This rate of switching is considerably lower than the 3% annual rate[162] noted by the U.K. Competition and Markets Authority for personal consumer accounts in its study of the U.K. market—which the CMA considered to be "very low" and a factor resulting in the imposition of regulatory remedies on retail banks in the U.K. to address competition concerns.[163]

As for retail customer financial literacy, as noted by Governor of the Central Bank of Ireland, Philip Lane, in a February 2017 speech, "A vast empirical literature shows that consumers tend to make poor financial choices, taking on too much debt, misunderstanding investment risk and choosing financial products that do not match their needs."[164]

Even in competitive markets, customers risk being taken advantage of. In the 2015 book by Nobel Laureates George Akerlof and Robert Shiller, *Phishing for Phools: The Economics of Manipulation and*

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160. COMPETITION & MARKETS AUTHORITY, RETAIL BANKING MARKET INVESTIGATION: FINAL REPORT, at xvi (2016), https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf [https://perma.cc/X9A7-9FNJ].

161. CENT. BANK OF IRELAND, CONSUMER PROTECTION BULLETIN: CURRENT ACCOUNTS AND SWITCHING 2 (2017), http://www.centralbank.ie/docs/default-source/Regulation/consumer-protection/compliance-monitoring/reviews-and-research/consumer-protection-bulletin—-current-accounts-and-switching—-november-2017.pdf [https://perma.cc/LP9K-MPDR]; *see* Press Release, Paschal Donohoe T.D., Minister for Fin. & Pub. Expenditure & Reform, Minister Donohoe Launches Phase Two of Switch Your Bank Campaign (Jan. 22, 2018), http://paschaldonohoe.ie/minister-donohoe-launches-phase-two-of-switch-your-bank-campaign [https://perma.cc/8WEU-7R2R] ("The Department of Finance is running this campaign as part of a range of competition measures agreed with the European Commission to raise awareness and promote customer switching in the retail financial product area. This was agreed in the context of the restructuring plans for AIB and PTSB. The campaign is being funded entirely by the two banks.").

162. COMPETITION & MARKETS AUTHORITY, *supra* note 160, at 155.

163. *Id.* at 423.

164. Press Release, Philip R. Lane, Governor, Cent. Bank of Ir., The Role of Financial Regulation in Protecting Consumers (Feb. 23, 2017), https://www.centralbank.ie/news/article/financial-regulation-protecting-consumers-governor-lane [https://perma.cc/J5AC-MM4F].

Deception, the authors argue that, even in competitive markets, sellers systematically exploit our psychological weaknesses and our ignorance through manipulation and deception.[165]

A recent example of such "phishing" arose in the March 2019 fine imposed by the U.K. Financial Conduct Authority on The Carphone Warehouse for misleading customers in the sale of mobile phone insurance products over a seven-year period.[166] The firm was fined over £29 million for this conduct.[167]

In light of these issues, the ongoing work of the U.K. Banking Standards Board to develop a Consumer Framework is interesting and potentially useful. In November 2017, the Banking Standards Board published a consultation document entitled *What Do Good Banking Outcomes Look Like to Consumers*?[168] This document sets out outcomes-focused criteria for assessing what good consumer outcomes look like. The criteria they have identified were access, choice, clarity, and transparency, safety and security, redress and being listened to, value for money, and fairness.[169]

The development of these industry-agreed criteria for assessing customer outcomes will likely be helpful in providing an industry-agreed language for assessing the consumer perspective (i.e., going beyond a minimalist approach of focusing on issues such as volume of complaints received). More generally, in our view, there may be a benefit in an industry approach or benchmarking to develop best practice in the area of dealing with customer complaints and to ensure that there is sufficiently useful board-level engagement on this issue. This would enable boards to assess effectively whether the behaviors of the firm are in line with espoused values (and to mitigate against the risk of board "blind spots" in relation to this):

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165. *See generally* GEORGE A. AKERLOF & ROBERT J. SHILLER, PHISHING FOR PHOOLS: THE ECONOMICS OF MANIPULATION AND DECEPTION (2015).

166. Press Release, Fin. Conduct Auth., FCA Fines the Carphone Warehouse Over €29m for Insurance Mis-Selling (Mar. 13, 2019), https://www.fca.org.uk/fca-fines-the-carphone-warehouse-over-29-million-for-insurance-misselling [https://perma.cc/8GNU-G9DY] (finding that during the seven-year period, policies worth almost €450 million were sold, although the Financial Conduct Authority found that in many cases the product had little or no value to customers or was unsuitable for them).

167. *Id.*

168. BANKING STANDARDS BD., WHAT DO GOOD BANKING OUTCOMES LOOK LIKE TO CONSUMERS? (2017) [hereinafter BSB, CONSULTATION], https://www.bankingstandardsboard.org.uk/wp-content/uploads/2017/11/What-do-good-banking-outcomes-look-like-to-consumers.pdf [https://perma.cc/KWY9-LQDV]; BANKING STANDARDS BD., SUMMARY OF RESPONSES TO THE BSB CONSULTATION ON WHAT GOOD BANKING OUTCOMES LOOK LIKE TO CONSUMERS (2018), https://www.bankingstandardsboard.org.uk/wp-content/uploads/2018/09/Summary-of-responses-to-Consumer-Consultation.pdf [https://perma.cc/TV33-TCKU]

169. BSB, CONSULTATION, *supra* note 168, at 4.

- Customer complaints provide a potentially significant countervailing influence on firms that will assist boards to identify and possibly address issues in which the firm takes unfair advantage of its customers (whether intentionally or otherwise). As stated by Dr. Ken Henry, Chairman of National Australian Bank (and former Australian Treasury Secretary) in evidence to the Australian Royal Commission into misconduct in the Australian financial services industry: "So how do you measure customer outcomes?---Mainly—mainly through complaints from customers, to be honest."[170]
- Financial services firms are subject to regulatory requirements in relation to complaints management.[171] The requirements, however, broadly tend to be procedural in nature.[172] There would be a benefit in industry considering this issue not simply from a regulatory or procedural perspective but increasingly from the perspective of the board's role in assessing whether the actual practices of their firm diverges from its stated values.
- Any such articulation of industry best practices and potential benchmarking would serve to address the risk of complacency of firms regarding the adequacy of their complaint management systems by subjecting the systems to constructive peer appraisal; in the words of Onora O'Neill, commenting on the role of the U.K. Banking Standards Board, "it is like someone else holding a mirror at an unfamiliar angle to give a view that in-house exercises may not provide."[173]
- As outlined in the Introduction to this article, there is currently a major problem of lack of public trust in the financial services

170. Transcript of Proceedings at 7117, In the Matter of a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Commonwealth Austl., Nov. 26, 2018), https://financialservices.royalcommission.gov.au/public-hearings/Documents/transcripts-2018/transcript-26-November-2018.pdf [https://perma.cc/PZY9-EY7V].

171. *See generally* CENT. BANK OF IRELAND, CONSUMER PROTECTION CODE 2012, at 66–68 (2015), https://www.centralbank.ie/docs/default-source/regulation/consumer-protection/other-codes-of-conduct/4-gns-4-2-7-cp-code-2012.pdf?sfvrsn=6 [https://perma.cc/5GM7-49UA] (showing the relevant requirements relating to complaints management in Ireland).

172. *See generally* CENT. BANK OF IRELAND, A GUIDE TO CONSUMER PROTECTION RISK ASSESSMENT 17 (2017), https://www.centralbank.ie/docs/default-source/regulation/consumer-protection/170328-cpra-guide-28-march-2017.pdf?sfvrsn=0 [https://perma.cc/VN9N-3WHA] (Under the CBI's Consumer Protection Risk Assessment Model, firms are expected to have effective complaints management systems in place, including systems to address "[r]oot cause analysis of complaints, appeals, issues or other matters escalated in relation to Consumer Protection Risk and evidence that this analysis was used to mitigate future similar risks[.]").

173. Baroness Onora O'Neill, Fed. Reserve Bank of N.Y., Remarks by Baroness Onora O'Neill: What is Banking For? (Oct. 20, 2016), https://www.bankingstandardsboard.org.uk/remarks-by-baroness-onora-oneill/ [https://perma.cc/78UJ-NBW6].

> industry.[174] The trustworthiness of the financial services industry may improve, and trust in this industry may thereby increase, if the industry further improves its standards in relation to the handling of customer complaints.

It may be that customers are more likely to complain to their financial institution if they consider that the chances of their complaint being effectively considered increase—interestingly, the Australian Royal Commission received over 10,000 customer complaints during the course of its deliberations.[175] This has the benefit for firms of providing useful indicators of potential misconduct risk. Indeed, whilst individual customer complaints may appear to be relatively trivial to boards, trend data including qualitative information on the trends can provide useful indicators of potential misconduct risk[176] (and would likely have proven useful to the boards of Wells Fargo and the U.K. banks dealing with PPI, described above, had they paid sufficiently close attention to such information that could and should have been available to them).

B. Effective Constructive Challenge by Boards of Executive Team

Each individual director on a board is individually responsible for engaging in effective constructive challenge of the executive team to ensure that the strategy and cultural values set by the board are being properly implemented by the executive team. Thus, for example, Article 91(8) CRD IV states that "[e]ach member of the management body [board] shall act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making."[177] With regard to the criterion of "independence of mind," the joint European Securities and Markets Authority/European Banking Authority Guidelines provide that, when assessing an individual's "independence of mind," the assessing regulator should consider whether the individual has "the necessary behavioural skills, including: i. courage, conviction and strength to effectively assess and challenge the proposed decisions of other members of the management body; ii. being able to ask

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174. Mark Carney, Governor of the Bank of England, for example, has stated that "the incidence of financial sector misconduct has risen to a level that has the potential to create systemic risks by undermining trust in both financial institutions and markets." Carney, *supra* note 2, at 7.

175. ROYAL COMMISSION FINAL REPORT, *supra* note 58, at xxxv.

176. *See, e.g.*, CENT. BANK OF IRELAND, *supra* note 171, at 68 ("A *regulated entity* must undertake an appropriate analysis of the patterns of *complaints* from *consumers* on a regular basis including investigating whether *complaints* indicate an isolated issue or a more widespread issue for *consumers*. This analysis of *consumer complaints* must be escalated to the *regulated entity*'s compliance/risk function and senior management.").

177. Council Directive 2013/36, art. 91, 2013 O.J. (L 176) 338, 386 (EU).

questions to the members of the management body in its management function; and iii. being able to resist 'group-think.'"[178] Apart from this individual assessment in the context of a fitness and probity application process, boards are also required to carry out regular reviews of their effectiveness.[179]

These review processes, together with ongoing supervision, provide regulators with some insights into the effectiveness of boards and individual members of boards. There is a limit, however, to how useful an insight can be when gained from process-driven regulatory engagements (e.g., reviews of board minutes that can often be relatively short and focused on decisions taken rather than the nature and extent of discussion at the board meeting, are unlikely to give particularly useful insights into the dynamics of board meetings and the effectiveness of board-level challenges of the executive team).

Accordingly, as outlined above, we consider that there is merit in industry initiatives to identify, "normalize," and potentially benchmark best practice in relation to how board members can best engage in constructive challenge whilst maintaining the effectiveness of the board as a whole.

Given that groupthink has been identified as an issue of concern by regulators—according to Andrew Haldane, The Bank of England's Chief Economist, "groupthink was the reason most banks (as well as many regulators, central banks and academics) failed in 2008"[180]—an industry culture and standards body could, using inter-disciplinary approaches, usefully identify international best practice, to address this problem and the issue of effective constructive challenge at the board level.

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178. EUROPEAN SECURITIES AND MKTS. AUTH. & EUROPEAN BANKING AUTH., FINAL REPORT: JOINT ESMA AND EBA GUIDELINES ON THE ASSESSMENT OF THE SUITABILITY OF MEMBERS OF THE MANAGEMENT BODY AND KEY FUNCTION HOLDERS UNDER DIRECTIVE 2013/36/EU AND DIRECTIVE 2014/65/EU, at 38 (2017), https://eba.europa.eu/sites/default/documents/files/documents/10180/1972984/43592777-a543-4a42-8d39-530dd4401832/Joint%20ESMA%20and%20EBA%20Guidelines%20on%20the%20assessment%20of%20suitability%20of%20members%20of%20the%20management%20body%20and%20key%20function%20holders%20(EBA-GL-2017-12).pdf [https://perma.cc/U7YS-M6EW].

179. Council Directive 2013/36, art. 88, 2013 O.J. (L 176) 338, 384 (EU).

180. Andrew G. Haldane, Chief Economist, Bank of Eng., Opening Remarks Given at the Investment Association Launch of the Diversity Project (Nov. 8, 2016), https://www.bankofengland.co.uk/-/media/boe/files/speech/2016/the-diversity-project.pdf?la=en&hash=1148C462A4E677583E61EEB5B957253B49115848 [https://perma.cc/G32S-T966]; *see also* IRISH BANKING CULTURE REPORT, *supra* note 8, at 5, 29 ("[W]e found the banks have much more work to do in terms of ensuring their organisations are sufficiently diverse and inclusive, particularly at senior level, to prevent group-think, guard against over-confidence, and promote internal challenge . . . [g]roup-think has been identified as a contributing factor to the financial crisis. Research suggests that diversity at senior levels can help to reduce the likelihood of group-think, improve decision-making, increase the level of challenge, and improve risk management.").

In this regard, it is interesting to note that the U.K. Banking Standards Board has created a new unit, called "BSB Insights," that will draw on insights from behavioral economics and organizational psychology to identify cultural or behavioral factors that enable, promote, or inhibit high standards in banking, understand their causes, and help to test the effectiveness of interventions.[181]

Any such guidance on best practice could also look at the related core behavioral problem of a lack of speaking up within financial services firms and the approach of the board and board members to addressing this. Whilst boards may well have approved and appropriate processes and procedures in place to enable and facilitate speaking up, this is of limited use if, in practice, there is a culture that does not encourage speaking up. As noted by the U.K. Banking Standards Board,

> Encouraging people to speak out and challenge—something that is central to a good risk culture—requires effort on the part of those leading an organisation to address all of the many factors that will reinforce conformity; to make, in other words, challenge and continuous improvement so acceptable that they become the norm. This requires not just talking about what's expected, but acting it out: demonstrating constructive challenge, for example; inviting and visibly responding to feedback; or sharing personal examples about speaking out, being challenged or making and learning from mistakes.
>
> To have credibility and carry weight, especially on an issue as difficult as speaking up, leaders need not just to tell stories about what is expected; they need to be in the stories that other people are telling. One interesting aspect of the assessment focus group discussions, in this context, is the extent to which participants talking about values or behaviours refer to the example set by their leaders or managers, or whether the latter are notable by their absence.[182]

C. Clarifying the Purpose of the Firm

The role of a corporation in society is becoming a topic of increasing public discussion.[183] A bank's role in wider society and its "social license to operate"[184] is also an issue of concern to financial services regulators globally. As stated in a 2015 speech by a Vice President of the New York Federal Reserve Bank of N.Y.,

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181. BANKING STANDARDS BD., *supra* note 150, at 3–4.

182. Cottrell, *supra* note 150, at 55.

183. *See, e.g.*, Brooks, *supra* note 19.

184. *See, e.g.*, Mark Carney, Governor, Bank of Eng., Remarks at the Harvard Club UK Southwark Cathedral Dinner: Three Truths for Finance (Sept. 23, 2015), https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/three-truths-for-finance.pdf [https://perma.cc/57RB-FT8R].

> Banks receive operating benefits unavailable to other industries because they provide important services to the public. For example, financial intermediation is enhanced through deposit insurance and access to the discount window. Public benefits, though, are not a gift. They are part of a *quid pro quo*. In exchange for receiving valuable operating benefits, a bank's implicit codes of conduct—that is, its culture—must reflect the public dimension of the services that banks provide.[185]

Furthermore, in October 2018, commenting on the proposed new legislation to introduce a U.K.-style individual accountability regime in Ireland, Minister for Finance Paschal Donohoe stated that "[his] objective in legislating for expanded Central Bank powers, is to cultivate a sustainable financial services industry, with rewards reaped over the long-term for customers, staff, and shareholders, and where consideration of the impact on individuals, the economy and society as a whole is firmly embedded in organisational culture."[186] Notably, in the U.K., the 2018 revised U.K. Corporate Governance Code 2018 provides, as one of its core principles, that the role of the board of a company is to "promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society."[187] This goes beyond the shareholder-value focus of companies in recent decades. Also, in Australia, a proposed revised edition of the Australian Corporate Governance Principles and Recommendations proposes to introduce a new principle regarding listed entities' social license to operate. "A listed entity should instill and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner."[188] Further, in the U.S., Senator Elizabeth Warren has proposed a legislative bill that would require certain-sized U.S. corporations to take account of a range of stakeholders, going beyond shareholders.[189]

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185. Alberto G. Musalem, Exec. Vice President, Fed. Reserve Bank of N.Y., Remarks at Towards a New Age of Responsibility in Banking and Finance: Getting the Culture and Ethics Right: Why Focus on Culture? (Nov. 23, 2015), https://www.newyorkfed.org/newsevents/speeches/2015/mus151123 [https://perma.cc/7HPT-22HW].

186. Paschal Donohoe T.D., Minister for Fin. & Pub. Expenditure & Reform, Cent. Bank of Ir., Speech to Central Bank/TCD Conference: Culture, Diversity and the Way Forward for Corporate Governance in Ireland (Oct. 25, 2018), http://paschaldonohoe.ie/central-banktcd-conference-culture-diversity-the-way-forward-for-corporate-governance-in-ireland/ [https://perma.cc/QRP9-W8GG].

187. U.K. FIN. REPORTING COUNCIL, *supra* note 17, at 4.

188. ASX CORP. GOVERNANCE COUNCIL, CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS 25 (2019), https://www.asx.com.au/documents/asx-compliance/consultation-draft-cgc-4th-edition.pdf [https://perma.cc/U2VX-2CED].

189. *See, e.g.*, Elizabeth Warren, *Companies Shouldn't Be Accountable Only to Shareholders*, WALL ST. J. (Aug. 14, 2018), https://www.wsj.com/articles/companies-shouldnt-be-accountable-only-to-shareholders-1534287687 (last visited Jan. 28, 2020).

Interestingly, in the U.K., the British Academy is currently engaged in a major research project on the future of the corporation.[190] The program aims to "contribute to . . . [redefining] business [in] the 21st century and build[ing] trust between business and society."[191] In December 2018, the Academy published its initial research conclusions,[192] pointing to the need to develop a new framework for the corporation around three interconnected principles: (1) well-defined and aligned purposes, (2) a commitment to trustworthiness, and (3) embedding an enabling culture. Also, according to the initial research conclusions, this shift would require co-ordinated action on a new approach to the use of five identified levers, relating to: ownership, corporate governance, regulation, taxation, and investment.[193]

The next phase of this major research project is continuing in 2019, looking at precise business practice and policy implications of the proposed framework; in particular, it will consider the laws and regulation, ownership and governance, and measurement and management required by the proposed new framework.[194]

As to the issue of a proposed shift from the current "shareholder value" paradigm of corporations to a future paradigm in which corporations take greater account of a wider social purpose, the research paper notes the development of the Friedman Doctrine, essentially equating corporate purpose with shareholder profits. While this doctrine may have addressed the problem of the lack of sufficient accountability of managers of a firm:

> It is at this point that our research suggests the nature of the corporation erred. While it was right to be concerned about the lack of accountability of management, it was wrong to see its resolution in control by one party to the firm. The reason why this happened was that the rights of shareholders were equated with the property rights of owners. Shareholders bore the risks and rewards of the success and failure of business and so had corresponding rights to control it.
>
> But shareholders are not in many cases owners in any meaningful sense of the word and do not aspire to act as owners. This misconception and preoccupation with one single party to the firm

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190. *The Future of the Corporation*, THE BRITISH ACAD. (2017), https://www.thebritishacademy.ac.uk/programmes/future-of-the-corporation [https://perma.cc/9BMB-32YL].

191. *Id.*

192. THE BRITISH ACAD., REFORMING BUSINESS FOR THE 21ST CENTURY: A FRAMEWORK FOR THE FUTURE OF THE CORPORATION (2018), https://www.thebritishacademy.ac.uk/sites/default/files/Reforming-Business-for-21st-Century-British-Academy.pdf [https://perma.cc/YW6Y-D236].

193. *Id.* at 8–10.

194. *Id.* at 25.

> rather than a wider constituency has been the cause of mounting environmental concerns, social tensions and political backlash.
>
> These have become particularly acute since the 2007–8 Financial Crisis, as many of the defects of the conventional wisdom were laid bare.[195]

In our view, addressing this issue of corporate purpose will be a key element in improving trust in the financial services industry over time. For many consumers, their distrust of the financial services industry derives to a significant extent from evidence that this industry has focused on short-term profit maximizing at the expense of consumer interest. This consumer perception appears to us to derive, at least in part, from a view that the "mindset" of those in the financial services industry is based on the above Friedman Doctrine, which, in extremis, suggests that firms can go to any lengths to profit maximize, unless specifically prohibited by law or the regulator—i.e., consumers cannot rely on financial firms to look after their interests, unless specifically required to do so by law or the regulator, and, even then, any reliance placed by customers on financial institutions complying with the law can be misplaced.[196]

This problem is compounded by a range of issues that arise in the financial services industry, described earlier in this paper, including: (1) information asymmetries between the financial services provider and the customer (reinforced by generally low levels of financial literacy of retail consumers); (2) conflicts of interest in financial services firms; (3) market power of firms, particularly arising from lack of customer engagement/willingness to switch provider; and (4) the relatively high rewards for the staff of financial services firms in successfully contributing to short-term profits of the firm, sometimes with little, if any, downside for doing so at the expense of the customer interest (other than compliance with clear minimum legal requirements).

As outlined above, in accordance with the framework for assessing culture set out by Edgar Schein, where the culture of a firm involves widespread discrepancies between desired behaviors and observed behaviors, as is the case in the financial services industry, leaders need to "locate the cultural DNA and change some of that"[197] or, in other words, address culture issues at the level of taken-for-granted underlying basic assumptions and not merely at the level of artifacts or espoused values and beliefs.

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195. THE BRITISH ACAD., *supra* note 192, at 14–15.

196. *See, e.g.*, Press Release, Paschal Donohoe T.D., Minister for Fin. & Pub. Expenditure & Reform, Statement on the Tracker Mortgage Examination (Oct. 25, 2017), http://paschaldonohoe.ie/?p=47378 [https://perma.cc/6RAG-QU9R].

197. SCHEIN, *supra* note 23, at 27.

It is our view, therefore, that a key to improving culture in the financial services industry in the longer term will be addressing the need to tackle the "Friedman Doctrine" mindset in the industry (and in corporations more widely) and recognizing the need for firms' purposes to encompass wider purposes than "shareholder value."

There is a limited amount that firms can do individually to address this industry-wide mindset issue, given, for example, the coordination failures problem identified by the New York Federal Reserve as discussed above.

Accordingly, bodies such as the U.K. Banking Standards Board and Irish Banking Culture Board would be particularly well-placed to build on the above-described on-going work of the British Academy to consider how financial services firms can embed a "mindset" regarding the purpose of the firm that takes sufficient account of the interests of a wider range of stakeholders than merely those of shareholders.

VII. CONCLUSIONS

Boards of financial services firms have a clear and critical role in establishing the values of the firm and monitoring whether the behaviors of the firm are aligned with these values.

Quite apart from ensuring that appropriate structures and governance are in place, increasingly more is expected of boards in terms of ensuring that they (1) have available to them the best and most reliable information in order to enable them to perform this function effectively—and to proactively seek out further information and explanations where there are indications available to the board that actual behaviors within the firm do not align with stated values; and (2) constructively challenge executive management.

In our view, given that, as noted above by the DNB, "in essence, peer pressure regulates behaviour,"[198] there is merit in improving the standard of board performance in these particular areas on the basis of industry-wide initiatives, as suggested in this Article. Any such initiatives would, of course, be in addition to minimum standards of behavior as established by law and regulatory requirements and expectations.

Furthermore, there is also merit, for the same reasons in our view, in industry-wide engagement in the evolving public debate, to address the issue of the mindset within the industry, which is arguably based on the shareholder value, or Friedman Doctrine, and if and how this can evolve into a wider conception of the purpose of a financial services organization in society.

198. SUPERVISION OF BEHAVIOR AND CULTURE, *supra* note 3, at 50.